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The Coming Encounter: International Arbitration and Bankruptcy

Jay Lawrence Westbrook*

I. INTRODUCTION

The recent explosion in international trade and investment has been accompanied by an increasing tendency in the business world to choose arbitration as the mechanism for resolving international commercial disputes, principally because of the greater assurance of neutrality offered by the arbitral forum as opposed to the national courts of either of the parties.¹ A contemporary development caused by the onslaught of "unthinkable" economic change since the U.S. abandonment of the gold standard in 1971 is the growth in the number of insolvencies among U.S. enterprises heavily involved in transnational business.² The coincident expansion in both the use of international arbitration and the number of insolvencies among U.S. companies doing business abroad will inevitably confront U.S. courts with the problem of reconciling the conflicting principles of U.S. bankruptcy law and the law of international arbitration.³

* Assistant Professor of Law, University of Texas School of Law. The author wishes to express his great appreciation and admiration for the work done on this Article by his research assistants, James McMichael, Paul Monroe, and Joseph Halbach. He is also grateful for the helpful comments of Professors Douglas Laycock, Hans Baade, Russell Weintraub and Douglas Whaley.

Many of the views expressed herein are based on the author's experience in private practice from 1969-1979.

1. See generally Goekjian, *The Conduct of International Arbitration*, 11 LAW. AM. 409 (1979).

2. See, e.g., *In re ITEL Corp.*, 17 Bankr. 942 (9th Cir. 1982); *In re White Motor Credit Corp.*, 11 Bankr. 294 (N.D. Ohio 1981); *In re United Merchants & Mfrs., Inc.*, 3 Bankr. 286 (S.D.N.Y. 1980). Foreign multinationals with U.S. assets and creditors are experiencing increased insolvency rates as well. See Becker, *Transnational Insolvency Transformed*, 29 AM. J. COMP. L. 706, 706 (1981); Riesenfeld, *Domestic Effects of Foreign Liquidation and Rehabilitation Proceedings in the Light of Comparative Law*, in Festschrift GÜHARD KEGEL 433, 434 nn.6-7 (1977).

3. Although this Article discusses the effect of international arbitration agreements in bankruptcy, the analysis might also be applicable to the resolution of many similar issues raised by domestic arbitration agreements. A survey of the cases involving domestic arbitration agreements illustrates that there is no consensus concerning their effect in bankruptcy. Compare, e.g.,

In recognition of the increased use of arbitration agreements in international commerce, the United Nations Conference on International Commercial Arbitration adopted the Convention on the Recognition and Enforcement of Foreign Arbitral Awards on June 10, 1958.⁴ The United States acceded to the Convention in 1970,⁵ and enacted implementing legislation on July 31, 1970, as an amendment to the Federal Arbitration Act (F.A.A.), designating new chapter 2 of the Act to deal with recognition and enforcement of the Convention.⁶ According to the Supreme Court, the goal of the Convention and the purpose of the implementing legislation were "to encourage the recognition and enforcement of commercial arbitration agreements in international contracts and to unify the standards by which agreements to arbitrate are observed and arbitral awards are enforced in the signatory countries."⁷

When a U.S. party enters into a transnational commercial contract containing an international arbitration clause⁸ and later becomes bankrupt before the contract is fully performed, the principles reflected in the U.N. Convention are bound to come into conflict with the contrary principles of the Bankruptcy Code favoring consolidation of all claims against or on behalf of the debtor in bankruptcy court.⁹ The U.S. bankruptcy court must then determine the extent to which the arbitration agreement or arbitral award is enforceable in the bankruptcy proceeding.¹⁰ It is the purpose of this Article to examine some

Barber-Greene Co. v. Zeco Co., 17 Bankr. 248, 249-50 (Bankr. Minn. 1982) (enforced domestic arbitration agreement against trustee) with *In re Ludwig Honold Mfg. Co.*, 22 Bankr. 436, 438 (Bankr. E.D. Pa. 1982) (declined enforcement).

4. U.N. Doc. E/Conf. 26/9/Rev. 1 (1958).

5. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *opened for signature* June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 3 (acceded to by U.S. Sept. 1, 1970; entered into force Dec. 29, 1970) [hereinafter cited as U.N. Convention].

6. Act of July 31, 1970, Pub. L. No. 91-368, 84 Stat. 692 (1970) (codified at 9 U.S.C. §§ 201-208 (1976)).

7. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 520 n.15 (1974).

8. For present purposes, a "transnational commercial contract" involves one or more parties whose principal place of business is located outside the United States, and an "international arbitration agreement" is one which calls for arbitration in a forum outside the United States, although both phrases are routinely used differently and more broadly.

9. It is assumed in this Article that the debtor's principal place of business and the largest part of its assets and liabilities are in the United States, so that a sensible international conflicts rule would select U.S. law as controlling the debtor's liquidation or rehabilitation. This Article does not attempt to analyze the numerous choice of law issues presented by the bankruptcy of a multinational entity nor the effect such an analysis might have upon the Article's conclusions under various circumstances.

10. It seems settled that the trustee can insist on arbitration of claims on

of the central issues that have already arisen or are likely to arise in the future because of the conflict between the U.S. commitment to international arbitration and U.S. bankruptcy policy.

United States international arbitration policy is embodied in the United Nations Convention, which applies to all foreign arbitral awards.¹¹ The F.A.A. appears to treat all arbitration agreements or arbitral awards as within the Convention's coverage, unless the parties to the agreement or award are both U.S. citizens and there is no "reasonable relation with one or more foreign states."¹² Each signatory state is required under the Convention to "recognize" an arbitration agreement "concerning a subject matter capable of settlement by arbitration,"¹³ and the F.A.A. empowers any U.S. district court to "direct that arbitration be held in accordance with the agreement at any place therein provided for."¹⁴ Similarly, the Convention obligates signatory states to recognize arbitral awards as binding and to enforce them according to legal rules of procedure which may not be substantially more onerous than those applicable to enforcement of domestic arbitral awards.¹⁵ In *Scherk v. Alberto-Culver, Inc.*,¹⁶ the Supreme Court declared that international arbitration agreements are even more favored than domestic ones and are to be enforced as a matter of overriding federal policy because of their importance to international commerce.¹⁷ Thus, one who seeks to enforce an international arbitration agreement or award in any context, including bankruptcy, comes armed with a public policy both well established and recently renewed.

The special characteristics of the Bankruptcy Code,¹⁸ on the other hand, are exclusive jurisdiction by the bankruptcy

behalf of the bankrupt estate against a nonbankrupt party who had entered into an arbitration agreement with the debtor. *Schilling v. Canadian Foreign S.S. Co.*, 190 F. Supp. 462 (S.D.N.Y. 1961). See Kreindler, *The Convergence of Arbitration and Bankruptcy*, 26 ARB. J. 34, 35 (1971).

11. U.N. Convention, *supra* note 5, art. I, para. 1.

12. 9 U.S.C. § 202 (1976). See also *infra* note 31.

13. U.N. Convention, *supra* note 5, art. II, para. 1.

14. 9 U.S.C. § 206 (1976).

15. U.N. Convention, *supra* note 5, art. III. The F.A.A. provides a procedure under which any party to the arbitration may, within three years of an arbitral award covered by the Convention, apply to a U.S. district court for "an order confirming the award as against any other party to the arbitration." 9 U.S.C. § 207 (1976).

16. 417 U.S. 506 (1974).

17. *Id.* at 515-17.

18. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified at 11 U.S.C. §§ 101-151326 (Supp. IV 1980)).

court over all the property of the debtor and unified control over all claims both by and against the debtor, whether in a liquidation or rehabilitation proceeding.¹⁹ These features of bankruptcy stem from the universal objective of bankruptcy law—the orderly liquidation or rehabilitation of a debtor in financial distress in a manner that maximizes payments to creditors and ensures equality of distribution.

The objective of bankruptcy law is best served by vesting total control of the debtor's affairs in the bankruptcy court. Thus, the Code grants the bankruptcy courts original jurisdiction over all "civil proceedings . . . arising in or related to cases under [the Code]"²⁰ and "exclusive jurisdiction of all of the property, wherever located, of the debtor."²¹ This pervasive jurisdiction over claims liquidation is protected by section 362 of the Code, which provides for an "automatic stay" or injunction against nearly all efforts to prosecute or enforce claims against a debtor or a debtor's property.²²

Creditors who wish to share in the distribution of the bankrupt estate must assert their claims by filing a proof of claim in

19. The Code offers two types of relief to a financially distressed debtor. A debtor may file for relief through liquidation under chapter 7 of the Code, in which case the debtor's nonexempt assets are collected and sold, and the proceeds are distributed to creditors. 11 U.S.C. §§ 701-766 (Supp. IV 1980). On the other hand, a debtor may file for rehabilitation or reorganization under chapters 11, or 13, the principal chapter for commercial purposes being chapter 11, in which the debtor submits to the creditors a plan providing for the adjustment of the debtor's debts and the repayment of creditors, usually from the future income of the debtor's reconstituted business. *Id.* §§ 1101-1174.

In rehabilitation cases the debtor ordinarily remains in control of the estate, and the debtor, in such cases, is referred to as a "debtor in possession" or D.I.P., who is subject to the same fiduciary obligations to creditors as a trustee in a chapter 7 proceeding. This Article will refer only to the trustee, but unless otherwise indicated the references to trustee also include a debtor in possession.

20. 28 U.S.C. § 1471(b) (Supp. IV 1980). In *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 102 S. Ct. 2858 (1982), the Supreme Court struck down the broad jurisdictional grant of § 1471(b). It did not do so on any theory that bankruptcy jurisdiction could not extend so far, but rather because Congress had failed to provide judges appointed under article III of the Constitution to exercise that jurisdiction. *Id.* at 2874. It seems that Congress may retain broad bankruptcy jurisdiction by making bankruptcy judges article III judges or by assigning the more expansive aspects of bankruptcy jurisdiction to the federal district judges. See Circuit Council Admin. Order 123. (8th Cir. Dec. 15, 1982) (on file at the *Minnesota Law Review*). Although it is admittedly difficult to determine the outer limits of the Court's ruling, there is no suggestion that the injunctive powers of the bankruptcy court, including the automatic stay, are invalid. This Article discusses these powers, which lie at the heart of the bankruptcy jurisdiction.

21. 28 U.S.C. § 1471(e) (Supp. IV 1980).

22. 11 U.S.C. § 362(a)(1) (Supp. IV 1980).

bankruptcy court.²³ Claims disputed by the trustee or another creditor are adjudicated by the bankruptcy court, the amount of any judgment against the bankrupt estate becoming the "allowed" claim of the victorious creditor.²⁴ Allowed secured claims receive a priority against the proceeds of the collateral, with any shortfall being treated as an unsecured claim.²⁵ Allowed unsecured claims are paid pro rata since there are usually inadequate funds in the estate to pay all creditors in this class in full.²⁶ Because the percentage of claims recovered by this class is typically very low, allowed unsecured claims can be described as being paid in "bankruptcy dollars," dollars that are worth much less than ordinary dollars. Expenses of administration, including postpetition operating costs, receive priority under the Code and are usually paid in full, or in what can be described as "administration (100 cents) dollars."²⁷ Because of the low percentage recovery on bankruptcy claims in general, it is often not economical to engage in full scale litigation. For this reason, bankruptcy procedures are designed to promote relatively informal and expeditious resolution of claims.

Foreign arbitration proceedings are not subject to the automatic stay of the bankruptcy court unless the foreign party to the proceeding has sufficient contacts with the United States to subject it to in personam jurisdiction in the United States.²⁸

23. *Id.* § 501.

24. *Id.* § 502(b).

25. *Id.* § 506.

26. *Id.* § 726(a)(2).

27. *Id.* §§ 503(b)(1)(A), 507(a)(1).

28. See *infra* note 31 and accompanying text. A domestic arbitration is subject to the automatic stay upon the filing of the bankruptcy petition. 11 U.S.C. § 362(a) (Supp. IV 1980). See also S. REP. NO. 989, 95th Cong., 2d Sess. 50, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5836; H.R. REP. NO. 595, 95th Cong., 1st Sess. 340 (1977), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, 6297. Even prior to the adoption of the Code, it seemed clear that domestic arbitrations were automatically stayed under the Bankruptcy Rules in proceedings under chapters X-XII. Fed. Bankr. R. 10-601(a); 11-44; 12-43; and Advisory Committee's Notes. See 13A COLLIER ON BANKRUPTCY ¶ 10-601.01 (14th ed. 1977) [hereinafter cited as COLLIER (14th)]. The leading bankruptcy treatise maintained, however, that arbitrations were not stayed in Chapter VIII liquidations. 1A COLLIER (14th), *supra*, ¶ 11.03. No explanation was given for the different treatment of liquidation in this regard, and no policy reason is evident. The distinction could not have been based on the relevant sections of the Bankruptcy Act, all of which spoke only of "suits." See Act of June 22, 1938, ch. 575, 30 Stat. 840, §§ 11, 314, 414, 614 (repealed 1978). Cf. *id.* § 2(a)(15) (repealed 1978) (allowing judges to issue injunctions restraining courts if necessary for the enforcement of the Act). It is also interesting that neither the commission bill, which was the basis for the new Code, nor the commission's notes included arbitration within the stay. H.R. 8200, 95th Cong., 2nd Sess. § 362 (1978) [hereinafter cited as Commission Bill]; REPORT OF THE COMMISSION ON THE BANKRUPTCY

This Article seeks to reconcile the conflicting bankruptcy and international arbitration policies with respect to international arbitral awards rendered in proceedings not subject to the automatic stay because the foreign party is not within the in personam jurisdiction of the United States. Part II of the Article discusses the effect postpetition international arbitral awards should have in U.S. bankruptcy proceedings. It argues that conclusive effect should be denied such awards unless the foreign party has received the bankruptcy court's prior approval to liquidate the claim in arbitration pursuant to the parties' contract or agreement. Part III explores the limits of the bankruptcy court's discretion in determining whether to recognize or refuse to recognize the parties' arbitration agreement in the exercise of its approval power. Finally, Part IV examines the extent to which prepetition international arbitral awards against the debtor should be given effect in the bankruptcy proceedings of the debtor.

II. EFFECT OF POSTPETITION ARBITRAL AWARDS IN BANKRUPTCY

The automatic stay of the bankruptcy court is enforced through the bankruptcy court's power to impose a contempt sanction against a recalcitrant creditor who proceeds notwithstanding the stay.²⁹ Any postpetition proceeding stayed by the bankruptcy order is simply void, and any judgment rendered in a stayed proceeding is subject to collateral attack in bankruptcy.³⁰ It is reasonably clear that any postpetition domestic arbitral award would be void in bankruptcy by operation of the automatic stay.

The situation with respect to postpetition international arbitral awards is different. Foreign proceedings are not within

LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess. pt. II at 117-23 (1975) [hereinafter cited as COMMISSION REPORT].

29. See, e.g., *Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47, 52-53 (2d Cir. 1976), cert. denied, 429 U.S. 1093 (1977); *Preferred Surfacing, Inc. v. Gwinnet Bank & Trust Co.*, 400 F. Supp. 280, 284-85 (N.D. Ga. 1975); *In re Reed*, 11 Bankr. 258, 261-62 (Bankr. Utah 1981); *Edwards v. Pullman Trailmobile*, 5 Bankr. 663, 665 (M.D. Ala. 1980); *Coleman Am. Cas. v. Littleton Nat'l Bank*, 8 Bankr. 384, 387 (Bankr. D. Kan. 1981). See also Commission Bill, *supra* note 28; Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REF. 177, 259-66 (1978) [hereinafter cited as *Automatic Stay Part I*]. But see *Hatcher v. Mid-American Acceptance Corp.*, 14 Bankr. 757, 759 (Bankr. W.D. La. 1981).

30. See, e.g., *Kalb v. Feuerstein*, 308 U.S. 433, 438-39 (1940); *Potts v. Pctts*, 142 F.2d 883, 888 (6th Cir. 1950); *In re Kaid*, 347 F. Supp. 540, 543 (E.D. Va. 1972); *In re Garner*, 13 Bankr. 799 (Bankr. S.D.N.Y. 1981). See also Commission Bill, *supra* note 28.

the territorial jurisdiction of the United States and are thus not subject to the automatic stay of the bankruptcy court.³¹ Consequently, an international arbitration proceeding commenced in a foreign country by a party not subject to the in personam jurisdiction of the U.S. courts may go forward notwithstanding the filing of a petition in U.S. bankruptcy court by another party to the arbitration proceeding. Thus, the U.S. bankruptcy courts must determine what effect to give such postpetition international arbitral awards.

31. If the United States is the forum for the arbitration, it is clear that the U.S. courts would have the power to stay the proceeding. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 17(a) (1965). For most purposes the law of the place of arbitration controls the proceeding. See U.N. Convention, *supra* note 5, art. I, paras. 1, 3(1), (3), art. V, para. 1(a), (d), (e). See generally Goekjian, *supra* note 1, at 411-13. But see, e.g., Societe AKSA, SA. v. Societe NORSOLOR, SA., Cour d'appel de Paris, Dec. 9, 1980, reprinted in 20 ILL.M. 887 (1981).

There is no indication that Congress intended to exempt transnational arbitrations taking place in this country from the operation of the automatic stay. If the nullification rule discussed in this Article is applied to international arbitration, then *a fortiori* the stay should be applied to all U.S. based arbitrations. See *infra* text accompanying notes 41-55.

More difficult questions are presented if the arbitration is to be held outside the United States. If the foreign party had sufficient contacts with the United States to make it subject to suit here absent the arbitration clause, then a good case can be made that the foreign party is subject to the automatic stay and may not proceed with the arbitration. In that situation the trustee could sue the foreign party in the bankruptcy court and obtain an injunction against further arbitration. See 11 U.S.C. § 105(a) (Supp. IV 1980); 28 U.S.C. § 1471(c) (Supp. IV 1980). Since the automatic stay was designed to eliminate the requirement for a specific stay in each case, it should generally apply whenever a specific stay would be routinely granted, absent a statutory exception. Cf. Kennedy, *The Automatic Stay in Bankruptcy*, 12 U. MICH. J.L. REF. 3, 62 (1979) [hereinafter cited as *Automatic Stay Part II*] ("automatic stays . . . have tended merely to replace stays ordered by courts on applications filed by petitioners"). On the other hand, if the foreign party had only minimum contacts with regard to some transaction unrelated to the arbitration agreement, the trustee would not be able to get personal jurisdiction over the foreign party, and presumably the automatic stay would not and could not apply. But see *In re W&G Dev. A.G.*, 3 BANKR. CT. DEC. (CRR) 655 (Bankr. S.D.N.Y. 1977).

For a discussion of the interesting related problem of determining whether an arbitration is "domestic" so as to be outside the coverage of the U.N. Convention, see McMahon, *Implementation of the United Nations Convention on Foreign Arbitral Awards in the United States*, 2 J. MAR. L. & COM. 735, 741-42 n.29 (1971). See also Domke, *The United States Implementation of the United Nations Arbitral Convention*, 19 AM. J.COMP. L. 575, 577 (1971); Paulsson, *The Role of the Swedish Courts in Transnational Commercial Arbitration*, 21 VA. J. INT'L L. 211, 230-35 (1977). At least one case has articulated a liberal standard for finding an arbitration covered by the Convention (and therefore not "domestic" for coverage purposes). See *Fuller Co. v. Compagne Des Bauxites De Guinee*, 421 F. Supp. 938, 941 (W.D. Pa. 1976).

A. *FOTOCROME* AND THE NULLIFICATION RULE

In *Fotochrome, Inc. v. Copal Co.*,³² the Second Circuit decided the effect in bankruptcy of a foreign arbitral award rendered after the filing of a bankruptcy petition. That case presented the court with an arbitration clause in a distribution contract between Fotochrome, a domestic corporation located in New York, and Copal, a Japanese camera maker, under which Fotochrome agreed to distribute in the United States cameras manufactured by Copal. When a dispute broke out in which each party accused the other of violating the agreement, Copal initiated arbitration proceedings in Japan as called for by the arbitration clause. Before the arbitration proceeding could be completed, Fotochrome filed for an arrangement under Chapter XI of the Bankruptcy Act.³³ The bankruptcy court issued a restraining order staying any arbitration involving Fotochrome, and the latter notified the Japanese arbitral tribunal that a petition had been filed and a stay had been entered. The arbitral tribunal determined that it was not bound by the stay and proceeded to issue an arbitral award in favor of Copal for over \$600,000. Upon receiving the arbitral award, Copal immediately reduced the award to judgment in Japan and filed a proof of claim in the bankruptcy court. The referee in the bankruptcy ruled that the restraining order of the bankruptcy court operated to stay the arbitration proceeding and that the bankruptcy court could therefore relitigate the merits of Copal's claim.³⁴

The district court reversed the bankruptcy referee³⁵ and the Second Circuit affirmed. The latter's precise holding was that a foreign arbitral award commenced prior to the filing of a

32. 517 F.2d 512 (2d Cir. 1975).

33. Chapter XI under the Bankruptcy Act was basically similar to chapter 11 under the Code insofar as is relevant here.

34. The bankruptcy court had found the Convention inapplicable, since U.S. accession post-dated the petition in bankruptcy. [1973-1975 Transfer Binder] BANK L. REP. (CCH) ¶ 64,987 (Bankr. E.D.N.Y. 1973) (summary). The Second Circuit panel held that the Convention applied retroactively. 517 F.2d at 515, n.3. *Accord* Fertilizer Corp. v. IDI Management, Inc., 517 F. Supp. 948, 951-52 (S.D. Ohio 1981). The Supreme Court in *Scherk* did not feel compelled to decide this issue. *Scherk v. Alberto-Culver*, 417 U.S. 506, 520 n.15 (1974).

35. *In re Fotochrome*, 377 F. Supp. 26, 33 (E.D.N.Y. 1974). In the district court the potential conflict between the U.N. Convention and the Bankruptcy Act was resolved by the rule that the later in time should prevail. *Id.* See Comment, *International Arbitration—Bankruptcy—The Impact of the U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards on the U.S. Bankruptcy Act*, 1 INT'L TRADE L.J. 263, 268 (1976). Presumably, the subsequent adoption of the Code would now require a reversal of the result, illustrating the defect in the "last in time" approach.

bankruptcy petition and not subject to the bankruptcy court's automatic stay because of a lack of personal jurisdiction over the nonbankrupt party is a provable debt in bankruptcy if reduced to judgment in the United States. The Second Circuit found that because the bankruptcy court lacked personal jurisdiction over Copal, which did not have the required minimum contacts with the United States, the stay "did not operate against Copal."³⁶ The court directed Copal to seek confirmation of the award in U.S. district court, affording Fotochrome an opportunity to raise any of the defenses permitted under the Convention,³⁷ as a condition to giving the award binding effect in bankruptcy.³⁸

36. 517 F.2d at 516.

37. Article V of the Convention specifies seven grounds upon which a state in which enforcement is sought may refuse to recognize and enforce an arbitral award. Two of the seven grounds are assertible by the forum state on its own motion. See *infra* text accompanying notes 143-47. The *Fotochrome* court held that Fotochrome would have the right to assert any of these defenses against the enforceability of the award in the proceeding to confirm the award. 517 F.2d at 519. The court relied on the F.A.A. which provides for confirmation of international arbitral awards in a U.S. district court "unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention." 9 U.S.C. § 207 (1976).

38. 517 F.2d at 520. The court seemed to take comfort from the fact that Fotochrome could defend against enforcement of the award under article V(1)(b) of the Convention on the ground that it had been "otherwise unable to present [its] case". *Id.* at 518. It seems clear that this defense contemplates procedural unfairness in the arbitration, not problems caused by the confusion of the debtor's affairs attendant upon bankruptcy. See, e.g., *Parsons and Whittemore Overseas Co. v. Societe Generale de L'Industrie Du Papier*, 508 F.2d 969, 975 (2d Cir. 1974) (inability to present certain witnesses does not amount to denial of opportunity to present case); *Judgement of June 3, 1971, Obergericht of Basle, Switz., summarized in 1979 Y.B. COM. ARB. 309* (refusal to grant extension because of firm director's compulsory military service does not amount to denial). Cf. *Biotronik Mess-und Therapiegeraete GmbH & Co. v. Medford Medical Instrument Co.*, 415 F. Supp. 133, 137-38 (D.N.J. 1976) (enforcement of adverse foreign arbitration award cannot be avoided on theory that foreign party perpetrated fraud when it appeared alone at arbitration hearing). See also Comment, *Chapter XI Jurisdiction Over Foreign Arbitral Awards*, 42 BROOKLYN L. REV. 726, 759-60 n.97 (1976). See generally B. Harrell, *Case Law Construing the Exceptions to the Enforcement of Foreign Awards Under the New York Convention 25-27* (December 1, 1980) (unpublished manuscript) (on file at the *Minnesota Law Review*).

The *Fotochrome* court had to reach to permit Fotochrome to assert the Convention's defenses in the U.S., since Copal had previously obtained a Japanese judgment on the award. The court held that the Japanese judgment was not itself enforceable under New York law. 517 F.2d at 518-19. If the judgment had been enforced, Fotochrome would have been precluded from asserting the Convention's defenses in the U.S. confirmation proceeding under the doctrine of *res judicata*. That the court's conclusion makes no sense may explain why no authority is cited in support of it. It is also directly contrary to prior authority in the Second Circuit. See, e.g., *Island Territory of Curacao v. Solitron Devices*, 489 F.2d 1313, 1318-19 (2d Cir. 1973), *cert. denied*, 416 U.S. 986 (1974). See

The *Fotochrome* opinion³⁹ unfortunately ignored the pre-Code bankruptcy precedent reflecting the importance of centralized claims control in the bankruptcy court in its effort to vindicate enforcement of the U.N. Convention. Because the *Fotochrome* court did not recognize this important bankruptcy policy, it was left with nothing against which to balance the powerful federal policy favoring enforcement of international arbitral awards reflected in the 1970 amendments to the Federal Arbitration Act.⁴⁰

The automatic stay in bankruptcy is a relatively recent development. In the past, the bankruptcy court issued stays only with respect to specific pending or threatened proceedings. A nonbankruptcy proceeding against the debtor often continued after the filing of a petition in bankruptcy either because the trustee did not choose to stay it or because the trustee was simply unaware of it. Thus, bankruptcy courts were called upon to determine the effect in bankruptcy of a postpetition judgment or award entered against a debtor in an unstayed proceeding.

Although there is little authority regarding the effect of unstayed postpetition domestic arbitration awards obtained without bankruptcy court approval,⁴¹ there have been a number of cases in which courts were required to decide the effect in bankruptcy of nonbankruptcy court judgments entered against a debtor after bankruptcy. The early decisions made such judgments conclusive,⁴² but the more modern cases, and the com-

also N.Y. CIV. PRAC. LAW § 5302 (McKinney 1978) (Foreign Money Judgment Act); Comment, *supra*, at 738-41.

39. The *Fotochrome* opinion was greeted with general acclaim in the law reviews. See, e.g., Note, *Judicial Interpretations of Foreign Arbitral Awards Under the U.N. Convention*, 8 LAW & POL'Y INT'L BUS. 737, 752 (1976); Comment, *supra* note 38, at 743; Comment, *Bankruptcy—International Arbitration—A Foreign Arbitral Award Rendered After the Filing of a Chapter XI Bankruptcy Petition and Filed as a Proof of Claim Is Valid and Unreviewable on the Merits*, 16 VA. J. INT'L L. 216, 224 (1975). But see, e.g., Comment, *International Arbitration—Bankruptcy—U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards Makes Foreign Award a Provable Claim When Bankruptcy Court Has No Jurisdiction to Enjoin Foreign Arbitration Proceeding*, 9 VAND. J. TRANSNAT'L L. 187, 198 (1975).

40. The Second Circuit relied primarily on an equity reorganization case, *Riehle v. Margolies*, 279 U.S. 218 (1929) for bankruptcy policy. 517 F.2d at 517. The district court seemed more concerned with bankruptcy policy, but failed to develop or analyze it. 377 F. Supp. at 28-29.

41. See, e.g., *Taylor v. Brodt*, 396 N.Y.S.2d 143, 144 (1977) (confirmation of award denied because of bankruptcy stay); *In re Markowitz Co.*, 6 Am. Bankr. Rep. (N.S.) 221, 222 (Ref. S.D.N.Y. 1925) (dicta suggesting award not necessarily conclusive); *supra* note 3.

42. The reasoning of these cases was that the failure to stay the nonbank-

mentators, support a rule voiding postpetition judgments for bankruptcy purposes, even though the proceeding in which the judgment was entered had not been subjected to a bankruptcy stay.⁴³ Under the modern rule, the underlying merits of a creditor's claim remain subject to relitigation in full in bankruptcy notwithstanding a prior judgment if that judgment was obtained after the debtor filed a petition in bankruptcy.⁴⁴

The conceptual basis for what this Article will call the "nullification" rule rests on the traditional idea that upon bankruptcy all the debtor's assets pass to a distinct legal entity, the bankrupt estate, burdened only by those liabilities extant on the date of bankruptcy.⁴⁵ It follows that any pending litigation to which the estate's representative is not a party should not

ruptcy proceeding constituted an election by the trustee to permit liquidation of the creditor's claim in that proceeding, rather than in the bankruptcy court. *See, e.g.,* Hill v. Harding, 107 U.S. 631, 633 (1882); Norton v. Switzer, 93 U.S. 355, 362-63 (1876) (bankruptcy trustee "silently acquiesced"); Eyster v. Gaff, 91 U.S. 521, 524 (1875); Doe v. Childress, 88 U.S. (21 Wall.) 642, 647 (1874); *cf.* Boynton v. Ball, 121 U.S. 457, 467-68 (1887) (final discharge not obtained until after judgment rendered in state court).

Section 63(a)(5) of the 1898 Act made postpetition judgments "provable" in bankruptcy and could have been taken as codifying the cases cited above. *See* United States v. Paddock, 180 F.2d 121, 124 (5th Cir. 1950); *In re* Anton, 11 F. Supp. 345, 346 (D. Minn. 1935). In fact it appears that § 63(a)(5) was included for a different purpose: to ensure that postpetition judgments based on prepetition claims would be discharged. *See In re* Pinkel, 1 Am. Bankr. Rep. 333, 339 (Ref. N.D.N.Y. 1899); 1 H. REMINGTON, BANKRUPTCY LAW OF THE UNITED STATES § 695 (1908).

43. *See, e.g.,* Marks v. Brucker, 434 F.2d 897, 900-01 (9th Cir. 1970); Coleman v. Alcock, 272 F.2d 618, 621-22 (5th Cir. 1959); *In re* Paramount Publix Corp., 85 F.2d 42, 43 (2d Cir. 1936); *In re* Continental Engine Co., 234 F. 58, 60 (7th Cir. 1916); *In re* Barrett & Co., 27 F.2d 159, 160-61 (S.D. Ga.), *aff'd sub nom.* Rhodes v. Elliston, 29 F.2d 737, 738 (5th Cir. 1928); *In re* Hoey, Tilden & Co., 292 F. 269, 272 (S.D.N.Y. 1922). *Contra* United States v. Paddock, 178 F.2d 394, 399 (5th Cir. 1949), *reh'g denied*, 180 F.2d 121 (5th Cir. 1950); *In re* Anton, 11 F. Supp. 345, 346-47 (D. Minn. 1935); *In re* Buchan's Soap Corp., 169 F. 1017, 1018 (S.D.N.Y. 1909); *cf.* Heiser v. Woodruff, 327 U.S. 726, 728 (1946) (allowance of claim based upon money judgment acquired against bankrupt before bankruptcy); Straton v. New, 283 U.S. 318, 326 (1931) (where judgment constituting lien on debtor's real estate is recovered more than four months prior to filing petition, bankruptcy court is without jurisdiction to enjoin prosecution of creditor's action); Doyle v. Nemerov's Executors, 223 F.2d 54, 57 (2d Cir. 1955) (state court order awarding allowances to attorneys was res judicata in subsequent bankruptcy proceeding where petition was not approved until after order was issued).

44. The Collier treatise favors the rule stated in the text. *See* 1A COLLIER (14th), *supra* note 28, ¶ 11.09, 3 COLLIER (14th), *supra* note 28, ¶ 57.15 n.48; 3A COLLIER (14th), *supra* note 28, ¶ 63.01 nn.9-12, ¶ 63.27. *See also* J. Moore, *Res Judicata and Collateral Estoppel in Bankruptcy*, 68 YALE L.J. 1, 50 nn.236-38 (1958).

45. *See, e.g.,* Brotherhood of Ry. Employees v. REA Express, 523 F.2d 164, 170 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017 (1976). *But see In re* Unishops, 543 F.2d 1017, 1018 (2d Cir. 1976).

bind the estate.⁴⁶ The policy reason for the modern rule is the overriding importance of centralized control over all claims against the debtor in order to protect the debtor's creditors from spurious or inflated claims against the estate.

Judge Learned Hand adopted this rationale for the nullification rule in *In re Paramount Publix Corp.*⁴⁷ This is a case presenting the ideal circumstance for applying the rule since the claim being asserted was based on a postpetition judgment apparently obtained by default and patently for an inflated amount. In holding that a judgment obtained after the filing of a bankruptcy petition does not liquidate a claim for bankruptcy purposes, Judge Hand emphasized that if the judgment were given binding effect "the result [would be] to introduce among [other creditors] an unwarranted, or overblown, claim which they have never had any chance to contest."⁴⁸

46. *In re Barrett & Co.*, 27 F.2d 159, 161-62 (S.D. Ga.), *aff'd sub nom.* Rhodes v. Elliston, 29 F.2d 737 (5th Cir. 1928); *In re Hoey, Tilden & Co.*, 292 F. 269, 271 (S.D.N.Y. 1922). See 3A COLLIER (14th), *supra* note 28, ¶ 63.27.

47. 85 F.2d 42 (2d Cir. 1936). In rejecting the earlier cases and adopting the nullification rule, the courts felt aided by some new language added in the 1898 Act. Upon careful comparison of the 1867 and 1898 Acts, these arguments may have raised as many questions as they answered. Compare *In re Paramount Publix*, 85 F.2d at 44-45 with *Norton v. Switzer* 93 U.S. 355, 362-63 (1876).

48. 85 F.2d at 44. The cases contrary to the nullification rule are not persuasive. Two of the older cases gave conclusive effect to postpetition proceedings merely on the basis of the 1867 Act cases. See *In re Anton*, 11 F. Supp. 345, 346-47 (D. Minn. 1935); *In re Buchanan's Soap Corp.*, 169 F. 1017, 1018 (S.D.N.Y. 1909). *United States v. Paddock*, 178 F.2d 394, 399 (5th Cir. 1950), held a government Renegotiation Act decision valid and conclusive against the debtor even though the debtor had entered reorganization during the Renegotiation Act proceeding. The court cited in support of its decision *In re Barrett & Co.*, 27 F.2d 159 (S.D. Ga.), *aff'd sub nom.* Rhodes v. Elliston, 29 F.2d 733 (5th Cir. 1928), a decision generally cited in support of the nullification rule. When the trustee in *Paddock* sought rehearing, the court tried to distinguish *Barrett* by saying that the nullification rule was *Barrett's* alternative holding and thus mere dictum in the case. *United States v. Paddock*, 180 F.2d 121, 123-24 (5th Cir. 1950). This reading of *Barrett* is directly contradicted by the Fifth Circuit's affirmation of *Barrett* specifically on the basis of the two-entity rationale of the nullification rule. 29 F.2d at 738.

Paradise v. Vogtlandische Machienen-Fabrik, 99 F.2d 53 (3rd Cir. 1938), involved an attempt by defendants who lost a patent case to avoid the result by asserting the plaintiff's bankruptcy during the patent proceeding. The court held that the plaintiff's trustee in bankruptcy knew and approved of the suit and thus would be bound by it. *Id.* at 55. It should be noted that the patent case had been tried and decided before bankruptcy. Only the actual entry of judgment took place during the pendency of bankruptcy proceedings.

In re Falsone, 247 F. 607 (S.D. Fla. 1917) was a case where the trustee was actually a party to the nonbankruptcy proceeding. Similarly, in *Heiser v. Woodruff*, 327 U.S. 726 (1946), the trustee intervened in the state suit after default, sought to reopen the case on state grounds, and then took an appeal, which he lost. *Straten v. New*, 283 U.S. 318 (1931), might be understood, in mod-

In re Paramount illustrates the evil that the nullification rule is designed to prevent—the reduction of the bankrupt estate by merit-foreclosing judgments obtained by default or quasi-default during the pendency of the bankruptcy proceeding. Many debtors enter bankruptcy surrounded by pending or threatened lawsuits, actions which may even have precipitated the debtor's bankruptcy. The nullification rule—whether standing alone or applied by way of the automatic stay—ensures that the trustee in bankruptcy will have an opportunity to learn about these suits and settle or defend them on the merits. “Breathing room” of this sort is equally necessary in a chapter 11 proceeding, since law suits are often neglected in the debtor's prepetition financial frenzy, a frenzy which typically continues through the early stages of the rehabilitation effort. The nullification rule assures the debtor's creditors that the merits of suits against the debtor will not be improperly resolved, and the bankrupt estate unnecessarily diminished, because of the lack of a vigorous defense.

Although the nullification rule was not immediately and universally accepted,⁴⁹ any question about its validity today

ern terms, on the ground that the property at issue was no longer property of the estate, and therefore the state lien enforcement action could continue.

49. Justice Brandeis squarely rejected the rule in *Riehle v. Margolies*, 279 U.S. 218 (1929). At issue in *Riehle* was the finality of a state court judgment in a federal equity receivership, as opposed to a bankruptcy proceeding. In receiverships an anti-injunction statute, Act of Mar. 3, 1911, ch. 231, § 265, 36 Stat. 1162 (current version at 28 U.S.C. § 2283 (1976)) prevented the staying of state court proceedings against the receivership debtor. The legal analysis in *Riehle* turned on that statute, which did not, and still does not, apply in bankruptcy. 279 U.S. at 223. See 1A COLLIER (14th), *supra* note 28, ¶ 11.09. Nonetheless, Justice Brandeis took the occasion to reject explicitly the notion that claims liquidation should be closely controlled by a court having jurisdiction over the property to be distributed. 279 U.S. at 222-24, 228 n.4. The occasion was presented by the sharply opposing views on this point taken by the three different Second Circuit panels which had heard three appeals in *Riehle*. See *Hatch v. Morosco Holding Co.*, 5 F.2d 1015 (2d Cir. 1925) (Hough, Manton & L. Hand, JJ.); second appeal, 19 F.2d 766 (2d Cir. 1927) (Hough, Manton & Swan, JJ.); third appeal, 26 F.2d 247 (2d Cir. 1928) (L. Hand, A. Hand & Swan, JJ.). Not surprisingly, the two panels which included Judge Learned Hand (the first and third) took the view that the results in the state court proceedings were not binding in the receivership, while the second panel, on which he did not sit, came to the contrary conclusion. On the third appeal, the panel, *per curiam*, felt required to affirm the conclusive effect of the state judgment, because the second panel had made this result “the law of the case.” 26 F.2d at 247. The third panel then proceeded to invite reversal by the Supreme Court based upon the panel's conviction that claims control should rest with the receivership court. *Id.* The Supreme Court took the case, but affirmed, adopting the policy rationale of the second panel. One assumes this whole disorderly episode was an embarrassment to a singularly distinguished circuit court and especially to one of its most distinguished members, Learned Hand. See

seems to have been resolved in favor of the rule by the development of the pervasive automatic stay.⁵⁰ The modern stay is based on the conviction that the bankruptcy court must exert total control over the liquidation of claims.⁵¹ In most cases the stay itself nullifies any unapproved postpetition proceeding.

generally Moore & Oglebay, *The Supreme Court, Stare Decisis, and the Law of the Case*, 21 TEX. L. REV. 514, 544-47 (1943).

Seven years later Judge Learned Hand in *Paramount* rejected the application of *Riehle* to bankruptcy. 85 F.2d at 43. His view ultimately became the dominant one in the relatively few cases in which bankruptcy stays did not moot the question altogether.

The curious coda to this story is found in *Doyle v. Nemerov's Executors*, 223 F.2d 54 (2d Cir. 1955), an opinion written by Learned Hand. The result is not inconsistent with the nullification rule, but the reasoning is. In *Doyle*, Judge Hand relied on *Riehle* for the proposition that a postpetition state judgment may be valid in bankruptcy. 223 F.2d at 56 n.2. The opinion suggests that liquidation of a claim against a debtor in a nonbankruptcy forum is perfectly satisfactory. This conclusion is startling coming from the same jurist who wrote eloquently twenty-four years earlier about the danger to other creditors posed by nonbankruptcy litigation against a reorganizing debtor. *Compare In re Paramount Publix Corp.*, 85 F.2d at 43-44 (where creditors must abate their claims, the result is an unwarranted or overblown claim which they did not have an opportunity to contest) with *Doyle v. Nemerov's Executors*, 223 F.2d at 57 ("There is no reason to suppose that state courts will not as satisfactorily liquidate existing claims in personam in reorganization as they will in bankruptcy.") A comment on the *Doyle* case found the result to be correct, but only if the court retained discretion to reopen the merits in order to protect other creditors. Comment, *Bankruptcy—Corporate Reorganization—Merits of Allowance of Fees by State Court After Filing but Prior to Approval of Involuntary Petition for Reorganization May Not Be Reexamined by Reorganization Court*, 69 HARV. L. REV. 754, 756 (1956).

50. H.R. REP., *supra* note 28, at 340-41, 1978 U.S. CODE CONG. & AD. NEWS at 6296-97. *Compare* *Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d at 53, 57 (stay necessary to centralize claims) and *Bohack v. Borden, Inc.*, 599 F.2d 1160, 1167 (2d Cir. 1979) (same) with *In re Barrett & Co.*, 27 F.2d at 161 (nullification rule important so that all claims are determined in bankruptcy court).

51. The protection of creditors against unjustified claims is not often singled out as a function of the automatic stay, although it is central to the rationale for the nullification rule. On the other hand, the "centralization" of the claims process must have such a purpose, along with expedition and reduction of expense. *See* *Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47, 56-57 (2d Cir. 1976); *Bohack v. Borden, Inc.*, 599 F.2d 1160, 1167 (2d Cir. 1979). *See also* 2 H. REMINGTON, *supra* note 42, § 2690; *cf.* 1 H. REMINGTON, *supra* note 42, § 1647 ("occasion will arise when it will be to the creditors' interest to have the trustee defend even a suit merely in personam"); *Automatic Stay Part I*, *supra* note 29, at 185 n.43 (bankrupt who did not obtain injunctive relief from bankruptcy court had to pursue his remedy to U.S. Supreme Court before finally getting relief); *Automatic Stay Part II*, *supra* note 31, at 61, 62 (automatic stays have dual purpose of enabling debtors to obtain fresh starts and of protecting creditors).

It may be that the existence of the nullification rule minimized focus upon creditor protection in the analysis of stays, just as the increasingly pervasive stay has nearly eliminated any domestic occasion for the application of the nullification rule.

Where it does not, the policy of bankruptcy control over the liquidation of claims against the bankrupt can be vindicated by the application of the nullification rule, including its application to foreign arbitral awards otherwise required to be recognized under the U.N. Convention.⁵²

The *Fotochrome* case itself suggests the prejudice that can result from failure to apply the rule. At the time of Fotochrome's bankruptcy petition, Copal had completed its case in the arbitration proceeding, but Fotochrome had not yet offered its witnesses or other evidence.⁵³ Although Fotochrome originally intended to call two witnesses, it never produced them; the arbitral tribunal eventually ruled in favor of Copal without ever hearing Fotochrome's evidence. While a two-entry witness list suggests that Fotochrome's case may have been insubstantial, such an inference is by no means compelled. Experience with prebankruptcy debtors teaches that the debtor's defense may simply have lacked sufficient resources, both in terms of money and time.⁵⁴ The debtor's postbankruptcy assertion of its right to defend and counterclaim against Copal suggests it believed it could defeat, or at least substantially reduce, Copal's claim. If the testing process of full litigation in bankruptcy would have reduced or eliminated Copal's claim, then the foreclosure of relitigation cost the debtor's other creditors dearly. Only in the largest of bankruptcies would a \$600,000 claim not seriously dilute the recoveries of other creditors.⁵⁵

52. The rationale for the nullification rule is strengthened in the context of a foreign proceeding. The principal cases opposing the rule turned in significant part upon the notion that the failure to impose a stay gives rise to an inference that the unstayed proceedings were intended to have effect. *See, e.g., Riehle v. Margolies*, 279 U.S. 218, 223 (1929); *Norton v. Switzer*, 93 U.S. 355, 361-62 (1876). That argument, however, does not apply in the case of foreign arbitration proceedings. Congress has not deliberately chosen to exempt foreign proceedings from the operation of the stay, because Congress lacked the power to make the stay reach so far even if it had wanted to. *See supra* note 31 and accompanying text.

53. Although the district court opinion suggests that the proceedings were completed, 377 F. Supp. at 28, the more detailed statement in the Second Circuit opinion indicates that Fotochrome had not yet presented its case, 517 F.2d at 514.

54. Fotochrome three times failed to appear to present its witnesses during the last months before bankruptcy. 517 F.2d at 514. While this manner of (not) proceeding is deplorable and while some solvent parties to arbitrations are guilty of no less, these facts are also consistent with the possibility of sheer neglect of this distant, expensive proceeding by a management sliding into bankruptcy.

55. It is also possible that full litigation might have produced an affirmative recovery for the debtor on its \$800,000 counterclaim, in which case the preclusion of relitigation cost the other creditors more dearly still.

It is clear that bankruptcy policy would be better served by the adoption of a rule nullifying for bankruptcy purposes any postbankruptcy arbitration award, regardless of the applicability of the automatic stay to such arbitration proceedings. Next, one must consider the effect of the powerful U.S. policies favoring the enforcement of international arbitration agreements and arbitral awards.

B. THE U.N. CONVENTION AND U.S. POLICIES FAVORING ENFORCEMENT OF FOREIGN ARBITRAL AWARDS

There are three possible grounds for not applying the nullification rule to foreign arbitral awards: 1) U.S. courts should not attempt to use local law to control foreign proceedings; 2) the U.N. Convention and the implementing law require U.S. courts to enforce arbitral awards covered by the Convention; and 3) the strong federal policy favoring enforcement of foreign arbitral awards should prevail over the conflicting bankruptcy policy reflected in the nullification rule.

1. *Lack of Jurisdiction*

One argument for exempting foreign arbitral awards from the nullification rule might rely on the apparent anomaly created by denying effect to a proceeding which U.S. courts are powerless to control.⁵⁶ The lack of personal jurisdiction over a foreign party admittedly prevents U.S. courts from controlling a foreign party's conduct overseas, and the lack of territorial jurisdiction over foreign tribunals prevents U.S. courts from controlling the effect given an arbitral award against the non-U.S. assets of a U.S. bankrupt. Yet, these effects stemming from the absence of personal and extra-territorial jurisdiction should not end the inquiry into the scope of U.S. jurisdiction. The source of the bankruptcy court's power is its exclusive in rem jurisdiction over all the U.S. assets of the bankrupt.⁵⁷ This jurisdiction gives the bankruptcy court the power to deny effect "defensively" to that which it lacks the power to prevent or undo "offensively." Two examples of the bankruptcy court's power in

56. Such an argument would no doubt begin with the doctrine that Congress is presumed to have intended to regulate only domestic matters unless it explicitly states its intention to the contrary. RESTATEMENT, *supra* note 31, § 38. *But see* RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES § 403(4) and comment f (Tent. Draft No. 2, 1981) [hereinafter cited as RESTATEMENT, REVISED]. *See also* RESTATEMENT, *supra* note 31, § 17(b); RESTATEMENT, REVISED, *supra*, § 402(1)(b).

57. *See supra* note 21, and accompanying text.

this regard are found in the areas of voidable transfers and foreign distributions.

Under the former Bankruptcy Act, the avoidance of voidable transfers was generally outside the summary jurisdiction of the bankruptcy court. Section 502(d) of the Bankruptcy Code⁵⁸ provides that "the court shall disallow any claim of any entity . . . that is a transferee of a transfer avoidable under [the Code], unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable . . ." ⁵⁹ The equivalent provision in the old Bankruptcy Act in effect enabled the bankruptcy court to act against voidable transfers "defensively," by claim denial, although it lacked the power to void these same transfers "offensively." The trustee in bankruptcy was required to bring an avoidance action in some nonbankruptcy court.⁶⁰ For example, if a creditor who had received a preference was prepared to forgo a bankruptcy claim, it could enjoy the fruits of its preference unless the trustee could get jurisdiction over the preferred creditor in some nonbankruptcy court.⁶¹ If, on the other hand, the preferred creditor wished to share in the distribution of the assets of the estate, it was required to surrender its preference as a condition.⁶² If the creditor did file a claim, it was required to litigate any dispute about the preferential nature of the transfer in the bankruptcy court, losing the right to a jury trial that it otherwise might have had in a nonbankruptcy court proceeding.⁶³ The purpose of the required election was not punitive, but was solely to vindicate the fundamental bankruptcy policy of equality of distribution.⁶⁴ Although it was then thought that important policies, including the right to jury trial, supported the withholding of general avoidance jurisdiction from the bankruptcy courts, these policies were subordinated to basic bankruptcy policies in the context of an affirmative claim against the assets of the estate, a claim necessarily in competition with the claims of other creditors.⁶⁵

58. 11 U.S.C. § 502(d) (Supp. IV 1980).

59. *Id.*

60. 11 U.S.C. §§ 96(b); 107(e) (1976) (repealed 1978). See 2 COLLIER (14th), *supra* note 28, ¶ 23.15[7].

61. See, e.g., 3 COLLIER (14th), *supra* note 28, ¶ 57.19; 2 COLLIER (14th), *supra* note 28, ¶ 23.06[9].

62. See 3 COLLIER (14th), *supra* note 28, ¶ 57.19[1].

63. See *Katchen v. Landy*, 382 U.S. 323, 338-40 (1966). See also 3 COLLIER (14th), *supra* note 28, ¶ 57.19[5.1].

64. See 3 COLLIER (14th), *supra* note 28, ¶ 57.19[2].

65. See *In re Pollman*, 156 F. 221, 222-23 (S.D.N.Y. 1907) (German creditor recovered in part from its attachment of German realty); cf. *In re Pacat Fi-*

Another example of this power is found in section 508(a) of the Code, which bars creditors who have received payment of an allowed claim in a foreign proceeding from receiving any payment from the bankrupt's U.S. assets until all other claimants of equal priority have received payments of an equal amount.⁶⁶ This section helps protect U.S. claimants from the effects of unequal treatment in a foreign proceeding even though the U.S. bankruptcy court is powerless to control that proceeding.

There is no conceptual reason why indirect protection of fundamental bankruptcy policy should not obtain with respect to postpetition arbitral awards through application of the nullification rule. Application of the rule would in effect put the nonbankrupt party to an election similar to that faced by a creditor receiving a voidable transfer. If a foreign arbitration proceeding were pending when the U.S. party to the proceeding filed a petition in bankruptcy, the foreign party could elect to proceed with the arbitration, hoping to enforce any award against the bankrupt's non-U.S. assets, or the foreign party could elect to file a proof of claim in the bankruptcy court and seek the court's permission to liquidate its claim in arbitration. Under this approach, the U.S. courts would not appear to be seeking any direct control over a foreign proceeding but would be protecting the integrity of the bankrupt estate from false or inflated claims for the benefit of the other creditors.

It might be objected that the approach suggested here would require a foreign party to become entangled in the U.S. courts contrary to its bargain. The response must be that proceedings in the U.S. courts are always required if one wishes to enforce a foreign award against U.S. assets. Following the suggested approach, the foreign party would be required to make an application to the U.S. courts to obtain approval of proceed-

nance Corp., 295 F. 394, 410 (S.D.N.Y. 1923) (American creditor with French attachment). See also Robinet, Brussels Trib. de Commerce, June 21, 1965, *Jurisprudence commerciale de Belgique* 1-2 (1968) IV 161, discussed in Nadelmann, *Codification of Conflicts Rules for Bankruptcy* (1974), reprinted in *Hearings on H.R. 31, 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong., 2d Sess., ser. 27, pt. 3, at 1457, 1489-90 (1976) [hereinafter cited as Nadelmann, *Codification*] [the hearings hereinafter cited as *Hearings*]. Another example of this power under the old Act is found in the power of the bankruptcy courts to enjoin lien enforcement, although they lacked jurisdiction to determine the substantive rights of the secured creditor. See Peitzman & Smith, *The Secured Creditor's Complaint: Relief From the Automatic Stays in Bankruptcy Proceedings*, 65 CAL. L. REV. 1216, 1218, 1222 (1977).

66. 11 U.S.C. § 508(a) (Supp. IV 1980).

ing with arbitration if, and only if, it wished to be able subsequently to assert any arbitral award as conclusive in bankruptcy. Since a foreign party would have to retain U.S. counsel and apply to the U.S. courts ultimately in any case, the additional burden would be relatively minor.

2. *Exceptions to Enforcement Under the U.N. Convention*

Chapter 2 of the Federal Arbitration Act requires U.S. courts to enforce the U.N. Convention in accordance with the provisions of the Act.⁶⁷ Section 207 of the Act provides that U.S. courts shall confirm awards falling under the Convention unless the court "finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention."⁶⁸ Article V of the Convention lists seven grounds for refusing enforcement of an award, three of which might plausibly apply where a party to an arbitration proceeding has filed a petition in bankruptcy.

Article V(2)(b) is the broadest of the three grounds. It provides that enforcement may be refused if such enforcement would violate the public policy of the enforcing state.⁶⁹ The U.S. courts have determined that this "public policy" limitation is to be narrowly construed, so that its scope has been narrowed to include only those policies that embody "the forum state's most basic notions of morality and justice."⁷⁰ It is not likely that the bankruptcy policy underlying the nullification rule rises to the level of that standard.

A second possible basis for nonenforcement is the exception provided in article V(2)(a), which permits nonenforcement where "[t]he subject matter of the difference is not capable of settlement by arbitration under the law of that country."⁷¹ Enforcement could therefore be refused whenever the claim underlying the foreign arbitral award could not have been settled

67. 9 U.S.C. § 201 (1976).

68. *Id.* § 207.

69. U.N. Convention, *supra* note 5, art. V, para. 2(b).

70. *Parsons & Whittemore Overseas Co. v. Societe General De L'Industrie du Papier*, 508 F.2d 969, 974 (2d Cir. 1974). *See* *Island Territory of Curacao v. Solitron Devices, Inc.*, 482 F.2d 1313, 1320 (2d Cir. 1973); *Fertilizer Corp. v. IDI Management, Inc.*, 517 F. Supp. 948, 955 (S.D. Ohio 1981); *Laminoirs-Trefleries-Cabeleries de Leas, S.A. v. Southwire Co.*, 484 F. Supp. 1063, 1068 (N.D. Ga. 1980); *Antco Shipping Co. v. Sidermar, S.P.A.*, 417 F. Supp. 207, 216 (S.D.N.Y. 1976); *Biotronik Messand Therepiegerate v. Medford Medical Instruments Co.*, 415 F. Supp. 133, 139 (D.N.J. 1976). *See also* Comment, *supra* note 38, at 732 n.33.

71. U.N. Convention, *supra* note 5, art. V, para. 2(a).

by arbitration under the domestic law of the enforcing state. One could argue that, because claims against bankrupts are not arbitrable in the United States without permission of the bankruptcy court, the Convention does not require foreign awards based on such claims to receive more favorable treatment. The defect in this argument, however, lies in the language of the exception itself. By its terms, it applies only where the nature of the dispute is not arbitrable generally, and not to the situation in which the dispute is not arbitrable because of the status of one of the parties.

There is one exception under the Convention which does turn on the status of the parties. Article V(1)(a) authorizes nonenforcement if "[t]he parties to the agreement . . . were, under the law applicable to them, under some incapacity . . ."⁷² Although this exception, on its face, seems to refer to the parties' capacity at the time the arbitration agreement was made, rather than to their capacity at the time of the arbitration proceedings, the background of the provision suggests that the drafters were concerned with ensuring that both parties be properly represented during the arbitration proceeding; therefore, the provision refers to the parties' capacity at the time of arbitration.⁷³ Moreover, the incapacity determination is to be

72. U.N. Convention, *supra* note 5, art. V, para. 1(a). See also U.N. Doc. E/CONF.26/SR.17, 24, International Commercial Arbitration—New York Convention pt. III, at C (G. Gaja ed. 1979) [hereinafter cited as ICA-Convention]; B. Harrell, *supra* note 38, at 14-15. A provision regarding incapacity of a party as a defense had been part of the earlier Geneva Convention on the Execution of Foreign Arbitral Awards, 92 L.N.T.S. 301 (Sept. 26, 1927). This provision was carried forward in the preliminary drafts submitted to the Conference by the International Chamber of Commerce and by the 1955 Ad Hoc Committee. U.N. Doc. E/2704 and Con. 1 (1958), ICA-Convention, *supra*, at A.1.4, Annex A.1.7. It was omitted, however, from the working draft submitted to the Conference. U.N. Doc. E/CONF. 26/L.43 (1958), ICA-Convention, *supra*, at B.5.1. Its omission may have arisen from a belief that an incapacity defense would rarely arise, especially in a commercial context. See U.N. Doc. E/CONF. 26/SR.17 (1958), ICA-Convention, *supra*, at C.143. After several discussions of the issue, the final language concerning incapacity was inserted at the last meeting of the Conference. U.N. Doc. E/CONF.26/5a24 (1958), ICA-Convention, *supra*, at C.220, 221, 223. See also B. Harrell, *supra* note 38, at 14-15.

73. See Contini, *International Commercial Arbitration*, 8 AM. J. COMP. L. 283, 300-01 (1959). The context in which the incapacity defense is found admittedly suggests that it may refer to the parties' capacity when the arbitration agreement arose, since article V(1)(a) deals with the validity of the agreement underlying the award and the incapacity clause refers back to article II which applies to recognition of the agreement prior to an award. The earlier drafts containing the incapacity defense had not set it forth in the same provision containing the agreement invalidity defense, but instead had expressly linked incapacity to lack of proper representation. U.N. Doc. E/2704 and Con. 1 (1955), ICA-Convention, *supra* note 72, at A.1.1, Annex .7 (1955 Ad Hoc Committee draft); U.N. Doc. E/CONF. 26/L.17 (1958), ICA-Convention, *supra* note 72, at

made "under the law applicable to [the parties]." This provision requires the application of the law of the party's home jurisdiction, as opposed to the law of the state in which the award was made or the law of the underlying contract.⁷⁴ In the case of a U.S. party, U.S. law would apply.

The bankruptcy of one of the parties to an arbitration agreement prior to an award falls squarely under this third exception. Under U.S. law, the bankrupt cannot bind the bankrupt estate by participating in a postpetition proceeding.⁷⁵ If an award against the bankrupt party would be ineffective against the assets of the bankrupt under the law governing its capacity, the party is under a legal incapacity with respect to those assets. Since the Convention makes U.S. law applicable with re-

B.1.12 (Netherlands Amendments May 26, 1958). Of course, the change in the location of the provision could be argued to demonstrate that the conference intended to make it refer to capacity at the time the agreement arose. However, the Netherlands delegate who offered the incapacity language which was adopted specifically referred to incapacity in relation to the award, not to the agreement, suggesting that the focus remained upon incapacity during arbitration. U.N. Doc. E/CONF. 26/SR.24 (1958), ICA-Convention, *supra* note 72, at C.220.

An earlier change offered by the Norwegian delegate had inserted the word "proper" before the word "notice" in the provision which became article V(1)(b). U.N. Doc. E/CONF. 26/SR.17 (1958), ICA-Convention, *supra* note 72, at C.148. The reason for this change was to provide "implicitly" for the incapacity defense. *Id.* at C.143; P. SANDERS, 2 INTERNATIONAL COMMERCIAL ARBITRATION 315 (1960); B. Harrell, *supra* note 38, at 14. Again this amendment strongly suggests that the Conference was concerned with incapacity at the time of the arbitration, since "proper" modified "notice . . . of the arbitration proceedings . . ." Even if one accepted the argument that the Dutch amendment's new location meant it referred to incapacity when the agreement arose, the adoption of the Norwegian amendment on the basis stated certainly supports a defense of incapacity at the time of the arbitration. It would seem better, however, to base the defense on article V(1)(a), especially since a separate choice of law provision is applied. The conflicts provision is generally consistent with U.S. and international practice. See RESTATEMENT, *supra* note 31, § 17(b); Hon-berger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W.L. REV. 631, 636 (1980) (the decision whether to give effect to foreign judgments in American courts is based in terms of international fair play and justice); cf. Nadelmann, *Rehabilitating International Bankruptcy Law: Lessons Taught by Herstatt and Co.*, 52 N.Y.U. L. REV. 1, 32 (1977) (principle that extra-territorial effect of bankruptcy judgment may only be sought for adjudications made at debtor's commercial domicile). Cf. Draft of a Convention on Bankruptcy, Winding-Up, Arrangements, Compositions and Similar Proceedings, *reprinted in* 2 COMM. MKT. REP. (CCH) ¶ 6111, ¶ 6115 (1981) (exclusive jurisdiction in bankruptcy in courts of state where debtor has center of administration).

74. U.N. Doc. E/CONF. 26/SR.24, ICA-Convention, *supra* note 72, at C.220. See also P. SANDERS, *supra* note 73, at 315. The Netherland delegate who offered the language which was adopted stated that the parties' capacity would be tested only according to the law governing their personal status, and that the change was not intended to have any other substantive effect. *Id.*

75. See *supra* text accompanying notes 45-46.

spect to the capacity of U.S. parties, it follows that a bankrupt U.S. party is "under some incapacity" for purposes of determining the enforceability of a postpetition arbitral award, and thus such awards should not be enforceable under the Convention as to bankruptcy estate assets. This result serves the underlying purpose of both article V(1)(a) and the nullification rule, both of which seek to ensure that the parties were adequately represented in the arbitration proceeding.⁷⁶

3. *The Federal Policy Favoring International Arbitration*

The U.S. courts long ago abandoned their hostility to resolution of disputes by arbitration. One of the few limitations that have survived, however, is the doctrine of *Wilko v. Swan*.⁷⁷ In that case the Supreme Court declared that the plaintiff could not be forced to arbitrate a federal Securities Act claim. Balancing arbitration policy against securities policy, the Court expressed particular concern that arbitration of securities claims would deprive the courts of the opportunity to ensure that the rights created by the Securities Act were effectively enforced.⁷⁸

Two decades later a majority of the Supreme Court reacted very differently when presented with a securities claim arising from a transnational, rather than a domestic, transaction. In *Scherk v. Alberto-Culver Co.*,⁷⁹ the Securities Act claim arose out of an international corporate acquisition structured as a

76. The United States is also a party to a number of bilateral arbitration agreements. See Quigley, *Accession by the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 70 YALE L.J. 1049, 1051-54 (1961). Accession to the U.N. Convention does not abrogate these treaties. U.N. Convention, *supra* note 5, art. VII, para. 1. While these treaties will not be analyzed in detail, it is believed that they would permit the results which this Article suggests are permitted under the provisions of the U.N. Convention, since they are generally less strict in requiring enforcement than the U.N. Convention. Quigley, *supra*, at 1051-54.

The Inter-American Convention on International Commercial Arbitration, OAS Ser. A 20 (SEPF), reprinted in 14 I.L.M. 336 (1975), has been sent to the Senate for ratification. TREATY DOC. 97-12, 97th Cong., 1st Sess. (June 15, 1981). If it is approved, the analysis concerning enforcement of arbitration agreements and awards in the bankruptcy context should be similar to that under the U.N. Convention, since the drafters modeled the Inter-American Convention after the U.N. Convention. See Norberg, *General Introduction to Inter-American Commercial Arbitration*, 1978 Y.B. COM. ARB. 1, 12. Compare U.N. Convention, *supra* note 5, art. V, para. 1(a) (refusing enforcement of an award where the parties were under some incapacity or where the agreement is not valid under the law of the country where the award was made) with Inter-American Convention, *supra*, art. V, para. 1(a) (similar).

77. 346 U.S. 427 (1953).

78. *Id.* at 438.

79. 417 U.S. 506, *reh'g denied*, 417 U.S. 885 (1974).

stock purchase. The acquisition agreement provided for International Chamber of Commerce arbitration in Paris. The Court held the arbitration clause fully enforceable despite the securities claim, rejecting the defendant's contention that *Wilko* was dispositive of the arbitrability issue. The Court reasoned that the protective policies of the securities laws were outweighed in this case by the overriding importance of enforcing arbitration clauses in international contracts.⁸⁰

In explaining its holding, the Court stressed the danger that a dispute might be submitted to a forum hostile to one of the parties in the absence of an agreement between the parties specifying in advance the forum to which disputes shall be submitted.⁸¹ The neutrality of the arbitral forum is the most important factor in its widespread use internationally, despite serious disadvantages of expense and delay.⁸² Because of the need for neutrality and certainty in settling international disputes, the Court in *Scherk* found the *Wilko* exception inapposite in the context of international arbitration agreements.⁸³

The Supreme Court's *Scherk* decision creates a substantial potential conflict between U.S. bankruptcy policies and the policies announced in *Scherk* with regard to international arbitral awards. The conflict should be resolved by seeking a solution that accommodates the conflicting policies as much as possible. In this instance, it seems that such an accommodation would be best achieved by a rule requiring the prior approval of the bankruptcy court for the commencement or continuance of an international arbitration proceeding as a condition to enforcing any award resulting from that arbitration in bankruptcy. Such an approach would ensure the bankruptcy court's centralized control of the liquidation of claims against the assets within its control, while not affecting the validity of an unapproved award against the foreign assets of the bankrupt. Furthermore, requiring bankruptcy court approval would not prevent vindication of U.S. international trade policies, since the bankruptcy courts could be required to respect international arbitration agreements in most cases. The principal purpose of granting the bankruptcy courts approval power would be to enable them

80. *Id.* at 516-17.

81. *Id.* at 516.

82. See, e.g., Geokjian, *ICC Arbitration From A Practitioner's Perspective*, 14 J. INT'L L. & ECON. 407, 430-31, 433-34 (1980); Geokjian, *supra* note 1, at 410-11; Paulsson, *supra* note 31, at 212; Stevenson, *An Introduction to ICC Arbitration*, 14 J. INT'L L. & ECON. 381, 382-84 (1980).

83. 417 U.S. at 517.

to control the timing of the arbitration in order to prevent defaults. On the other hand, the contrary rule adopted in *Fotochrome* takes the process of liquidating claims against the bankrupt estate completely out of the bankruptcy court's hands, thereby risking the diminution of the bankrupt estate by claims obtained by default or quasi-default.⁸⁴ There is nothing in bankruptcy court control in itself that materially reduces the foreign party's rights, other than its "right" to take advantage of a financially distressed debtor distracted by the rush into bankruptcy.⁸⁵

III. THE BANKRUPTCY COURT'S POWER TO REFUSE ARBITRATION

If a nonbankrupt party seeks bankruptcy court approval to liquidate its claim in arbitration pursuant to an arbitration agreement with the bankrupt, but the trustee objects, the court must determine the extent of its power to refuse to enforce the arbitration agreement against the trustee. This part of the discussion seeks to identify the circumstances under which it would be appropriate for the bankruptcy court to refuse approval of the nonbankrupt party's request to arbitrate its claim against the bankrupt.

A. THE TRUSTEE'S POWER TO REJECT ARBITRATION AGREEMENTS

In bankruptcy the efficacy of an arbitration agreement lies in the power of a contract between a creditor and the debtor to bind the trustee.⁸⁶ Although the trustee in bankruptcy suc-

84. The better rule can be followed even in the Second Circuit without doing violence to stare decisis, because of the policy developments represented by the pervasive stay adopted in the Bankruptcy Rules and in the new Bankruptcy Code, neither of which applied to the dispute in *Fotochrome*. Such a rule will ensure the avoidance of defaults. Whether the courts should go further and claim discretion in some instances to refuse to enforce international arbitration agreements in bankruptcy is the subject of Part III of this Article.

85. While this Article does not discuss the effect to be given foreign court judgments rendered against the debtor after bankruptcy, presumptively they should be treated no better than arbitration awards. To apply the nullification rule to them is to treat them no differently than U.S. postpetition judgments. See *supra* text accompanying note 43. Moreover, foreign judgments do not invoke the special consideration given to foreign arbitral awards. The United States is not party to a convention for the enforcement of judgments and there is no policy equivalent to that of *Scherk* applicable to foreign judgments.

86. See, e.g., *Caribbean S.S. Co. v. Sonmea Denizcilik VE Ticaret A.S.*, 598 F.2d 1264, 1266 (2d Cir. 1979); *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 35 A.D.2d 469, 471, 318 N.Y.S.2d 764, 766 (N.Y. App. Div.), *aff'd*, 29 N.Y.2d 690, 325

ceeds to the debtor's assets with all the burdens of the debtor's preexisting contractual obligations,⁸⁷ the Bankruptcy Code grants the trustee the power to assume or reject any executory contract or unexpired lease of the debtor.⁸⁸ According to the best-known test, a contract is considered executory if "the obligation of both the bankrupt and the other party to the contract are [sic] so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."⁸⁹

If the trustee assumes, the trustee must assume the burdens as well as the benefits of the contract—the trustee must accept the contract as a whole.⁹⁰ Upon assumption, the trustee is obligated to perform the contract in full as is the nonbankrupt party.⁹¹ Therefore, the costs of the trustee's performance of, or failure to perform, an assumed contract are administrative expenses payable in administration dollars.⁹²

If, on the other hand, the trustee rejects an executory contract, the rejection constitutes a breach of the contract and subjects the estate to a claim for money damages on behalf of the injured party.⁹³ Significantly, however, the injured party cannot insist on specific performance by the trustee.⁹⁴ Instead, the

N.Y.S.2d 419 (1971); M. DOMKE, *THE LAW AND PRACTICE OF COMMERCIAL ARBITRATION* § 10.06, at 86-87 (1968).

87. *See, e.g.*, *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 35 A.D.2d at 471, 318 N.Y.S.2d at 766.

88. 11 U.S.C. § 365(a) (Supp. IV 1980). *See generally* 2 COLLIER ON BANKRUPTCY ¶ 365.01 (15th ed. 1979) [hereinafter cited as COLLIER (15th)]. The statutory language is "assume" or "reject." Assumption is sometimes called "acceptance," "adoption," or "affirmance," while rejection is sometimes termed "disaffirmance."

89. Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973) [hereinafter cited as Countryman, *Part I*]. For cases applying Professor Countryman's formulation, see, e.g., *In re Select-A-Seat Corp.*, 625 F.2d 290, 292 (9th Cir. 1980); *In re Chicago, Rock I. & Pac. Ry. Co.*, 604 F.2d 1002, 1004 (7th Cir. 1979); *Jenson v. Continental Fin. Corp.*, 591 F.2d 477, 481 (8th Cir. 1979); *In re Knutson*, 563 F.2d 916, 917 (8th Cir. 1977); *In re Tilev*, 558 F.2d 1369, 1372 (10th Cir. 1977); *In re Unishops, Inc.*, 553 F.2d 305, 308 (2d Cir. 1977). The Sixth Circuit has offered another approach to the executory contract problem. *Chattanooga Memorial Park v. Still (In re Jolly)*, 574 F.2d 349, 350-52 (6th Cir.), *cert. denied*, 439 U.S. 929 (1978) (contract not executory if the purposes of rejection have already been achieved or cannot be achieved through rejection).

90. 2 COLLIER (15th), *supra* note 88, ¶ 365.01, at 365-67.

91. *Id.*

92. *Id.* *See also* Fogel, *Executory Contracts and Unexpired Leases in the Bankruptcy Code*, 64 MINN. L. REV. 341, 379 (1980).

93. 11 U.S.C. § 365(g) (Supp. IV 1980).

94. *See In re Philadelphia Penn Worsted Co.*, 278 F.2d 661, 664 (3d Cir. 1960); *National Bank v. Louisville Trust Co.*, 67 F.2d 97, 101 (6th Cir. 1933), *cert. denied*, 291 U.S. 665 (1934); *In re New York Investors Mut. Groups, Inc.*, 143 F. Supp. 51, 54 (S.D.N.Y. 1956); *In re Middleton*, 3 Bankr. 610, 613 (Bankr. E.D. Pa.

injured party is treated as having a prepetition claim for damages arising as if the breach occurred immediately before the filing of the bankruptcy petition.⁹⁵ A rejection claim, in contrast to an assumption claim, is therefore payable in less valuable bankruptcy dollars.

If the trustee rejects a contract containing an arbitration clause, the trustee creates a prepetition claim for breach in favor of the other party to the contract. The latter may also have other prepetition claims against the debtor under the other provisions of the contract. The issue is whether these prepetition claims, including the claim arising from rejection, must be liquidated pursuant to the arbitration clause. The few cases addressing the issue have pointed in both directions.⁹⁶

*Tobin v. Plein*⁹⁷ is the only case holding an arbitration agreement enforceable without qualification. There a corporation went into bankruptcy and its trustee sought arbitration, alleging breach of contract by one of the shareholders. The district court ruled that the contract must be deemed rejected because the trustee had not assumed it within the prescribed period.⁹⁸ It further held that the claims arising out of the rejected contract were not subject to the arbitration clause in the contract.⁹⁹ The court of appeals, without analysis or argument, reversed, holding that rejection of the contract did not affect the arbitrability of the prepetition claims.¹⁰⁰

1980); see also Countryman, *Part I, supra* note 89, at 440 n.11; cf. Express Co. v. Railroad Co., 99 U.S. 191, 200-01 (1878) (injured party cannot insist on specific performance by receiver appointed in foreclosure proceedings). But see Julis, *Classifying Rights and Interests Under the Bankruptcy Code*, 55 AM. BANKR. L.J. 223, 232-42 (1981).

95. 11 U.S.C. §§ 365(g)(1); 502(g) (Supp. IV 1980).

96. M. DOMKE, *supra* note 86, at § 10.06.

97. 301 F.2d 378 (2d Cir. 1962).

98. *Id.* at 379.

99. *Id.* at 381.

100. *Id.* In *Tobin*, the trustee wanted arbitration, while the other party claimed the contract was "deemed" rejected by the passage of time. *Id.* at 380. In liquidation cases, an executory contract is deemed rejected if not assumed by the trustee within sixty days after bankruptcy. 11 U.S.C. § 365(d)(1) (Supp. IV 1980). The nonbankrupt party is often the one urging that a contract must be deemed rejected; on the other hand, the trustee may have inadvertently failed to assume an otherwise favorable contract. In these circumstances, the court finds itself being urged to use the trustee's avoidance powers against the trustee. Skewed results may follow from this anomaly. *Tobin* may be a case where the "deemed rejected" rule made the result different from that which would have obtained had the trustee sought to reject the arbitration agreement.

A recent case squarely presented the issue discussed in the text, but the court declined to decide it. *Allegaert v. Perot*, 548 F.2d 432, 435 n.7 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977). This case may be read as casting some doubt on the authority of *Tobin*.

In *Truck Drivers Local Union No. 807 v. Bohack Corp.*,¹⁰¹ a Chapter XI case, the debtor rejected its collective bargaining agreement with its employees, and the employee's union filed a grievance under the contract's arbitration provision. Ultimately, the issue in the case became the arbitrability of the union's claims for damages on account of the debtor's rejection of the contract. The Second Circuit held that the arbitration agreement survived bankruptcy,¹⁰² although it apparently recognized that the bankruptcy court retained discretion to refuse arbitration.¹⁰³

L.O. Koven & Brother, Inc. v. Local Union No. 5767 United Steel Workers of America, AFL-CIO,¹⁰⁴ relied on by the *Bohack* court¹⁰⁵ and also involving a union grievance, arose after the confirmation of a reorganization plan and after the discharge of the bankrupt company from a Chapter XI proceeding. *Koven* held that the union's nonbankruptcy claims were subject to the

101. 541 F.2d 312 (2d Cir. 1976), *cert. denied*, 439 U.S. 825 (1978).

102. *Id.* at 319-21.

103. *Id.* at 320-21, 320 n.13. The district court, on remand, apparently interpreted the Second Circuit opinion as requiring arbitration of the union's rejection claims. *Bohack Corp. v. Truck Drivers Local Union No. 807*, 431 F. Supp. 646, 655 (E.D.N.Y.), *aff'd*, 567 F.2d 237 (2d Cir. 1977), *cert. denied*, 439 U.S. 825 (1978).

104. 381 F.2d 196 (3d Cir. 1967).

105. The court of appeals opinion in *Bohack* also relied upon *Schilling v. Canadian Foreign S.S. Co.*, 190 F. Supp. 462 (S.D.N.Y. 1961). *Schilling* in fact indicated that arbitration agreements could not be enforced with respect to claims against the debtor, the situation presented in *Bohack*. *Id.* at 463. This comment in *Schilling* must be treated as dictum, however, since that case dealt with claims by the debtor and the court distinguished such claims from claims against the debtor. *Id.* It held that the debtor was required to assert its claims against the other party in arbitration pursuant to their contractual arbitration clause, even though the debtor would not be bound to arbitrate a claim by the other party against the debtor. *Id.*

The "defensive-offensive" distinction suggested in *Schilling* has some superficial appeal but may be unworkable in practice. Commercial litigation often involves both a claim and a counterclaim. Bifurcated litigation is obviously undesirable. It is true that frequently one party would be much happier with a "wash" (no recovery on either side) than the other—i.e., is conscious of less merit in its position—but identification of the "real" claimant at a preliminary stage is often difficult. Of course, the trustee may be forced to arbitrate if the trustee cannot obtain personal jurisdiction over a foreign party in bankruptcy court and if the other party chooses not to assert a claim against the bankrupt. In that case, the trustee could be required to remain in the arbitral forum for all purposes. See *Harmon v. Komisar*, 15 Tenn. App. 405, 409 (1932). The argument would be that the trustee assumed the contract by his conduct. But see 2 COLLIER (15th), *supra* note 88, ¶ 365.03, at 365-21-23; 4A COLLIER (14th), *supra* note 28, ¶ 70.43, at 531. Under any other circumstances, it is suggested that the enforcement of the arbitration agreement should turn on the factors discussed in the text, rather than on a plaintiff versus defendant distinction.

arbitration agreement.¹⁰⁶ The court's holding was based expressly on the fact that the claims were against the surviving company, not against the bankrupt estate, and therefore no rights of bankruptcy creditors were in any way implicated.¹⁰⁷ The case thus offers no support for the proposition that a trustee is bound by an arbitration clause in the litigation of claims against the estate. If anything can be drawn from *Koven*, it is the negative of that proposition, based on the *Koven* court's strenuous effort to distinguish claims against an estate from the nonbankruptcy claims before the court.¹⁰⁸

The leading case refusing enforcement of an arbitration agreement against a trustee is *Johnson v. England*.¹⁰⁹ The dispute in *Johnson* involved the prebankruptcy failure of the debtor to make a required payment to its employees' pension fund pursuant to the collective bargaining contract. The court held that the arbitration agreement in the collective bargaining contract was not binding, because arbitration would affect the interests of the trustee and the bankrupt's general creditors, parties who had never consented to arbitration.¹¹⁰ As in *Bohack*, however, the court focused primarily on the nature of the issues to be resolved as being more or less suitable for arbitration, without mentioning the rejection doctrine. The court nevertheless made it clear that it would approve arbitration of certain aspects of the dispute in the exercise of the lower court's discretion.¹¹¹

106. The claims were for prebankruptcy and postbankruptcy breaches of the collective bargaining agreement. 381 F.2d at 198-200.

107. *Id.* at 203-04.

108. There are several other cases in which arbitration agreements were enforced in bankruptcy, but in situations like *Koven* where creditors were not threatened. *See, e.g.*, *Fillick v. Kehr*, 369 F.2d 899, 905 (2d Cir. 1966) (criticized in Comment, *Bankruptcy—Ancillary Jurisdiction—Arbitration of Pre-Bankruptcy Claim Held Not to Present Unusual Circumstance Justifying Exercise of Bankruptcy Jurisdiction*, 42 N.Y.U.L. REV. 743 (1967)) (non-dischargeable claim versus debtor); *Transmarittina Sarda Italnavi Flotte Ruiniti, S.P.A. v. Foremost Ins. Co.*, 482 F. Supp. 110, 113-15 (S.D.N.Y. 1979) (claim against insurer); *American Ship Building Co. v. Willy H. Schlieker, K.G.*, 219 F. Supp. 905, 908 (S.D.N.Y. 1963) (letter of credit payable against award); *In re Grain Products Corp.*, 20 F. Supp. 134, 134 (S.D.N.Y. 1937) (bank deposit); *Plein v. Charchat*, 17 A.D.2d 25, 28, 230 N.Y.S.2d 633, 636 (N.Y. App. Div. 1962) (claim of corporation's trustee in bankruptcy against 50% shareholder for diverting funds); *see generally Automatic Stay Part I, supra* note 29, at 212.

109. 356 F.2d 44 (9th Cir.), *cert. denied*, 384 U.S. 961 (1966).

110. *Id.* at 51. *Accord* *Cuvrell v. Mazur (In re F & T Contractors, Inc.)*, 649 F.2d 1229, 1232 (6th Cir. 1981).

111. 356 F.2d at 51-52. *Accord, e.g.*, *Cuvrell v. Mazur*, 649 F.2d at 1232; *In re Muskegon Motor Specialties Co.*, 313 F.2d 841, 843 (6th Cir.), *cert. denied sub nom.* *International Union, UAW v. Davis*, 375 U.S. 832 (1963).

Surprisingly, none of these courts analyzed these cases as a traditional executory contract problem. It is now firmly established in the United States, as well as in many other countries, that an arbitration clause is considered a separable contract between the parties which survives as an obligation of the promisor even if the underlying contract is voidable.¹¹² Viewed as an independent contractual obligation of the parties, an arbitration agreement is a classic executory contract, since neither side has substantially performed the arbitration agreement at the time enforcement is sought.¹¹³ Although "arbitration survives the contract" as a matter of contract law, executory obligations may be avoided by the trustee as a matter of bankruptcy law through the exercise of the trustee's power to reject executory contracts.¹¹⁴ What makes an arbitration clause "survive" the contract¹¹⁵ is that courts are willing to enforce specifically such agreements by issuing an order staying any judicial proceeding and compelling arbitration.¹¹⁶ To

112. See, e.g., *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-04 (1967); M. DOMKE, *supra* note 86, at Ch. 8; Comment, *Federal Arbitration Act and Application of the "Separability Doctrine" in Federal Courts*, 1968 DUKE L.J. 588, 588-89. The defendant in *Prima Paint* was in bankruptcy—indeed its filing of a petition one week after the signing of the contract between the parties was the source of the plaintiff's annoyance. 388 U.S. at 398. There the bankrupt sought arbitration, so that the main questions here considered were not presented. For a similar severability rule in a number of other countries, see 1981 Y.B. COM. ARB. 7 (France), 34 (Italy), 65 (Netherlands); 1980 Y.B. COM. ARB. 6 (Belgium), 63 (Greece), 87 (Indonesia), 100 (Norway); 1979 Y.B. COM. ARB. 8 (Algeria), 27 (Austria), 65-66 (West Germany), 122 (Japan); 1978 Y.B. COM. ARB. 20 (Argentina), 97-98 (Mexico), 165 (Sweden), 187 (Switzerland); 1977 Y.B. COM. ARB. 6 (Australia); 1976 Y.B. COM. ARB. 20 (Bulgaria), 55 (Hungary), 67 (Poland), 80 (Rumania). *But see* 1979 Y.B. COM. ARB. 47 (Egypt), 141 (Kuwait); 1978 Y.B. COM. ARB. 108 (Panama); 1977 Y.B. COM. ARB. 34-35 (India), 51 (Israel), 67-68 (Nigeria), 78-79 (South Africa), 96 (United Kingdom); 1976 Y.B. COM. ARB. 43 (East Germany) (enumerating conditions in which an arbitral clause perishes along with the contract).

113. See 9 U.S.C. § 4 (1976). Failure to perform the arbitration agreement by either party would excuse the other from performance. *Mogge v. District No. 8, IAM*, 387 F.2d 880, 883 (7th Cir.), *cert. denied*, 391 U.S. 936 (1968) (dictum); *Lane, Ltd. v. Larus & Brother Co.*, 243 F.2d 364, 367 (2d Cir. 1957). On that basis, the Countryman test for an executory contract is satisfied. See *supra* text accompanying note 89.

114. See 11 U.S.C. § 365(a) (Supp. IV 1980). "The very purpose of bankruptcy proceedings is to diminish the rights of the creditors." *Schilling v. Canadian Foreign S.S. Co.*, 190 F. Supp. 462, 463 (S.D.N.Y. 1961).

115. See, e.g., *Truck Drivers Local Union No. 807 v. Bohack Corp.*, 541 F.2d 312, 321 n.15 (2d Cir. 1976), *cert. denied*, 439 U.S. 825 (1978); *In re Pahlberg Petition*, 131 F.2d 968, 970 (2d Cir. 1942).

116. The statutes requiring enforcement of arbitration agreements simply grant the remedy of specific performance denied by the common law on policy grounds. *Trafalgar Shipping Co. v. International Milling Co.*, 401 F.2d 568, 573 n.5 (2d Cir. 1968); *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d

compel a trustee to arbitrate, however, would be to require specific performance by the trustee of an obligation of the debtor, a remedy the law will not grant against a trustee in bankruptcy.¹¹⁷ If specific performance is not available against a trustee, it follows that an arbitration agreement is like any other executory contract which the trustee may reject.

The reason for the availability of specific performance to enforce arbitration agreements outside bankruptcy is that the harm arising from a breach of an arbitration agreement is often difficult or impossible to measure in damages.¹¹⁸ For the same reason, a claim for damages against a trustee in bankruptcy based on a rejected arbitration clause is also unlikely to adequately compensate the injured party. The same is true, in bankruptcy, of other specifically enforceable contractual obligations, notably contracts for the sale of land.¹¹⁹ The justification for the rule is that permitting specific performance would prefer those creditors to which it was granted over others with equally meritorious claims,¹²⁰ since specific performance of a contract results in full satisfaction while payment in money

978, 981-85 (2d Cir. 1942) (Frank, J.). See *Guinness-Harp Corp. v. Joseph Schlitz Brewing Co.*, 613 F.2d 468, 472 (2d Cir. 1980); *Joseph Muller Corp. Zurich v. Commonwealth Petrochemicals, Inc.*, 334 F. Supp. 1013, 1018 (S.D.N.Y. 1971) (dictum); *In re Utility Oil Corp.*, 10 F. Supp. 678, 680 (S.D.N.Y. 1934) (dictum). See also 5A A. CORBIN, CORBIN ON CONTRACTS § 1173 at 272 (1962). In the F.A.A., Congress merely intended to put arbitration agreements on the same footing as other contracts in this regard, and thus the usual equitable defenses to specific performance are available to resist enforcement of such an agreement. *Kulukundis Shipping Corp. v. Amtorg Trading Corp.*, 126 F.2d at 987 & n.30. See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. at 404 n.12. *But cf.* *Halcon Int'l, Inc. v. Monsanto Australia Ltd.*, 446 F.2d 156, 163 (7th Cir. 1971), *cert. denied*, 404 U.S. 949, *reh'g denied*, 404 U.S. 1029 (1972) (issue of laches is for administrator, not court); *Trafalgar Shipping Co. v. International Milling Co.*, 401 F.2d at 572-73 (on motion to compel arbitration, district court may consider any claims of laches which relate to issues the court must decide—arbitrator must resolve such claims which relate to issues that parties have agreed to submit to arbitration).

117. See *supra* note 94 and accompanying text.

118. Ordinarily only nominal damages can be recovered. 6A A. CORBIN, *supra* note 116, § 1440 at 419; 16 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1918A n.9, § 1923 nn.11-14 (1976). See *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d at 987 n.30 (dictum).

119. See *Countryman, Part I, supra* note 89, at 463-73. The new Code changes this result as to those purchasers in possession under a land sale contract. 11 U.S.C. 365(i) (Supp. IV 1980). See *Countryman, Executory Contracts in Bankruptcy, Part II*, 58 MINN. L. REV. 479, 565-66 (1974) [hereinafter cited as *Countryman, Part II*].

120. *National Bank v. Louisville Trust Co.*, 67 F.2d 97, 100 (6th Cir. 1933), *cert. denied*, 291 U.S. 665 (1934). See *In re New York Investors Mut. Group, Inc.*, 143 F. Supp. 51, 54 (S.D.N.Y. 1956). See also *Countryman, Part II, supra* note 119, at 566.

damages in bankruptcy dollars results in only partial satisfaction. Whatever maxims of equity might be raised here, the rule is based on the policy judgment that it is better that the creditors ordinarily entitled to specific performance should suffer for the good of all the creditors of the estate.¹²¹

There is, moreover, nothing in the Convention which requires that international arbitration agreements be treated any differently from domestic agreements when one of the parties has filed for relief in bankruptcy. Since arbitration agreements need not be enforced against a bankrupt party under the Convention,¹²² international arbitration agreements may be rejected in bankruptcy consistently with U.S. obligations under the Convention.¹²³

The Bankruptcy Code, however, conditions the trustee's

121. Holding that specific performance is not automatically available against a trustee with respect to international arbitration agreements of the debtor is not inconsistent with the results, if not the language, in most of the reported cases. These cases have emphasized discretionary factors in allocating disputes between arbitration and bankruptcy. Permitting the trustee to reject such agreements in certain egregious cases is consistent with the discretion granted the bankruptcy courts in previous decisions.

122. See *supra* text accompanying notes 72-76.

123. A rule which forbade rejection of international arbitration contracts would vindicate the *Scherk* policies at the expense of the important bankruptcy policies underlying the rejection power. The effect, at least in some cases, might be to deplete the estate unreasonably to the prejudice of other creditors. On the other hand, permitting rejection in principle will serve the bankruptcy policies without necessarily harming the trade policy, because rejection can be limited to special circumstances.

A *de minimus* argument might also be made: there will be little harm done to international arbitration policies if the occasional bankrupt is able to escape arbitration; the enforceability of international arbitration agreements will remain sufficiently predictable to ensure their continued use in international trade. The additional risk of dealing with a U.S. party will be minimal, unless the party appears at the outset to be financially weak.

This argument, standing alone, does not support a U.S. rule permitting the trustee of a bankrupt to avoid an international arbitration agreement. It ignores how "easy" U.S. bankruptcy may appear to our principal trading partners, whose bankruptcy laws are stricter. The tremendous sophistication of the reorganization mechanism in the United States, and the great concern our bankruptcy judges have for successful rehabilitation, means that marginal U.S. companies may seek bankruptcy help under circumstances far less dire than those required to persuade a European company to do so. See, e.g. *In re Manville Corp.* Nos. 82 Bankruptcy 11656-11676 (S.D.N.Y. Aug. 26, 1982). One can imagine situations in which a single contract with an arbitration clause might be so important to a U.S. company that it might consider bankruptcy just to get the benefits of a U.S. forum. For a company like Fotochrome, for example, the Copal dispute might be so large relative to its overall business that bankruptcy to avoid the arbitration clause might make sense, especially if there were some arguments for bankruptcy because of other company problems.

The principal justification for the rule urged in the text is the necessity of bankruptcy court claims control to the purposes of U.S. bankruptcy laws.

power of rejection on the approval of the bankruptcy court.¹²⁴ In exercising its discretion to withhold or grant approval, the bankruptcy court is faced with the additional policy considerations enunciated in *Scherk* when confronted with an international, as opposed to a domestic, arbitration agreement. The proper ambit of the court's discretion is the subject of the next section.

B. THE LIMITS OF THE COURT'S DISCRETION TO PERMIT REJECTION OF AN INTERNATIONAL ARBITRATION AGREEMENT

1. *In General*

Traditionally, the trustee in bankruptcy enjoyed broad discretion in assuming or rejecting executory contracts. The standard, derived from the notion of abandonment of an unprofitable asset of the debtor, has been a purely financial one: the trustee should be permitted to reject if it would relieve the estate from a burdensome obligation; on the other hand, the trustee should be permitted to assume if assumption would aid in the liquidation or rehabilitation of the estate.¹²⁵

In recent years the problem of rejecting collective bargaining agreements has given rise to some restrictions on the power of the trustee to reject contracts on a purely financial basis.¹²⁶ In *Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc.*,¹²⁷ the court found a conflict between the policies

124. 11 U.S.C. § 365(a) (Supp. IV 1980). One exception of substantial practical importance is that a contract is deemed rejected in chapter 7 liquidation after the passage of 60 days from entry of the order for relief. *Id.* § 365(d)(1). Such a "deemed" rejection need not always be given effect. 2 COLLIER (15th), *supra* note 88, ¶ 365.03, at 365-69. Where important federal policies must be given weight in considering approval of the rejection of a contract, as with collective bargaining agreements, an automatic rejection rule should not apply. *See infra* text accompanying notes 126-30. If federal policies regarding international arbitration are given the same deference as labor policies, as urged below, then the "deemed rejection" rule should not be applied to international arbitration agreements either.

125. *See* Fogel, *supra* note 92, at 345.

126. *See* 2 COLLIER (15th), *supra* note 88, ¶ 365.03; *cf.* Control Data Corp. v. Zelman (*In re Minges*), 602 F.2d 38, 44 (2d Cir. 1979) (power of trustee to reject executory lease provisions requires a reasonable likelihood that general creditors will derive substantial or significant benefit from proposed lease rejection).

127. 519 F.2d 698 (2d Cir. 1975). Earlier cases which had discussed the problem included *Carpenters Local Union No. 2746 v. Turney Wood Prod., Inc.*, 289 F. Supp. 143, 149 (W.D. Ark. 1968); *In re Overseas Nat'l Airways, Inc.*, 238 F. Supp. 359, 360 (E.D.N.Y. 1965); *In re Klaber Bros., Inc.*, 173 F. Supp. 83, 85 (S.D.N.Y. 1959); *In re Public Ledger, Inc.*, 63 F. Supp. 1008, 1013 (E.D. Pa. 1945), *rev'd in part*, 161 F.2d 762 (3d Cir. 1947).

underlying two federal statutes: the Bankruptcy Act and the National Labor Relations Act.¹²⁸ In seeking to accommodate these policies, the court held that although collective bargaining contracts are subject to rejection in bankruptcy, the bankruptcy court, in approving or disapproving rejection, would be required to consider not only the financial benefit or detriment to the bankrupt estate, but also the weighty federal policies favoring collective bargaining and the enforcement of collective bargaining agreements.¹²⁹ Another decision, following on the heels of *Kevin Steel*, tipped the balance decisively in favor of the labor relations policies of the N.L.R.A., holding that these policies forbid rejection unless the failure to reject will lead to collapse of the debtor's business and the loss of the employees' jobs.¹³⁰ These cases make it clear that countervailing federal policies can be brought to bear on the decision to reject a contract in bankruptcy, and that these policies can be given great weight.

A bankruptcy court confronted with a trustee's request to reject an international arbitration agreement faces a similar conflict of federal policies. The strength of the public policy favoring the enforcement of such agreements in international trade is demonstrated by *Scherk*.¹³¹ Following the example of the labor cases, it seems clear that the bankruptcy court should be required to enforce an international arbitration agreement unless there are very strong reasons for rejection in a particular case. Practical considerations following from the usual course of arbitration and the common situations presented in bankruptcy suggest three possible bases for rejection of an international arbitration clause: 1) very burdensome relative cost; 2) very burdensome relative delay; and 3) non-enforceability of the arbitration agreement under nonbankruptcy law.

128. The court denied a conflict, but proceeded to analyze the case as if there were one. 519 F.2d at 704-07. See Comment, *Rejection of Collective Bargaining Agreements by Trustees in Bankruptcy*, 81 DICK. L. REV. 64, 75 (1976).

129. 519 F.2d at 707.

130. *Brotherhood of Ry. Employees v. REA Express, Inc.*, 523 F.2d 164, 172 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017 (1975). See Comment, *supra* note 128, at 79-80. See also *Truck Drivers Local Union No. 807 v. Bohack Corp.*, 541 F.2d 312, 320 (2d Cir. 1976), *cert. denied*, 439 U.S. 825 (1978) (affirming support of *Kevin Steel* and *REA Express*); *In re Alan Wood Steel Co.*, 449 F. Supp. 165, 169 (E.D. Pa. 1978) (application to reject a collective bargaining agreement must be carefully scrutinized). *But see In re Bildisco*, 682 F.2d 72, 79-81 (3d Cir. 1982) (rejecting the more stringent test of *REA Express* and adopting the balancing test of *Kevin Steel*).

131. See *supra* text accompanying notes 79-83.

2. *Relative Cost*

As more bankruptcy cases are filed, there will no doubt be instances in which arbitration will be quicker and less expensive than proceeding in bankruptcy. Nonetheless, the greatest contemporary criticism of international arbitration is its growing cost and increasing delay.¹³² As a result, bankruptcy liquidation of claims and counterclaims will often be cheaper and faster.¹³³

Imagine a liquidation case in which Debtor Corporation is a U.S. distributor of both U.S. and foreign products. After a period of fast and profitable expansion domestically, the debtor enters into a large contract with Asian Manufacturing Company to distribute Asian's products in the United States. The contract provides for arbitration by the International Chamber of Commerce in a neutral forum, Taiwan. Shortly thereafter, the debtor's over-rapid expansion, together with an economic downturn, causes the company's financial collapse, and the corporation files for relief in bankruptcy. The estate has assets, after normal administration costs, of about \$300,000, and domestic claims of about \$300,000. Asian asserts a breach-of-contract claim for \$500,000, including lost profits. The trustee, seeking to reject the arbitration agreement, estimates that it will cost the estate \$25,000 to litigate the Asian claim in the bankruptcy court and \$75,000 to arbitrate in Taiwan. Asian estimates that it will spend \$50,000 to arbitrate in Taiwan, but \$75,000 if it has to litigate in the U.S. bankruptcy court. The \$25,000 difference would presumably be claimable by Asian as damages if the trustee rejects the arbitration agreement.

Under these circumstances, both parties will find a victory more favorable if Asian's claim is liquidated in bankruptcy. If the trustee wins, the general creditors of the estate recover eighty-four cents on the dollar in bankruptcy but only seventy-five cents on the dollar by a victory in arbitration.¹³⁴ Asian also fares better with a bankruptcy victory. It recovers thirty-three

132. See *supra* note 82.

133. See *Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 6 Bankr. 928, 930 (Bankr. Minn. 1980).

134. If the trustee wins in bankruptcy, assets remaining after expenses of litigation are \$275,000 and claims are \$325,000 (\$300,000 from domestic creditors plus \$25,000 representing Asian's rejection claim). The pro-rata recovery of the creditors is thus 84% of their prebankruptcy claims. If the trustee wins in arbitration, assets of the estate are reduced to \$225,000 by the increased cost of litigating in arbitration, and claims against assets are only \$300,000 (Asian has no rejection claim if the dispute is settled according to the arbitration agreement), resulting in a pro-rata distribution to creditors equal to 75% of their claims.

cents on the dollar in bankruptcy, while recovering only twenty-eight cents on the dollar with a victory in arbitration.¹³⁵ Asian might nonetheless have a legitimate desire to liquidate its claim in a neutral arbitral forum rather than in a U.S. court, a desire that could reasonably outweigh Asian's interest in a slightly greater recovery if the claim were liquidated in a U.S. bankruptcy court. The court, under these circumstances, could reasonably find that cost does not compel bankruptcy liquidation, and therefore grant the nonbankrupt party's request for arbitration.¹³⁶

On a rare set of facts cost could lead to a different result. If one assumes the same set of facts as above, except that the estate is worth only \$75,000, liquidation of Asian's claim in arbitration would extinguish the estate to the detriment of Asian and the debtor's U.S. creditors, whereas liquidation in bankruptcy preserves some positive value in the estate for distribution to the creditors.¹³⁷ These circumstances are analogous to the labor cases in which the courts held that an arbitration agreement may be rejected—that is, failure to reject will sink the debtor to the injury of the nonbankrupt party as well as the other creditors. Presumably, the same conclusion should obtain as to an arbitration agreement in a situation in which the available bankruptcy assets will simply not support the additional expense of arbitration.

The above examples have admittedly been oversimplified; actual cases will rarely be so easy. For one thing, attorney's fees are often awarded in arbitration¹³⁸ so that in reality computations will be more complicated. More important, the parties' actual concern under facts like those hypothesized would be with settlement; litigation would likely make little sense for

135. If Asian wins in bankruptcy, the assets of the estate would be \$275,000, and the claims against it would be \$825,000 (\$300,000 due to domestic creditors, \$500,000 due to Asian's contract claim, and \$25,000 due to Asian's rejection claim), resulting in a recovery of $33\frac{1}{3}\%$ of the creditor's claims. Thus, Asian would recover \$175,000 ($\$25,000 \times 33\frac{1}{3}\%$), for a net recovery of \$100,000 ($\$175,000 - \$75,000$) after taking into account its costs. If Asian wins in arbitration, the assets of the estate would be only \$225,000, and the claims \$800,000, giving creditors 28% of their prebankruptcy claims. Asian's net recovery in arbitration is thus only \$90,625 ($\$140,625 - \$50,000$) after expenses.

136. This highly over-simplified analysis ignores many important factors, notably the likelihood that Asian will be unlikely to win the full amount of its claims.

137. If Asian's claim is liquidated in arbitration, the estate is reduced to zero by the costs of litigation, and nobody recovers anything no matter who wins. On the other hand, if liquidation is in bankruptcy, there remain \$50,000 of assets in the estate for distribution to creditors, including Asian.

138. See, e.g., I.C.C. Arb. R. Art. 20 (1975).

either party. On the other hand, settlements are the products of the parties' predictions of litigation costs and likely results—the latter prediction being strongly influenced by the forum—so that even an admittedly simplistic analysis to some extent reflects the background against which a settlement would be struck. One can be sure that rejection or assumption of the arbitration agreement would be a very important practical factor in the shape of any settlement.

3. *Relative Delay*

Another factor which a trustee might urge in favor of rejection of arbitration is relative delay. Imagine, for example, a chapter 11 proceeding in which Asian has a very large claim arising from the discontinued part of Debtor Corporation's business. The debtor's plan of reorganization assumes going forward with a much smaller company with much smaller revenues than before. The projected profits are enough to fund a plan acceptable to domestic creditors if the Asian claim is either defeated or substantially reduced, but the plan would become less attractive than liquidation to the creditors if Asian's entire claim is accepted. If the trustee could show that arbitration would take at least two years, while bankruptcy litigation could be concluded within a year, and if the creditors' committee¹³⁹ advised the court that a majority of the creditors would vote for liquidation rather than accept a two year delay in confirming a plan,¹⁴⁰ the court could reasonably find that the case presented a compelling reason to deny arbitration. In this instance, it could be said that the temporal assets of the estate are unable to support arbitration, just as the financial assets could not do so in the previous example.¹⁴¹ Since all creditors would suffer from assumption of the arbitration agreement, the court should approve its rejection.

139. In a chapter 11 proceeding the court appoints a creditors' committee which usually consists of the holders of the seven largest claims against the debtor. 11 U.S.C. § 1102 (Supp. IV 1980). This committee can play an active role in the case, especially in the negotiation of a plan. *Id.* § 1103.

140. Before a plan may be confirmed, it must be accepted by a majority (as defined by the Code) of creditors of each class, with certain exceptions. *See id.* §§ 1126, 1129(b).

141. Once again the example is far too simple. The creditors' committee position may be only a bluff and in a real case the number of variables will be far greater. The examples are useful, however, as long as the reality is kept in mind.

4. *Nonenforceability*

In addition to relative cost and delay, the trustee might argue as a ground for rejection that regardless of the debtor's bankruptcy, the arbitration agreement is unenforceable under the U.N. Convention and the F.A.A. because of the unenforceability of any award resulting therefrom.¹⁴² Although this issue actually involves enforcement, not rejection, it is likely to come up at the same time. The bankruptcy court must determine whether the unenforceability of any award resulting from arbi-

142. Article II(1) of the U.N. Convention requires each signatory country to "recognize" arbitration agreements that are in writing. This has led some to argue that the Convention does not require signatory countries to "enforce" agreements as it requires with respect to arbitral awards. Hence, according to these commentators, signatory states are under no obligation to enforce such agreements specifically. See, e.g., Quigley, *supra* note 76, at 1063-64. Section 206 of the F.A.A., however, does grant U.S. district courts the power to compel a party to arbitrate in accordance with its agreement. 9 U.S.C. § 206 (Supp. IV 1980). Moreover, article II(3) commands a court of a signatory state seized of an action subject to an arbitration agreement to refer the parties to arbitration "unless it finds that the said agreement is null and void, inoperative or incapable of being performed." U.N. Convention, *supra* note 5, art. II, para. 3.

The failure specifically to link nonenforcement of agreements in article II to the grounds for nonenforcement of awards in article V suggests that there might be some agreements that are enforceable notwithstanding the nonenforceability of any award resulting therefrom and vice versa. One can certainly argue that the Conference did not intend the specific standards of articles II and V to be perfectly symmetrical, because drafts expressly linking the two articles were proposed and defeated. U.N. Doc. E/CONF. 26/SR.21, ICA-Convention, *supra* note 72, at C.198-200. Compare U.N. Doc. E/CONF. 26/C.3/L.3, ICA-Convention, *supra* note 72, at B.7.1 (June 5, 1958) (Belgian proposal) and U.N. Doc. E/CONF.26/L.52, ICA-Convention, *supra* note 72, at B.6.1 (Working Party Draft) with U.N. Convention, *supra* note 5, arts. II and V (language adopted from the proposals to draft article II was less in accordance with the language of article V than the unadopted language. The unadopted proposal, the Working Party Draft, would have added limitations to article II similar to those in article V). Yet several opponents of the defeated provisions agreed that the problem of incongruity between the articles should be resolved, and two amendments were offered by the delegate of the United Kingdom specifically for that purpose. The adoption of both amendments suggests that the Conference wanted to reconcile the incongruity between the two articles. U.N. Doc. E/CONF. 26/SR.21, ICA-Convention, *supra* note 72, at C. 198, 200. One of these two amendments was later dropped, but for unrelated reasons. U.N. Doc. E/CONF. 26/SR.24, ICA-Convention, *supra* note 72, at C. 221-22 (June 10, 1958). The reader's overall impression of the Convention's history in this respect is one of confusion, which the text of the Convention itself has nicely captured. In light of this history, courts should adopt the common sense notion that agreements should not be enforced under article II if an award based on that agreement would not be enforceable under article V. Thus, the more reasonable interpretation of the phrase "unless it finds that the said agreement is null and void, inoperative or incapable of being performed" is that an agreement is null and void if an award resulting therefrom could not meet the standards of article V.

tration is an issue which it should decide at the time preliminary approval of arbitration is being sought.

As has been pointed out, the F.A.A. permits the U.S. courts to deny enforcement only if one of the grounds for nonenforcement specified in the Convention applies.¹⁴³ As discussed earlier, that the Convention authorizes the enforcing state to deny enforcement on public policy grounds,¹⁴⁴ which in the United States are to be strictly limited,¹⁴⁵ or if the subject matter of the dispute is not arbitrable under the law of the enforcing state,¹⁴⁶ an exception that also would appear to have very limited applicability in the United States after *Scherk*.¹⁴⁷ Otherwise, the opponent of enforcement must prove that one of the five remaining grounds for nonenforcement under the Convention applies. Only one of these five bases for nonenforcement is susceptible of determination by the bankruptcy court at the time approval is sought.

The first of the grounds for nonenforcement actually states two separate defenses: that a party was subject to an incapacity; or that the agreement to arbitrate is not valid under the law chosen by the parties in their agreement or, absent a choice by the parties, under the law of the place where the award was made.¹⁴⁸ This Article has already discussed the meaning of the incapacity defense in the context of bankruptcy.¹⁴⁹ The other defense, the validity of the parties' arbitration agreement, obviously need not await the completion of the arbitration proceeding and could be resolved prior to the arbitration.

The second basis for nonenforcement under the Convention is that the party against whom enforcement is sought did not receive proper notice of the arbitration proceeding or was "otherwise unable to present his case."¹⁵⁰ This ground coupled with the third ground listed in article V(1)(d), requiring that the procedure employed by the arbitral tribunal be in accordance with the parties' agreement or the law of the arbitral tribunal, creates what may be called a due process exception.¹⁵¹ Whether a party to an arbitral proceeding has received due pro-

143. See *supra* text accompanying note 68.

144. See *supra* text accompanying note 69.

145. See *supra* text accompanying note 70.

146. See *supra* text accompanying note 71.

147. See *supra* text accompanying notes 79-83.

148. U.N. Convention, *supra* note 5, art. V, para. 1(a).

149. See *supra* note 73 and accompanying text.

150. U.N. Convention, *supra* note 5, art. V, para. 1(b).

151. See Quigley, *supra* note 76, at 1068.

cess cannot ordinarily be determined until after the the proceeding is completed.

The same can be said about the fourth and fifth exceptions. The fourth exception permits nonenforcement if the award exceeds the scope of the parties' submission to arbitration.¹⁵² A court cannot decide the applicability of this exception until the parties can produce an award from a completed arbitration proceeding. The fifth exception clearly presupposes that an award is already in existence at the time enforceability is determined since it excuses enforcement if the award is not yet binding or has been set aside by a jurisdiction under whose laws the award was made or in which the arbitration took place.¹⁵³

Thus, in the usual case the only issue that could be entertained at the approval stage is whether the arbitration agreement is valid under the law applicable to the agreement. This issue should be for the arbitral tribunal to determine in the first instance, unless the nonbankrupt party is subject to suit in the United States in connection with the underlying transaction.

If the nonbankrupt party could have been sued by the debtor in this country, then the debtor could have forced the arbitration issue by filing such a suit. The nonbankrupt party would have been compelled to defend by asserting the arbitration clause as the basis for a stay.¹⁵⁴ The debtor would then have had the opportunity to assert the invalidity of the arbitration clause. Under these circumstances, the arbitration agreement is subject to two attacks in the United States—one before and one after arbitration—even absent the bankruptcy of the debtor. Arguably, the trustee is not unfairly advantaged if afforded the same opportunity in the bankruptcy court.

If, on the other hand, the nonbankrupt party does not have sufficient contacts with the United States to permit such a suit, the debtor, absent the filing of a bankruptcy petition, would not have been able to test the validity of the arbitration agreement in the U.S. courts prior to arbitration. Given the strong U.S. policy in favor of international arbitration, the advantages it confers on the foreign party ought not to be diminished in bankruptcy except to the extent absolutely necessary to protect fundamental bankruptcy policies. Only in an unusual

152. U.N. Convention, *supra* note 5, art. V, para. 1(c).

153. *Id.* art. V, para. 1(e).

154. 9 U.S.C. § 3 (Supp. IV 1980).

case¹⁵⁵ should the trustee occupy a more favorable position than the debtor would have occupied.

The world of commerce will no doubt produce other instances in which bankruptcy approval of a trustee's rejection of an arbitration agreement would be appropriate. On the basis of the above, however, it would seem that only relatively narrow and unusual circumstances would justify refusal to require a trustee to honor the debtor's international arbitration agreement.

C. CAN THE TRUSTEE BE REQUIRED TO ARBITRATE A CAUSE OF ACTION DERIVED FROM CREDITORS?

To this point the discussion has concerned arbitration of claims and counterclaims that the trustee will defend and assert in the trustee's capacity as successor of the debtor. Rights asserted by the trustee in the trustee's capacity as representative of the debtor's creditors require separate consideration.

One claim within this special category has come before the courts in the domestic arbitration context—a trustee's suit to avoid a fraudulent conveyance made to a creditor and to recover the property so conveyed or its value.¹⁵⁶ In *Allegaert v. Perot*,¹⁵⁷ the trustee alleged causes of action against certain insiders under the federal securities laws, the Bankruptcy Code, and state law. The defendants sought arbitration of all these claims pursuant to arbitration clauses in an underlying contract and in accordance with the rules of the New York and American stock exchanges, but the court denied arbitration of

155. There might be a case in which the cost of arbitration would substantially diminish the recoveries of unsecured creditors and the trustee could make a very powerful showing of the invalidity of the arbitration agreement on the undisputed facts. In that unusual situation, a threshold attack on the agreement should be permitted, since the foreign party's award will very likely be of no value in bankruptcy and everyone will be hurt by a pointless arbitration.

156. In general terms, a fraudulent conveyance is a transfer of property with an actual intent to defraud creditors or under circumstances statutorily defined as avoidable regardless of intent. The most common example of an avoidable fraudulent conveyance is a transfer in exchange for less than a reasonably equivalent value when the transferor was insolvent or was rendered insolvent by the transfer. Such transfers can be voided by creditors of the transferor under state law. *E.g.*, UNIFORM FRAUDULENT CONVEYANCE ACT § 4, 7A U.L.A. (1980). The trustee can avoid a fraudulent conveyance under either state or federal law. *Compare* 11 U.S.C. § 544(b) (Supp. IV 1980) (trustee may avoid any transfer incurred by debtor voidable under applicable state law) *with* 11 U.S.C. § 548 (Supp. IV 1980) (trustee may avoid any transfer fraudulently incurred).

157. 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977).

both the securities and bankruptcy claims.¹⁵⁸ The court noted that the trustee's allegations that certain of the debtor's transfers were fraudulent could not have been asserted by the debtor and therefore did not derive from any cause of action possessed by the debtor.¹⁵⁹ Instead, such claims are derived from rights of the debtor's creditors to attack such conveyances prior to the debtor's bankruptcy. Since the trustee as to these claims was a representative of creditors who had never agreed to arbitration,¹⁶⁰ the court held that the arbitration agreements could not be enforced against the trustee. This aspect of *Perot* seems entirely sound since it is well-settled that arbitration agreements bind only those who have assented to them and their successors.¹⁶¹

A typical situation in which the fraudulent conveyance issue might arise would be a contract containing an arbitration provision between Debtor and Transferee in which Debtor agrees to exchange an office building for Transferee's shares of stock in Overvalued corporation. Debtor subsequently discovers that Overvalued corporation stock is worth substantially less than Transferee represented and also substantially less than the value of the office building Debtor gave in exchange. Because of the stock's low value, Debtor is rendered insolvent by the transaction and thereafter goes into bankruptcy. Against this transaction, Debtor's trustee in bankruptcy might assert breach of contract, common law fraud, securities fraud, and a fraudulent conveyance as grounds for avoiding the transfer.¹⁶² The first two causes of action would normally be subject to the arbitration clause, while the securities claim would be exempt from arbitration under U.S. law. On the basis of *Perot*, the fraudulent conveyance claims would also appear to be exempt from arbitration.

If this were an international transaction, the result should be different for the securities claim, but not for the fraudulent conveyance claim. The *Scherk* exception would require that the securities claim be submitted to arbitration pursuant to the

158. The securities claims were not arbitrable under the rule of *Wilko v. Swan*, 201 F.2d 439, 444 (2d Cir.) *rev'd*, 346 U.S. 427 (1953). 548 F.2d at 436-38. See *supra* notes 77-78 and accompanying text.

159. *Id.* at 436-37.

160. *Id.* at 436.

161. *E.g.*, *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 35 A.D.2d 469, 471-72, 318 N.Y.S.2d 764, 766-67 (1st Dept. 1971). See M. DOMKE, *supra* note 86, ch. 10, at 78.

162. See 11 U.S.C. § 548(a)(2)(A), (B) (Supp. IV 1980) (fraudulent conveyances).

parties' agreement.¹⁶³ The fraudulent conveyance action is different. Given that neither Debtor's trustee nor Debtor's creditors, to whom the fraudulent conveyance action exclusively belongs, were parties to the arbitration agreement, they cannot be compelled to arbitrate that which they never agreed to arbitrate.

It might seem that the assertion of a fraudulent conveyance on the facts assumed is merely a different theory for attacking the same transaction and arguably just the kind of end-run forbidden by *Scherk*. In fact there is a difference. The fraudulent conveyance claim is not merely another theory, but an independent cause of action asserted by a third party. The trustee inherited the other claims from the debtor burdened by the latter's agreement to arbitrate; the trustee brings the fraudulent conveyance action as representative of the debtor's creditors. Moreover, a court would not order a creditor to arbitrate a fraudulent conveyance action brought under the Uniform Fraudulent Conveyance Act. Because the trustee is merely acting as the representative of such a creditor in an action to avoid a fraudulent transfer under the Code, the trustee should similarly be free of any obligation to arbitrate.¹⁶⁴

A similar analysis might be made under section 544(a) of the Code, which grants the trustee the status of a lien creditor under state law.¹⁶⁵ This provision enables the trustee to challenge the validity of certain transfers, liens, or encumbrances just as if the trustee had been a creditor of the debtor who, as of the commencement of the case, had perfected a judicial lien on the debtor's property.¹⁶⁶ An example in which the trustee might use the avoidance power of section 544 would be a contract between a debtor and a foreign party containing both an arbitration clause and a clause giving the foreign party a security interest in the debtor's assets to secure the debtor's performance of its contractual obligations. If, after the debtor's bankruptcy, disputes arise concerning the debtor's performance of the contract and the validity of the foreign party's security interest, the foreign party's contract claims should

163. See *supra* notes 79-83 and accompanying text. The number of "international" contacts required to trigger *Scherk* is not entirely clear. See *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 517 n.11 (1974).

164. In the oft-quoted words of the Eighth Circuit: "While it is unquestionably true that the trustee stood in the shoes of the bankrupt, it is equally true that he stood in the overshoes of the creditors . . ." *Schneider v. O'Neal*, 243 F.2d 914, 918 (8th Cir. 1957).

165. 11 U.S.C. § 544(a) (Supp. IV 1980).

166. 4 COLLIER (15th), *supra* note 88, ¶ 544.02.

generally be resolved in arbitration; however, the validity or priority of the foreign party's lien, if attacked by the trustee, should be determined by the bankruptcy court. The trustee defends against the contract claim as successor to the debtor's assets, but attacks the validity of a lien as a representative of the debtor's creditors who never agreed to the arbitration clause.¹⁶⁷

From the foregoing it seems clear that there are certain claims by a trustee, those derived from the rights of creditors, which should not be subject to the debtor's arbitration agreement, even in connection with a transnational transaction. The result urged here is not inconsistent with the U.N. Convention nor the F.A.A., since the Convention does not contemplate enforcement of arbitration agreements against parties who have not agreed to arbitrate.¹⁶⁸

IV. THE EFFECT OF PREPETITION AWARDS

A. UNCONFIRMED AWARDS

If an arbitral award is made prior to bankruptcy but has not been reduced to judgment in either the United States or elsewhere, does the bankruptcy court have the power to refuse enforcement of the award? Under the F.A.A., this question must be answered by reference to the U.N. Convention.¹⁶⁹ Arti-

167. Whether the litigation should actually proceed on two different tracks is another question. The procedural disposition of multi-claim actions, in which some claims clearly are not subject to arbitration, while others are in the discretionary zone discussed above, is beyond the scope of this Article. In *Allegaert v. Perot*, 548 F.2d 432, 438 (2d Cir. 1977), the court stayed litigation of the state law claims pending resolution of the nonarbitrable federal claims. *Accord Lee v. Ply*Gen Industries, Inc.*, 593 F.2d 1266, 1275 (D.C. Cir. 1979); *Sibley v. Tandy Corp.*, 543 F.2d 540, 544 (5th Cir. 1976), *reh'g denied*, 547 F.2d 286, 287, *cert. denied*, 434 U.S. 824 (1977); *Hunt v. Mobil Oil Co.*, 444 F. Supp. 68, 71 (S.D.N.Y. 1977); *Shapiro v. Jaslow*, 320 F. Supp. 598, 600 (S.D.N.Y. 1970). Query if it would not make more sense to adjudicate all claims together which are factually "intertwined." See *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 336 (5th Cir. 1981). If so, the forum chosen should be the one appropriate for the claims which "predominate." Cf. *Sibley v. Tandy Corp.*, 543 F.2d at 543 (federal claim "dependent" on state arbitration claim); *Hunt v. Mobil Oil Corp.*, 444 F. Supp. at 70 (federal claim predominates).

168. See U.N. Convention, *supra* note 5, art. V, para. 1(c); *Quigley, supra* note 76, at 1067.

169. The only grounds on which a U.S. court may refuse enforcement of a foreign arbitral award falling under the Convention are those specified in article V of the Convention itself. 9 U.S.C. § 201 (1976). A prepetition award rendered in a country which has not acceded to the Convention raises different considerations. The U.S. courts have no obligation to enforce such awards, and the default risks are substantial. On the other hand, *Scherk* was decided as a pre-Convention case and the policies it announced would call for enforcement. See *supra* notes 79-83 and accompanying text. An accommodation might be

cle V of the Convention appears to permit the enforcing State to refuse enforcement "if the award is not yet binding."¹⁷⁰ Although the conference records are unclear regarding the meaning of "binding,"¹⁷¹ most commentators agree that it does not mean that the losing party can insist on reduction of the award to judgment in the rendering state as a condition to recognition in the enforcing state.¹⁷² Any other interpretation of this provision would have the untoward effect of reinstating the problem of the "double exequatur,"¹⁷³ the elimination of which was a goal of many supporters of the Convention. That the Convention does in fact eliminate the "double exequatur" is confirmed by article IV, which requires that the winning party need submit only a certified copy of the award and arbitration agreement as a prerequisite to enforcement in a nonrendering state. Prepetition awards, therefore, must be enforced in bankruptcy, even if not reduced to judgment, unless the court finds another basis in article V of the Convention to deny enforcement. Moreover, the court cannot rely on the bankruptcy of the debtor to refuse enforcement under article V(1)(a), as it could with respect to postpetition awards,¹⁷⁴ since the debtor would not have been bankrupt at the time of the prepetition award.

B. CONFIRMED AWARDS

It is possible that an award might be confirmed prior to bankruptcy by a foreign or by a U.S. judgment. Although unconfirmed awards are generally enforceable under the Convention, the impact of confirmation by judgment could be significant. If the judgment must be respected, the Convention's defenses would not be available, and the only defenses the trustee could assert would be those provided by state law, such as the Uniform Enforcement of Foreign Judgments Act¹⁷⁵

made by permitting relitigation, but with some presumptions in favor of the award. See, e.g., *infra* note 179 and accompanying text.

170. U.N. Convention, *supra* note 5, art. V, para. 1(e).

171. See, e.g., Note by Secretary General, U.N. Doc. E/CONF. 26/2, ICA-Con-vention, *supra* note 72, at A.4.1, para. 15-21; E/CONF. 26/SR.17 (Sept. 12, 1958), ICA-Con-vention, *supra* note 72, at C.135-48.

172. See, e.g., Contini, *supra* note 73, at 303-04; Domke, *supra* note 31, at 579; Springer, *The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 3 INT'L LAW. 320, 324 (1969).

173. The "double exequatur" refers to the requirement that an arbitral award first be reduced to judgment in the rendering state as a condition to obtaining a judgment on the award in an enforcing state.

174. See *supra* text accompanying notes 72-76.

175. UNIF. ENFORCEMENT OF FOREIGN JUDGMENTS ACT (1948 Act) § 8, 13 U.L.A. 190 (1980).

or the common law of foreign judgment recognition. If, on the other hand, the judgment could be ignored, not only could the trustee assert against the underlying award the defenses available under the Convention, but, if successful, the trustee could relitigate the merits.

1. *U.S. Judgments*

It seems that an award reduced to a U.S. judgment prior to the debtor's petition in bankruptcy must be considered conclusive in the U.S. courts, including the bankruptcy court. The reader might have observed that the policies underlying the nullification rule would seem to call for a different result, since there is a substantial risk that prepetition judgments could have been obtained without an adequate defense by the debtor. Indeed, these policies would suggest nullification of all judgments obtained within some "suspect period" prior to bankruptcy. Nevertheless, history has yielded a different result. Under the former Act, prepetition judgments were conclusive in bankruptcy, and there is no reason to think the law has been changed by the Code.¹⁷⁶

2. *Foreign Judgments*

Outside bankruptcy a good case can be made that a confirming foreign judgment should be enforced, and relitigation of the Convention's defenses precluded, if the requirements of state law¹⁷⁷ concerning enforcement of foreign judgments are met.¹⁷⁸ In such circumstances, the award debtor likely will

176. 3A COLLIER (14th), *supra* note 28, ¶ 63.10-.11. This rule developed under section 63(a)(1) of the Bankruptcy Act, 11 U.S.C. § 103(a) (1976) (repealed 1978), which made a prepetition judgment a provable claim. This provision has been dropped from the Code, together with the whole concept of "provability." Commission Bill, *supra* note 28, § 4-403 n.2. There is nothing in the legislative history of the Code, however, to suggest that the long-standing "finality" doctrine was meant to be changed.

177. The Uniform Act would permit the debtor to assert lack of personal jurisdiction or a severely inconvenient forum. UNIF. ENFORCEMENT OF FOREIGN JUDGMENTS ACT (1948 Act) § 8, 13 U.L.A. 190 (1980). These assertions would of course carry little weight as to a judgment of the state rendering the arbitration award, since the debtor had accepted that state for arbitration.

178. It could be argued that the need for uniform results under the Convention requires a federal rule, and therefore state judgment enforcement law should not control. While a good case can be made for a federal rule governing enforcement of all foreign judgments, there is no evident reason for a special rule with regard to judgments confirming awards, especially if the result is greater difficulty in enforcing the award. If the state would make the judgment conclusive, it should be enforced. If not, the F.A.A. will govern enforcement of the underlying award. Any notions of "merger" which would make confirmed

have had a fair opportunity to assert any of the Convention's defenses in a court of competent jurisdiction. The only defense that the award debtor might not have had available is that of U.S. public policy. Yet any judgment confirming, for example, an award of a pound of flesh would itself violate U.S. public policy and would not be enforced, so that invocation of the Convention's defenses to enforcing the foreign judgment in the United States would not be necessary to protect U.S. policy.

Even if the award debtor did not have an opportunity to litigate the Convention's defenses (for example, because the confirming court held the arbitration to be "domestic" and therefore not covered by the Convention), the judgment should be enforced. The plaintiff, in such a case, is not invoking the Convention in seeking enforcement, and therefore the Convention's defenses should not be available to the award debtor, leaving both parties exactly as they would have been if the Convention did not exist. A contrary result would require the conclusion that the Convention was intended to become the exclusive method of enforcing rights subject to arbitration thereunder. The Convention states the contrary on its face.¹⁷⁹

If enforcement is sought in a bankruptcy proceeding, the nullification policies of bankruptcy law might suggest a different result. In addition, one might observe that the Convention requires enforcement of foreign awards, not foreign judgments. On the other hand, state judgment recognition law, the analogy to U.S. judgments, and the policy against relitigation would all support enforcement of a foreign award reduced to judgment in a foreign state prior to the bankruptcy filing. One rule that commends itself in such circumstances is that a prepetition foreign judgment, which would be enforceable absent bankruptcy, places a burden on the trustee to convince the bankruptcy court not only of the existence of a defense to enforcement of the underlying award under the Convention, but also that there is a substantial likelihood of a materially different result if the merits are relitigated in the bankruptcy court.¹⁸⁰

awards less enforceable than unconfirmed ones should be dismissed out of hand as form over substance. *See Fotochrome, Inc. v. Copal Co.*, 517 F.2d 512, 517 (2d Cir. 1975).

179. U.N. Convention, *supra* note 5, art. VII, para. 1.

180. This result would be neatly analogous to the situation in which a jury verdict, but not a judgment thereon, is obtained before bankruptcy. There the verdict is not conclusive, as the judgment would have been, but it is entitled to great weight in the bankruptcy court's determination of the extent to which the claim should be reopened in bankruptcy. 3A COLLIER (14th), *supra* note 28, ¶ 63.10 at 1831.

A different problem would be presented by a foreign judgment obtained after bankruptcy on an award made before the petition was filed.¹⁸¹ It will be recalled that the *Fotochrome* court refused enforcement of such a judgment, although with no clear rationale. The *Fotochrome* result seems correct in this respect. That is, postpetition foreign judgments should be ignored unless the foreign proceeding in which the judgment was rendered had received the prior approval of the bankruptcy court. Unapproved postpetition state court proceedings are not recognized, and there is no reason to give foreign judgments any greater deference as long as the policies underlying the automatic stay and the nullification rule apply equally to domestic and foreign postpetition proceedings. In effect, therefore, prepetition awards reduced to judgment in an unapproved foreign proceeding after bankruptcy filing should be treated as unconfirmed awards.

If, after bankruptcy, the foreign party seeks bankruptcy court approval to confirm a prepetition award in a foreign court, the issue becomes more difficult. The effect of granting permission would be to require the trustee to assert the Convention's defenses in a foreign court, and to preclude relitigation of those defenses when the foreign judgment is later filed with the claimant's proof of claim in bankruptcy. The nullification policies would be largely satisfied, since the court could protect against default, and it could be argued on behalf of the foreign party that it might be prejudiced by having to litigate the defenses in the United States contrary to the expectations of the parties. Nonetheless, there are no treaties or commercial policies strongly supporting the enforcement of the creditor's prebankruptcy expectations about court proceedings, and the bankruptcy policies of expedition and economy surely must control. These policies require that litigation of defenses to the award be conducted in the bankruptcy court.¹⁸²

181. Obviously, a postpetition U.S. judgment confirming an award would be barred by the automatic stay and would in any case be void. *See supra* note 30 and accompanying text.

182. It could be argued that an arbitration clause operates implicitly as a choice of forum clause, designating the courts of the place of arbitration as a proper forum for confirmation of the award. The argument could then be made that important U.S. commercial policies support enforcement of the forum clause. *See The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972). The argument would be reinforced by the fact that arbitration clauses and forum clauses have similar purposes and effects. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 518-19 (1974). The first response must be that no treaty obligation compels enforcement of forum clauses. Even more important is the fact that forum clauses are not enforceable if they are seriously inconvenient or unrea-

V. CONCLUSION

The above analysis is very technical; yet, it may suggest several larger points regarding the role of national courts in transnational commercial disputes. The central policy propositions are that U.S. bankruptcy courts should boldly assert their jurisdiction over the issue of arbitration *vel non* whenever a sensible choice of law rule would select the United States as the primary bankruptcy jurisdiction for a particular debtor¹⁸³

sonable. *Zapata*, 407 U.S. at 10. No such limitation applies to arbitration clauses. When a trustee argues that it would be highly unreasonable to require foreign litigation over the award, the trustee should prevail.

183. For discussion of these questions, see generally Becker, *Letter—Rehabilitating International Bankruptcy Law: Lessons Taught by Herstatt and Co.*, 52 N.Y.U. L. REV. 726 (1977); Honsberger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W.L. REV. 631 (1980); Nadelmann, *Assumption of Bankruptcy Jurisdiction Over Non-Residents*, 41 TULANE L. REV. 75 (1966); Nadelmann, *Codification*, *supra* note 65; Nadelmann, *The National Bankruptcy Act and the Conflict of Laws*, 59 HARV. L. REV. 1025 (1946); Nadelmann, *Rehabilitating International Bankruptcy Law: Lessons Taught by Herstatt and Co.*, 52 N.Y.U. L. REV. 1 (1977); Nadelmann, *Revision of Conflicts Provisions in the American Bankruptcy Act*, 1 INT'L COMP. L.Q. 484 (1952) [hereinafter cited as Nadelmann, *Revision*].

It appears that Congress intended to give the U.S. bankruptcy courts world-wide jurisdiction over property of a U.S. debtor when it used the phrase "wherever located." 28 U.S.C. § 1471(e) (Supp. IV 1980). See Nadelmann, *Revision*, *supra*, at 486. If an international system of orderly bankruptcy administration is ever to be achieved, it may be that the court which has the greatest connection with the debtor and its affairs should assert broad jurisdiction, at least hoping that other courts may defer. The United States has taken a step in the obverse direction under the new Code. See 11 U.S.C. §§ 304, 306 (Supp. IV 1980). While affirmative steps toward cooperation may be useful, some assertive actions may also stimulate international cooperation. Cf. *Hearings*, *supra* note 65, at 1442-51 (testimony of Professor Nadelmann discussing the negative effect on international relations proposed changes in the Bankruptcy Code could have, and proposing ways to enhance cooperation with foreign parties to bankruptcy).

It seems to the author that no advance can be achieved in international cooperation if some assertion of worldwide jurisdiction is not made. A denial of jurisdiction, *Fotochrome* being an extreme example, leaves a foreign court which is inclined to comity with nothing to which it can defer. Imagine a U.S. debtor with an English establishment which is current on its English debts at the time of the debtor's U.S. bankruptcy. Under the circumstances, the English court may well be inclined to defer to the U.S. bankruptcy court. See Nadelmann, *Codification*, *supra* note 65, at 1485-86. Suppose further that a French arbitration award is entered against the debtor after bankruptcy and an enforcement proceeding in England seeks an English judgment on the award and seizure of the debtor's English assets in satisfaction. If the view of U.S. jurisdiction suggested by *Fotochrome* is accepted, the English court may be helpless. If the nullification rule is applied in U.S. courts and if those courts make it clear that they want to apply the rule to overseas assets to the extent the "power" of comity permits, the English court could declare the award unenforceable under the choice-of-law provisions of the U.N. Convention.

One analogy here is the world-wide jurisdiction said to rest in the courts of a decedent's domicile as to all his personal property. RESTATEMENT (SECOND)

but, having asserted jurisdiction, the bankruptcy courts should generally enforce international arbitration agreements. The alternative is legal chaos or, at least, incoherence. If our national courts will not fashion sensible rules about the role of international arbitration in the extraordinary circumstances of bankruptcy, can we expect foreign courts to do so? Even if the nonbankruptcy courts of each place of arbitration do assume this burden, they are not as well suited as the bankruptcy courts of the debtor's domicile to adapt an international arbitration agreement to the special circumstances of bankruptcy. Under the best of circumstances, the adoption of varying rules by each judicial system having territorial jurisdiction of a particular arbitration will hardly serve the goals of predictability and consistency so essential to any international business transaction.

The same problems plague many other aspects of transnational litigation. The general suggestion is that comity and coherence in international commercial relationships will not be achieved by a reflexive refusal to get involved. Only a power which has been asserted can then defer to international cooperation.

We live in a transitional age in which legal principles lag far behind the on-rushing internationalization of commerce. We must rely for now on national legal systems as the primary vehicle for the enforcement of legitimate commercial expectations.¹⁸⁴ Unless the courts of each nation are willing to assert jurisdiction and then defer when appropriate to international legal principles, parties will be left with erratic enforcement or no enforcement at all. The absence of enforceable expectations is the worst possible environment for commerce, especially

OF CONFLICTS OF LAWS § 317 and comment b (1969). The *Restatement* asserts that other courts should enforce the orders of the domiciliary court if the other courts' choice-of-law rules point to that jurisdiction as being appropriate for the probate proceedings. *Id.*

It may be that only treaties will eventually provide a solution to the international bankruptcy conundrum. See *Hearings, supra* note 65, at 1444 (testimony of Professor Nadelmann). On the other hand, creative, practical action by the courts is often a necessary stimulant to legislative and diplomatic action.

184. It is true, and of the greatest significance, that there is a rapid growth of truly international business and commercial law or proto-law. See, e.g., Draft Convention on Contracts for the International Sale of Goods, 33 U.N. GAOR UNCITRAL Supp. (No. 17) at 30, U.N. Doc A/13/17 (1978), 18 I.L.M. 639-66 (1979); Baade, *The Legal Effects of Codes of Conduct for Multinational Enterprises*, in LEGAL PROBLEMS OF CODES OF CONDUCT FOR MULTINATIONAL ENTERPRISES 3 (N. Horn ed. 1980). See generally Decisions (1975-1979) of the ICC Banking Commission (International Chamber of Commerce 1980). Nonetheless, these rules remain dependent on national courts for their enforcement.

that commerce which must leap the walls of cultural and political differences.¹⁸⁵

The creation within national legal systems of sound legal principles to govern international commerce is difficult. It takes, in particular, hard-working and courageous judges to follow a course both assertive and cooperative. Yet the effort should commend itself. If the flow of international commerce may create channels through which law may follow, if the chains of self-interest forged by commerce may restrain the blows too often commanded by politics or religion or ideology, then the lawyers and judges who fashion the law of international commerce may claim some contribution to a larger and better future.

185. *See* *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 516 (1974).