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CHAPTER 15 OF THE BANKRUPTCY CODE AND ITS IMPLICIT ASSUMPTIONS REGARDING THE FOREIGN EXCHANGE MARKET

JOHN J. CHUNG*

INTRODUCTION

Swept along by the rising tide of internationalist fervor, Chapter 15 of the United States Bankruptcy Code[1] became law in October 2005.[2] Chapter 15 governs transnational bankruptcies and is applicable to the bankruptcy of a debtor that does business in more than one country.[3] Under Chapter 15, the court of the debtor's home country arguably has authority to take control of the entire bankruptcy case and apply its domestic bankruptcy law to all of the debtor's assets and creditors worldwide.[4] The goal of Chapter 15's proponents is to require all of the creditors from around the world to seek repayment in the court of the debtor's home country.[5] Even creditors who engaged in transactions exclusively within the boundaries of their own country will be forced into foreign proceedings.[6] Chapter 15's supporters describe it as "one court, one law."[7]

The two major benefits to this approach, according to supporters, are certainty and efficiency.[8] All parties know in advance which country's law will

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1. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 11 U.S.C. § 1501–32 (2006) (hereinafter "Chapter 15"). *See generally* John J. Chung, *The New Chapter 15 of the Bankruptcy Code: A Step Toward Erosion of National Sovereignty*, 27 NW. J. INT'L L. & BUS. 89 (2006) (giving a description of Chapter 15's enactment, how the "push for internationalization" was instrumental to its enactment, and how it moved "the United States toward a universalist approach to transnational bankruptcies").

2. *See* 11 U.S.C. § 1501. Chapter 15 was enacted by Congress on April 20, 2005, and became effective 180 days later, on October 17, 2005. *Id.*

3. *See id.* § 1501(a). Chapter 15 states that "[t]he purpose of this chapter is . . . to provide effective mechanisms for dealing with cases of cross-border insolvency." *Id.*

4. *See* 11 U.S.C. §§ 1509–32 (giving the process of a Chapter 15 bankruptcy proceeding).

5. *See id.*

6. *See id.*

7. Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT'L LAW 31, 40 (2001) [hereinafter Tung, *Is International Bankruptcy Possible?*]. The process set forth in Chapter 15 is a step towards the "universalist approach." *Id.* at 35 (stating that "in [universalism's] most commonly described implementation, the bankruptcy regime of the debtor firm's home country—its courts and laws—should govern").

8. *Id.* at 35.

apply in the event of bankruptcy, and the elimination of duplicative proceedings generates supposed administrative efficiencies.[9]

The supporters, however, have overlooked the first and fundamental focus of bankruptcy law: money. Every bankruptcy case around the world is a fight about money: How much money will creditors recover? Who will recover less? Who will recover more? For most creditors, the whole point of the proceeding is to figure how much they will get on the distribution date. Despite this obvious reality, Chapter 15 contains a potentially debilitating flaw. Suppose all of the creditors from around the world are forced to seek relief in the debtor's home country.[10] In which currency will they be paid? What pieces of paper will they receive as payment? The short answer is that they will be paid in the currency of the home country.[11] That answer seems straightforward and satisfactory. But will creditors find that acceptable? Are creditors indifferent to what kind of currency they receive?

Creditors are not indifferent and in fact care deeply about the issue because they may suffer serious prejudice due to payment in a foreign currency. The prejudice results from the fact that currencies fluctuate in value against each other. The fluctuations are potentially prejudicial because creditor claims are valued and converted into the currency of the forum at one point in time, but claims are not actually paid out until a later time, maybe even years later.[12] What happens if the currency of the forum falls in value against the currency of the creditor's home currency? The answer is simple. When measured in its home currency, the foreign creditor will receive less.[13]

Ordinarily, most people are not affected by currency movements because they conduct all of their transactions in one currency. The only time most Americans become aware of foreign exchange values is when they travel abroad and need to exchange dollars for euros, pounds, or yen. Similarly, most business people are not troubled by foreign exchange issues because their business is conducted in their home country and with their home currency.

Chapter 15, however, changes that and imposes involuntary and unavoidable foreign exchange risk on creditors. Even if a creditor extends credit to another business in the same town, under a contract made and governed by local law and with the obligation to repay in the local currency, Chapter 15 imposes unavoidable currency risk on the creditor by requiring it to

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9. *Id.* at 41.

10. Chung, *supra* note 1, at 93–94. The home country court would have jurisdiction over all the debtor's assets and creditors and would displace the bankruptcy laws of the other countries where the debtor's property may be located. *Id.* at 94. In a Chapter 15 proceeding, even if the debtor's property is located within a different country and the relevant legal relationships were forged solely within that country's borders, the courts in that country would be required to defer to the foreign proceeding in the debtor's home country. *Id.*

11. *Id.*

12. 11 U.S.C. § 502(b) (2006) (stating that the court shall determine the amount of the claim as of the date of the filing of the petition).

13. *See* discussion *infra* Part II.B (describing the effect of currency fluctuations).

pursue its claim in the foreign jurisdiction where claims will be paid in foreign currency.[14] In the event of material currency fluctuations, the creditor's foreign exchange losses may result in prejudice so great that it undermines fundamental principles of bankruptcy law.

The proponents of Chapter 15 have been silent on this issue and would likely argue that foreign exchange risks are minimal. In order to hold this view, however, certain conditions must be assumed. In short, the viability of Chapter 15 is based on two implicit assumptions. The first assumption is that the currency of the foreign proceeding is convertible. After all, a distribution in a foreign currency that cannot be converted into a creditor's local currency is practically worthless. The second assumption is that foreign exchange rates are stable over time. Chapter 15 implicitly assumes that a distribution in the currency of the home country to a foreign creditor in Year Four (to pick a random year) will constitute fair compensation for a claim valued and allowed in Year One of the bankruptcy proceeding. However, what if the currency of the debtor's home country depreciates significantly or even collapses against the value of the creditor's local currency? The currency of the distribution in Year 4 may be nothing more than worthless pieces of paper to the creditor.

Interestingly enough, it appears that early attempts at regional harmonization of insolvency laws recognized the foreign exchange problem.[15] The Montevideo Treaties of 1889 and 1940 appear to have incorporated a mechanism to mitigate foreign exchange risk.[16] However, the proponents of Chapter 15 ignored the issue. Contemporary American case law suggests that forcing an American creditor into a foreign proceeding where it would receive worthless pieces of paper as payment would violate public policy.[17] Although this case law did not arise in the context of Chapter 15,[18] this Article contends that the same rationale should be applied to issues arising under Chapter 15.

From a bird's-eye view, this issue of foreign exchange risk highlights a severe limitation to the broad application of Chapter 15 in all transnational bankruptcies. Chapter 15 addresses a tiny part of global economic issues; it is not a world unto itself isolated from other forces. Hence, the scope of its application and viability must be weighed against much larger and more powerful forces such as the foreign exchange market, acknowledging that the foreign exchange issues hold the potential to overwhelm the effectiveness of

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14. *See infra* note 39 (providing an example of a typical Chapter 15 proceeding).

15. *See infra* notes 176–198 and accompanying text (describing the Montevideo Treaty of 1889 and the Montevideo Treaties of 1940).

16. *Id.*

17. *See, e.g.*, Finanz AG Zurich v. Banco Economico S.A., 192 F.3d 240, 250 (2d Cir. 1999) (concluding that "if the early conversion of a creditor's claims into foreign currency would render a debt . . . valueless, we might have cause to conclude that a conversion . . . was fundamentally unfair").

18. *Id.* at 242 (addressing a "forfaiting" transaction involving the sale of goods for promissory notes).

Chapter 15.[19] What is particularly ironic regarding Chapter 15 is that its ability to function falls apart in situations of the greatest economic duress - namely, situations caused by or related to currency crisis. The whole purpose of bankruptcy law is to provide a solution and a means to deal with financial distress at the debtor-creditor level. Yet, if and when multinational bankruptcies are caused by currency collapse, Chapter 15 fails to adequately address the problem.

In sum, this Article may be viewed as a challenge to Chapter 15's implicit assumptions regarding the fixed nature and meaning of the value of money. The foundation of bankruptcy law, which is the orderly repayment of debts, depends on the value of the thing (in this case, money) used as repayment. Chapter 15 assumes that the currency of one country has some reliable meaning or stable value in relation to another currency and that repayment in one currency has meaning or value in another currency. This Article exposes the problems with these assumptions.

Part I of this Article discusses the goals of Chapter 15 and its origins in the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law. It also discusses how the Model Law arose out of the debate between the territorialist and universalist approaches to transnational bankruptcy law and how Chapter 15 represents a significant advance by the supporters of universalism. Part II presents the two implicit assumptions embedded in Chapter 15 regarding the foreign exchange market. It illustrates the foreign exchange issue using three hypothetical scenarios based on actual currency events. It also points to recent history to show that dramatic currency fluctuations are actually common occurrences. Part III discusses how the foreign exchange issues may trigger Chapter 15's public policy exception and argues for the courts to apply the exception to protect creditors from material foreign exchange losses. Part IV highlights an additional problem raised by foreign exchange fluctuations in a transnational bankruptcy. It examines the possibility that foreign exchange losses may lead to violations of the absolute priority rule, which is one of the bedrock principles of American bankruptcy law. Part V asks whether foreign exchange issues present a genuine problem. It begins by discussing the current state of the foreign exchange market. It then acknowledges that foreign exchange issues have not been widely reported in American bankruptcy cases. It points out, though, that the territorial approach to transnational bankruptcies was in place before Chapter 15 and that one of the benefits of territorialism was that it insulated creditors

19. On average, approximately $3.2 trillion in different currencies and related financial products are traded *each day* in the worldwide foreign exchange market. *See* BANK FOR INTERNATIONAL SETTLEMENTS, TRIENNIAL CENTRAL BANK SURVEY OF FOREIGN EXCHANGE AND DERIVATIVES MARKET ACTIVITY IN APRIL 2007 (2007), http://www.bis.org/publ/rpfx07.pdf. The foreign exchange market is the largest in the world, much larger than the worldwide markets for stocks or commodities. *See* Justin Kuepper, *Getting Started in Foreign Exchange Futures*, INVESTOPEDIA, http://www.investopedia.com/articles/trading/04/102704.asp (last visited Nov. 2, 2008).

from foreign exchange risk. Because of Chapter 15, the protection of territorialism has been eroded, and foreign exchange problems will undoubtedly emerge. Part V also points out that the early efforts at harmonizing transnational bankruptcy law in the Montevideo Treaties of 1889 and 1940 attempted to protect creditors from foreign exchange risk. Part VI explores whether a bankruptcy trustee may protect creditors from currency losses through hedging activities in the foreign exchange market, and it discusses the inherent limits on a trustee's ability to utilize these financial tools. The Conclusion argues that any attempt at a broad application of Chapter 15 must be considered in light of the fact that transnational bankruptcies occur against a much larger backdrop of international economic realities, such as the foreign exchange market. The utility of Chapter 15 is necessarily limited by the larger forces at work, and those larger forces will (and should) drive the application of Chapter 15, not the other way around.

I. THE ORIGIN AND PURPOSE OF CHAPTER 15[20]

Chapter 15 is based on and explicitly tracks the Model Law on Cross-Border Insolvency (the "Model Law")[21] promulgated by the United Nations Commission on International Trade Law ("UNCITRAL") based in Vienna.[22] In the 1990s, the issue of cooperation in international bankruptcies became the subject of a "working group" formed by UNCITRAL.[23] Its goal was to "modernize insolvency practices and laws" around the world.[24] The efforts of this group led to the promulgation of the Model Law at UNCITRAL's Thirtieth Session on May 12–30, 1997.[25] The Model Law was approved by resolution of

20. This section highlights a few of the main features of the law. For those interested in a full study of the scholarly debate preceding and surrounding the enactment of Chapter 15, the articles of Professor Lynn M. LoPucki and Professor Jay Lawrence Westbrook are the leading sources. Professor John A. E. Pottow's work is also necessary reading for anyone with an interest in this area.

21. MODEL LAW ON CROSS-BORDER INSOLVENCY (U.N. Comm'n on Int'l Trade Law 2007).

22. 11 U.S.C. § 1501(a) (2006); Jay Lawrence Westbrook, *Chapter 15 at Last*, 79 AM. BANKR. L.J. 713, 719 (2005) [hereinafter Westbrook, *Chapter 15 at Last*]; Jay L. Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles, and The EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1, 3 (2002) [hereinafter Westbook, *Multinational Enterprises in General Default*].

23. Westbrook, *Chapter 15 at Last*, *supra* note 22, at 719.

24. Susan Block-Lieb & Terence Halliday, *Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law*, 42 TEX. INT'L L.J. 475, 490 (2007). UNCITRAL's self-described overall purpose is to modernize and harmonize the rules of international business. *Id.* at 490–91. It describes harmonization "as the process through which domestic laws may be modified to enhance predictability in cross-border commercial transactions." *Id.* at 493.

25. Evelyn H. Biery et al., *A Look at Transnational Insolvencies and Chapter 15 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 47 B.C. L. REV. 23, 49

the United Nations General Assembly later that year in December.[26] The foundation of the Model Law is based on four themes: (1) Access, (2) Recognition, (3) Relief, and (4) Cooperation.[27] As one would expect, given the origin of the Model Law, its proponents envision a world where each country will adopt its own version of the Model Law. The result would be a uniform system of bankruptcy choice of law, where each country would defer to the foreign main proceeding in the debtor's home country.[28]

(2005); Westbrook, *Multinational Enterprises in General Default*, *supra* note 22, at 2 n.3, 3.

26. Biery et al., *supra* note 25, at 49.

27. IAN F. FLETCHER, INSOLVENCY IN PRIVATE INTERNATIONAL LAW 453 (2d ed. 2005). According to Professor Fletcher, the principal themes of the Model Law are:

> (a) to establish the principle that a foreign representative, holding office under an insolvency proceeding opened under the law of one state, has a right of direct access to the courts of other states where it may be expedient to take action of some kind;
> (b) to establish basic principles and procedures for the recognition of foreign insolvency proceedings and for the provision of relief and assistance in cross-border cases;
> (c) to establish a positive legal framework sanctioning cooperation between courts in different jurisdictions, and between courts and foreign representatives;
> (d) to establish a framework of basic rules to be applied in cases where concurrent insolvency proceedings take place, so that coordination can be optimized in the interests of attaining the fairest possible outcome for all creditors and other parties concerned (including the debtor).

Id.

28. In order to understand the motivation to create the Model Law, it may be helpful to understand the state of transnational bankruptcy law earlier in the twentieth Century. One commentator described it as follows:

> A survey made of the present status of international bankruptcy law shows that a trustee in bankruptcy, even if appointed by the court of the debtor's commercial domicile, has but a slight chance to recover by legal proceedings assets that are located abroad. Only a few countries recognize the foreign trustee's title to property of the debtor. Often the trustee is not admitted at all by the courts as the creditors' or the estate's legal representative with power to claim the assets. If admitted, his rights are rarely sustained against local creditors attaching local assets. In some countries the trustee can qualify as the legal representative of the foreign bankruptcy in submitting himself to an exequatur proceeding, but liens secured by attachment before his qualification are sustained. Almost nowhere does a foreign bankruptcy, even when declared by the court of the commercial domicile of the debtor, preclude another bankruptcy declaration by a local court having bankruptcy jurisdiction. No collaboration is guaranteed between the several administrations in the case of concurrent bankruptcies. As each bankruptcy court follows its own law, the same claim can be void in one proceeding and valid in another.

Kurt H. Nadelmann, *Bankruptcy Treaties*, 93 U. PA. L. REV. 58, 59–60 (1944) (footnote omitted). Such a state of transnational bankruptcy is what the drafters of the Model Law sought to improve. Before the promulgation of the Model Law, some courts attempted to address the problems of cross-border cooperation and coordination on a case-by-case basis. *See, e.g.*, *In re* Maxwell Commc'n Corp., 93 F.3d 1036, 1053 (2d Cir. 1996) (stating that "bankruptcy courts may best be able to effectuate the purposes of bankruptcy law by cooperating with foreign courts on a case-by-case basis"). The Model Law may be viewed as an attempt to establish a formal and regular system of international cooperation and coordination.

Chapter 15, enacted as part of the Bankruptcy Abuse Protection and Consumer Protection Act of 2005, became effective on October 17, 2005.[29] Entitled "Ancillary and Other Cross-Border Cases,"[30] Chapter 15 applies to the bankruptcy of an American multinational corporation or a foreign multinational corporation with assets or operations in the United States.[31]

Section 1501(a) enumerates the five objectives of Chapter 15: (1) cooperation between U.S. courts and foreign courts; (2) "greater legal certainty for trade and investment"; (3) "fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor"; (4) "protection and maximization of the value of the debtor's assets"; and (5) "facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment."[32] Chapter 15 requires American courts to "cooperate to the maximum extent possible with a foreign court or a foreign representative."[33]

A Chapter 15 case is commenced with a petition to the court by a foreign representative for "recognition" of a foreign proceeding.[34] Chapter 15 focuses

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29. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005). The drafters of Chapter 15 tried to avoid changing the language of the Model Law, even where alternative language would have been consistent with American statutory style and practice. Westbrook, *Chapter 15 at Last*, *supra* note 22, at 719–20 (stating that "[a]ny departures from the actual text of the Model Law . . . were as narrow and limited as possible").

30. 11 U.S.C. § 1501 (2006). The term "ancillary" generally refers to a limited proceeding that is designed to assist a "foreign main proceeding." Biery et al., *supra* note 25, at 31. "Once an ancillary proceeding is invoked, the domestic court's primary responsibility is to aid the foreign court in administering the debtor's assets. . . . In contrast to the ancillary proceeding, parallel proceedings are full domestic insolvencies . . . in each country where the debtor has assets." *Id.* at 31–32; *see also* Westbrook, *Multinational Enterprises in General Default*, *supra* note 22, at 5, 10 (comparing universalism, or "ancillary proceedings," to territorialism, or "parallel proceedings").

The use of the word "ancillary" in the title of Chapter 15 indicates that the purpose of the legislation is to promote "a general rule that countries other than the home country of the debtor, where a main proceeding would be brought, should usually act through ancillary proceedings in aid of the main proceedings, in preference to a system of full bankruptcies . . . in each state where assets are found." H.R. REP. NO. 109-31, at 107–08 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 171; *see also* Westbrook, *Multinational Enterprises in General Default*, *supra* note 22, at 10–12 (describing "ancillary" and "parallel" proceedings).

31. Westbrook, *Chapter 15 at Last*, *supra* note 22, at 715 (noting how "the sweep of Chapter 15 is very broad" and it will apply "whenever there is a foreign insolvency proceeding relating to a debtor that is subject to a bankruptcy case of some kind in the United States").

32. 11 U.S.C. § 1501(a)(1)–(5).

33. *Id.* § 1525(a). "Perhaps the most innovative provision in the chapter is the authorization for the courts, as well as a trustee or DIP [debtor in possession], to communicate directly with the foreign court and trustee [pursuant to §§ 1525 and 1526]." Westbrook, *Chapter 15 at Last*, *supra* note 22, at 723.

34. 11 U.S.C. §§ 1504, 1515(a). "Foreign proceeding" and "foreign representative" are defined in § 101(23) and (24).

on what is referred to as a "foreign main proceeding,"[35] defined as "a foreign proceeding pending in the country where the debtor has the center of its main interests."[36] Chapter 15 contemplates that a debtor's center of main interests will be its place of incorporation, unless contrary proof is provided.[37] The recognition of a foreign main proceeding is a key event in a Chapter 15 bankruptcy because it decides the governing bankruptcy law.[38] If the debtor obtains recognition of a foreign main proceeding, the bankruptcy law of its home country will govern the case.[39]

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35. *Id.* § 1502(4). Chapter 15 also governs a "foreign nonmain proceeding," defined as "a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment." *Id.* § 1502(5); Westbrook, *Chapter 15 at Last, supra* note 22, at 717 (comparing and contrasting "main" versus "nonmain" proceedings). An "establishment" is defined as "any place of operations where the debtor carries out a non-transitory economic activity." 11 U.S.C. § 1502(2). As one would expect, the recognition of a foreign main proceeding triggers more provisions of Chapter 15 than a foreign nonmain proceeding. *See id.* § 1520.

36. 11 U.S.C. § 1502(4). The phrase "center of its main interests," a phrase not previously found in American jurisprudence, is an example of the almost verbatim adoption of the language of the Model Law. *See* Westbook, *Chapter 15 at Last, supra* note 22, at 719.

37. Westbrook, *Multinational Enterprises in General Default, supra* note 22, at 14. Professor Westbrook has likened the "center of its main interests" test to the more familiar "principal place of business" test used in the United States, and he predicts that the Model Law language will be no more difficult to apply than the familiar American test. *See* Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2316 (2000) [hereinafter Westbrook, *A Global Solution*].

38. *See* Chung, *supra* note 1, at 97–98. Recognition of a foreign main proceeding triggers a number of provisions of the Bankruptcy Code, including the automatic stay and the foreign representative's right to operate the American part of the debtor's business. *Id.*

39. *Id.* at 98. A typical case resolved under Chapter 15 looks something like the following:

> [A] Canadian company with its headquarters in Toronto commences bankruptcy proceedings in Canada. It has one widget-making factory in Canada, and one in the United States. Each of the factories has unpaid employees and suppliers. The American factory secures a bank loan from an American lender, and the Canadian factory secures a loan from a Canadian bank. The Canadian representative applies for recognition of a foreign main proceeding under Chapter 15. The American court grants the application. All proceedings and creditor actions in the United States are stayed, and the Canadian representative takes control of all United States assets and operates the American factory. The American creditors then pursue their claims in the Canadian proceeding. The Canadian judge has jurisdiction over all the assets and creditors[, applies Canadian bankruptcy law to the entire case,] and resolves all claims together.

Id.

A. Chapter 15's Place in the Debate between the Territorialist and the Universalist Approaches to Transnational Bankruptcies

In order to understand the context out of which Chapter 15 arose and its potential consequences, it is necessary to understand territorialism and universalism, the two competing and opposite models of international bankruptcy jurisdiction that define the debate.[40] This understanding is necessary because the "Model Law makes universalism the foundation of the United States' international bankruptcy policy."[41] Universalism is best understood by contrasting it to territorialism.

Territorialism is simply the traditional practice of nations exercising exclusive jurisdiction over parties and assets within their borders.[42] It is the default rule in every substantive area of law, including bankruptcy.[43] It rests upon traditional notions of national sovereignty, which means that the law of the sovereign is imposed on all people and property within its territorial reach.[44] In a transnational bankruptcy conducted under the principles of territorialism, each country decides, pursuant to its own laws, how the debtor's assets within its territory will be treated in the face of creditor claims, without deference to any foreign proceeding involving the same debtor.[45]

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40. Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216, 2218–21 (2000) [hereinafter LoPucki, *The Case for Cooperative Territoriality*]. *See generally* Westbrook, *A Global Solution, supra* note 37 (discussing universalism); John A. E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 VA. J. INT'L L. 935 (2006) [hereinafter Pottow, *Procedural Incrementalism*] (discussing the Model Law's "incrementalist and procedurally animated approach" to universalism).

41. Lynn M. LoPucki, *Universalism Unravels*, 79 AM. BANKR. L.J. 143, 143 (2005) [hereinafter LoPucki, *Universalism Unravels*].

42. LoPucki, *The Case for Cooperative Territoriality, supra* note 40, at 2218; Frederick Tung, *Fear of Commitment in International Bankruptcy*, 33 GEO. WASH. INT'L L. REV. 555, 561 (2001) [hereinafter Tung, *Fear of Commitment*].

43. LoPucki, *The Case for Cooperative Territoriality, supra* note 40, at 2218.

44. Westbrook, *Multinational Enterprises in General Default, supra* note 22, at 5. To its detractors, territorialism is referred to pejoratively as the "grab rule" because each nation's court "grabs" the assets within its jurisdiction for distribution under its own laws. Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177, 2179 (2000); Pottow, *Procedural Incrementalism, supra* note 40, at 944–45.

45. LoPucki, *The Case for Cooperative Territoriality, supra* note 40, at 2218; Tung, *Is International Bankruptcy Possible?, supra* note 7, at 40. The following is a simple example of territorialism:

> Suppose a business has assets in both Country A and Country B but only files a bankruptcy petition in Country A. The laws of Country A will govern the disposition of assets within its territory, but the assets in Country B will not be affected by the filing. The creditors in Country B may move to seize the assets in Country B notwithstanding the bankruptcy filing in Country A. In order to protect its assets in Country B, the business will need to commence a separate bankruptcy proceeding in that country which would proceed under the laws of Country B. Thus, there would be two separate and independent proceedings,

Universalism, on the other hand, is based on the concept of "one law, one court."[46] It envisions a single bankruptcy proceeding in the debtor's "home country," where a single court applies the bankruptcy law of its country and makes a "unified worldwide distribution to creditors through liquidation or reorganization."[47] That court would have global jurisdiction over all of the debtor's assets and creditors, wherever located.[48] Creditors will supposedly benefit through increased legal predictability and economic efficiencies.[49] Universalism requires a country to defer to a foreign legal proceeding, even with respect to property within its own territory and legal relationships formed and conducted wholly within its own borders.[50] This result is the stated goal of Chapter 15.

II. CHAPTER 15'S IMPLICIT ASSUMPTIONS REGARDING FOREIGN EXCHANGE RATES

Because of the enactment of Chapter 15, the universalists believe they are well on the way to creating a seamless, efficient system of addressing transnational bankruptcies.[51] The universalists praise the potential efficiencies of resolving all creditor claims in one proceeding.[52] They claim that proof of

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each applying a different law.

Id.

46. Tung, *Is International Bankruptcy Possible?*, *supra* note 7, at 40. As one scholar has noted,

> In its purest conceptual form, universalism aspires to the harmonization of one worldwide, substantive law of bankruptcy. The most common model of universalism, however, follows a pluralist route. Sidestepping the issue of which substantive provisions the ideal bankruptcy law would possess, it simply selects from one of the pre-existing bankruptcy regimes ex post. To the extent that other courts are needed (to give legal force to the orders of the courts of the governing jurisdiction), such courts could convene ancillary proceedings designed to effectuate the controlling court's orders. The current universalist paradigm thus concedes the divergence of present domestic bankruptcy laws and advocates only a pluralist system of choice-of-law; its theory does not envision (or rely upon) substantive harmonization of those bankruptcy laws.

Pottow, *Procedural Incrementalism, supra* note 40, at 948 (footnotes omitted).

47. Jay Lawrence Westbrook, *Universalism and Choice of Law*, 23 PENN. ST. INT'L L. REV. 625, 625–26 (2005) [hereinafter Westbrook, *Universalism*]; *see also* Guzman, *supra* note 44, at 2179.

48. Tung, *Fear of Commitment, supra* note 42, at 569.

49. *See, e.g.*, John A. E. Pottow, *The Myth (and Realities) of Forum Shopping in Transnational Insolvency*, 32 BROOK. J. INT'L L. 785, 787–91 (2007).

50. Tung, *Fear of Commitment, supra* note 42, at 569 (stating how universalism will "disempower local courts").

51. There is a contrary, skeptical view as to whether Chapter 15 actually delivers its supposed benefits. This view is discussed in the author's prior articles on Chapter 15. *See* John J. Chung, *The Retrogressive Flaw of Chapter 15 of the Bankruptcy Code: A Lesson from Maritime Law*, 17 DUKE J. COMP. & INT'L L. 253 (2007); Chung, *supra* note 1.

52. Tung, *Is International Bankruptcy Possible?*, *supra* note 7, at 41 (stating that the

international cooperation and coordination will be seen in the gathering of creditors from all over the world in one courtroom.[53]

However, even if one accepts the need for and benefit of the universalist approach, Chapter 15 and the Model Law are surprisingly ineffective in dealing with conditions created by economic crisis. This ineffectiveness is because Chapter 15 implicitly assumes two conditions regarding the foreign exchange markets, and if either of the two assumptions is missing, Chapter 15 become unworkable. The proponents of the Model Law have missed the fact that creditors from different countries do not share a common currency. Many (perhaps most) of the creditors in a Model Law proceeding will not be paid a distribution in their own currency. Does this matter? Will creditors happily accept any kind of paper for their claims? Any attempt to argue that money is money, no matter what, is based on mistaken assumptions regarding the nature and value of money. Thus, these assumptions challenge the feasibility of the Model Law and Chapter 15.

A. Chapter 15's First Assumption Regarding Foreign Exchange

The first implicit assumption is that the currency of the home country proceeding must be convertible.[54] In other words, if an American creditor is forced to pursue its claims in a foreign court, the local currency of that court must be convertible into U.S. dollars. After all, a currency distribution that has no value outside of the home country is practically worthless to a foreign creditor.[55]

This situation may be illustrated by examining the hypothetical country of Transitiona, a country with an emerging (but not fully developed) economy that has spawned several multinational businesses. Transitiona has adopted the Model Law.[56] One of its corporations does business in the United States, where it has secured and unsecured creditors. This corporation encounters financial difficulties and files an insolvency proceeding in Transitiona, its home country. It then applies in a U.S. bankruptcy court for recognition of the Transitiona proceeding as the foreign main proceeding. The judge, who just returned from a conference where the speakers uniformly extolled the virtues of universalism, grants the application and orders all creditors to pursue their claims in Transitiona. Having no choice, the American creditors file their claims in Transitiona and ultimately receive a distribution from the debtor's liquidation.

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conceptual benefits of universalism are efficiency, equality, and avoidance of duplicative proceedings).

53. *See id.* at 40.

54. *See* INVESTOPEDIA, http://www.investopedia.com/terms/c/convertibility.asp (last visited Nov. 3, 2008). Convertibility is the "ease with which a country's currency can be converted into gold or another currency." *Id.*

55. *Id.*

56. *See* MODEL LAW ON CROSS-BORDER INSOLVENCY (U.N. Comm'n on Int'l Trade Law 2007).

Suppose further that the liquidation was unusually successful and that all creditors received 100% of their claimed amounts. There is a problem, however. The creditors are paid in Transitiona's currency, which is not convertible. In other words, the currency cannot be exchanged for U.S. dollars.

The creditors would certainly object because the currency would not have value to them. Would the universalists argue that this result is fair because the currency has value in Transitiona? In all likelihood, a U.S. court would not force American creditors to pursue their claims in another country if the currency of that country were not convertible into U.S. dollars.

Although this hypothetical may seem extreme, it is presented to expose one of the assumptions on which the Model Law is based. At a minimum, the feasibility of the Model Law depends on the convertibility of the debtor's home currency to the creditors' home currencies. Fortunately, an American creditor facing the possibility of being forced into a proceeding in a country without a convertible currency would be protected by (among other provisions) §§ 1507(b) and 1522(a), which expressly require the court to protect the interests of creditors.[57]

If the universalists concede this as an implicit assumption, they will quickly point out that the assumption is not material because of the unlikelihood of a case involving a multinational debtor whose local currency is not convertible. As a general rule, countries without convertible currencies have weak, dysfunctional economies that are isolated from market forces.[58] It may be unlikely that such an economy would produce a company capable of doing business around the world. Whether or not this factual view is correct is a matter for empirical verification. Nonetheless, most would probably agree that the convertibility of the home country's currency is a necessary condition for the operation of Chapter 15 and the Model Law. As unlikely as it may be for a Chapter 15 proceeding to be commenced by a corporation whose home country

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57. *See* 11 U.S.C. §§ 1507(b), 1522(a) (2006). Section 1507(b) provides, in pertinent part:

> In determining whether to provide additional assistance under this title or under other laws of the United States, the court shall consider whether such additional assistance, consistent with the principles of comity, will reasonably assure—(1) just treatment of all holders of claims against or interests in the debtor's property; (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding; . . . .

Id. Section 1522(a) provides:

> The court may grant relief under section 1519 or 1521, or may modify or terminate relief under subsection (c), only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected.

Id. Although the issue does not appear to have been addressed by a court, it seems obvious that a court would protect a local creditor and not force it into a proceeding where the distribution will be in a non-convertible currency. *See id.* §§ 1507(a)–(b), 1522(a).

58. *See* Jacob A. Frenkel, *Commentary: Currency Convertibility in Eastern Europe*, *in* CENTRAL BANKING ISSUES IN EMERGING MARKET-ORIENTED ECONOMIES (1990), www.kc.frb.org/Publicat/sympos/1990/S90FRENK.pdf.

does not have a convertible currency, the preceding hypothetical highlights the existence and importance of foreign exchange issues.

B. Chapter 15's Second Implicit Assumption Regarding Foreign Exchange

The second implicit assumption of Chapter 15 is more likely and presents a greater challenge to the workability of the law. Chapter 15 necessarily assumes that foreign exchange rates are stable over time. If currency fluctuations are significant or extreme, it becomes an open question whether Chapter 15 provides fair treatment of similarly situated creditors. The problem posed by currency fluctuations can be demonstrated by three hypothetical scenarios, all based on actual events. The first two involve the bankruptcy filing of Debtor, Inc., an American business with operations in the United States and Canada. The third involves Debtor AG, a business which has its center of its main interests in the fictional country of Weimar.

1. Hypothetical One

Hypothetical One is based on the state of law before Chapter 15 became effective.[59] It is based on the territorial approach to bankruptcy law. Debtor, Inc. has its center of its main interests in Buffalo, New York, which is the site of its headquarters and a widget-making factory. It leases a warehouse in Toronto where it stores a supply of widgets. It distributes its widgets in Canada by hiring independent, local delivery companies. Because its widgets are shipped out as soon as they arrive in the Canadian warehouse, it has no significant assets in Canada, except for a local bank account with an average daily balance of 1,000,000 Canadian dollars.

Suppose Debtor, Inc. has 5,000,000 Canadian dollars of unsecured claims against it held by the Canadian delivery companies, and further suppose that the Canadian bank account is available for distribution to the unsecured creditors. Suppose that all of Debtor, Inc.'s assets in the United States are fully encumbered by secured claims, with the sole exception of a bank account holding 1,000,000 U.S. dollars. Suppose further that Debtor, Inc. has 5,000,000 U.S. dollars of unsecured claims against it held by American delivery companies.

Suppose the insolvency of Debtor, Inc. results in two separate bankruptcy filings filed on the same day—one in the United States and one in Canada. Each court operates independently of the other and exercises jurisdiction over the assets within its national borders. The Canadian court would exercise jurisdiction over the Canadian bank account and distribute the 1,000,000 Canadian dollars to the Canadian unsecured creditors. The result would be a recovery of 20% on the unsecured claims in Canada. The American court

59. *See infra* note 125 (describing 11 U.S.C. § 304 (2000), the law prior to the time Chapter 15 took effect).

would exercise jurisdiction over the American bank account and distribute the 1,000,000 U.S. dollars to the American unsecured creditors. The result would be a recovery of 20% to the unsecured claims in the United States. This hypothetical demonstrates that there is no foreign exchange loss for the creditors because their claims are addressed within their respective national borders.

2. Hypothetical Two

To illustrate the currency problem, Hypothetical Two is based on a scenario where the Model Law was in effect in both the United States and Canada on June 30, 2004. Hypothetical Two is based on the same facts as Hypothetical One, except for the following differences. Suppose again that the insolvency of Debtor, Inc. results in two separate bankruptcy filings on June 30, 2004, one in the United States and one in Canada. Under the Model Law, the U.S. bankruptcy trustee applies to the Canadian court for recognition of the U.S. proceeding as a foreign main proceeding because New York is the center of Debtor, Inc.'s main interests.[60] The Canadian court grants the application and defers to the jurisdiction of the U.S. proceeding. Debtor, Inc. then immediately transfers the money from the Canadian bank account to its U.S. bank account.[61] On June 30, 2004, one Canadian dollar was equal to .75 U.S. dollars.[62] Therefore, the American bankruptcy estate is increased by 750,000 U.S. dollars (.75 x 1,000,000 Canadian dollars), with 1,750,000 U.S. dollars available for distribution to unsecured creditors. The American unsecured creditors file their proofs of claim, which total 5,000,000 U.S. dollars. The Canadian unsecured creditors file their proofs of claim, which total 5,000,000 Canadian dollars. And these filings are the start of the problem.

The Canadian claims are converted to U.S. dollars as of the petition date, so 5,000,000 Canadian dollars of unsecured claims are allowed in the amount of 3,750,000 U.S. dollars. The estate would therefore hold 1,750,000 U.S. dollars available for distribution to holders of 8,750,000 U.S. dollars in unsecured claims, which equals a recovery of 20% for each unsecured creditor. There would be no problem if the distribution to the unsecured creditors occurred on the same date as the petition date because the Canadians would be able to immediately reconvert their 750,000 U.S. dollars (20% x 3,750,000

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60. *See* MODEL LAW ON CROSS-BORDER INSOLVENCY (U.N. Comm'n on Int'l Trade Law 2007).

61. The transfer of assets back to the home country of the debtor would not be unexpected. *See* Felixstowe Dock & Ry. Co. v. U.S. Lines Inc., [1989] Q.B. 360. In *Felixstowe*, an American debtor attempted to transfer assets out of England and back to the United States where it was the debtor in a Chapter 11 bankruptcy proceeding. *Id.* at 360. The English court enjoined the transfer, noting that the U.K. creditors would "suffer very substantial prejudice." *Id.* at 389.

62. *See* Bank of Canada, 10-Year Currency Converter, http://www.bankofcanada.ca/en/rates/exchform.html (last visited Nov. 3, 2008).

U.S. dollars) back to 1,000,000 Canadian dollars (20% x 5,000,000 Canadian dollars). However, distributions are not made on the petition date.[63]

Suppose Debtor, Inc. is involved in a complicated Chapter 11 proceeding, and further suppose a plan of reorganization is confirmed with an effective date of September 28, 2007. Suppose further that the plan provides for a distribution of 20% to all unsecured creditors as of the effective date. That provision would mean that the Canadian claimants receive their 750,000 U.S. dollars on September 28, 2007. Suppose then that the Canadian claimants reconvert their U.S. dollars back to Canadian dollars. On that day, one U.S. dollar was worth one Canadian dollar.[64] Thus, the Canadian claims would receive 750,000 Canadian dollars in exchange for the distribution of 750,000 U.S. dollars.

Compare the difference in the amounts. As of the petition date (June 30, 2004), the 20% recovery against the amount of the Canadian unsecured claims in U.S. dollars ($750,000) was equal to 1,000,000 Canadian dollars. As of the distribution date (September 28, 2007), the 20% recovery on the amount of the Canadian unsecured claims in U.S. dollars ($750,000) was equal to 750,000 Canadian dollars. The time lag between the petition date and the distribution date results in a diminution of the distribution to the Canadian claimants by 250,000 Canadian dollars, or a loss of 25%. In terms of the percentage of recovery, as of the petition date, the Canadian claimants are looking at a 20% recovery (1,000,000 Canadian dollars / 5,000,000 Canadian dollars). As of the distribution date, however, the Canadian claimants actually receive only a 15% recovery. At the same time, the American unsecured claimants receive a 20% recovery.

The glaring unfairness with this result is that the Canadians have been prejudiced solely because they are Canadian and transact in Canadian dollars. Even though there is no intent to discriminate against foreign creditors, it is unavoidable that foreigners will be prejudiced simply because they are foreigners. This prejudice obviously runs counter to notions of fairness and the spirit of international cooperation underlying the Model Law.[65]

3. The Legal Certainty of Hypothetical Two

For those unfamiliar with bankruptcy law, the question may arise whether the law actually works in the way described in Hypothetical Two. The answer is yes. Creditors will be ordered to pursue their claims in a foreign court if the foreign proceeding is recognized as a foreign main proceeding, and as a general

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63. *See, e.g.*, 11 U.S.C. § 726 (stating the requirements for the distribution of a bankruptcy estate in a Chapter 7 liquidation).

64. *See* Bank of Canada, 10-Year Currency Converter, http://www.bankofcanada.ca/en/rates/exchform.html (last visited Nov. 3, 2008).

65. *See* MODEL LAW ON CROSS-BORDER INSOLVENCY pmbl.(c) (U.N. Comm'n on Int'l Trade Law 2007) (stating that an objective of the Model Law is to provide "[f]air and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons").

matter, the amount of their claims will be set as of the commencement of the case.[66]

With regard to the first point, the entire purpose of the Model Law and Chapter 15 is to give deference to one court in one country.[67] One court will be recognized as the foreign main proceeding, and all courts in other countries that follow the Model Law are required to defer to that proceeding.[68] Creditors are thus forced into the court system of a foreign country, whether they wish to have their claims resolved there or not.

This result has already occurred under Chapter 15. In *In re Ephedra Products Liability Litigation*,[69] a group of American tort claimants filed personal injury and wrongful death lawsuits in the United States against a company called Muscletech Research and Development, Inc. ("Muscletech").[70] Muscletech commenced an insolvency proceeding in Canada, and pursuant to Chapter 15, petitioned a U.S. court for recognition of the Canadian proceeding as the foreign main proceeding.[71] The U.S. court granted recognition.[72] The Canadian proceeding established a procedure to resolve the tort claims, but the American tort claimants objected to the procedure and asked the U.S. court to refuse to recognize and enforce the Canadian procedure.[73] The U.S. district court denied the claimants' request and enforced the application of the Canadian proceeding.[74]

In re Ephedra Products illustrates the beauty (or nightmare, depending on one's perspective) of Chapter 15. Under the Model Law and Chapter 15, a local creditor may be forced to pursue its claims in a foreign proceeding, whether it wishes to or not. This requirement is the result even if the local creditor never leaves its own country and enters into a contract or transaction governed by its local law.

With regard to the second point, the amount of an uncontested, liquidated claim is determined as of the filing date of the petition.[75] In other

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66. *See* 11 U.S.C. § 502(b) (2006) (stating that the court shall determine the amount of the claim as of the date of the filing of the petition).

67. *See* 11 U.S.C. §§ 1509–24 (stating how foreign creditors are given access to courts, the steps to recognizing a foreign proceeding, and how relief is obtained); MODEL LAW ON CROSS-BORDER INSOLVENCY pt.1, ch.3, arts.15–24 (U.N. Comm'n on Int'l Trade Law 2007).

68. *See generally* Chung, *supra* note 1, at 97–98 (describing a Chapter 15 proceeding).

69. 349 B.R. 333 (S.D.N.Y. 2006).

70. *Id.* at 334.

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.* at 337.

75. *See* 11 U.S.C. § 502(b) (2006); *In re* Cardelucci, 285 F.3d 1231, 1235 (9th Cir. 2002).

> Upon the filing of the bankruptcy petition, creditors with a claim against the estate must pursue their rights to the claim in federal court and entitlement to a claim is a matter of federal law. . . . Absent a timely objection, all claims filed against the bankrupt estate are 'deemed allowed' as of the date of filing. 11 U.S.C. § 502(a). This allowed claim, like a

words, the holder of an uncontested, liquidated claim will not have the amount of its claim determined as of a later date, such as the date the money is actually distributed; the filing date is the controlling date.[76] Furthermore, all claimants in a U.S. bankruptcy court (whether American or foreign) shall have their claims determined in U.S. dollars.[77] Read together, Chapter 15 and the other

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> judgment, gives the creditor a legal "right to payment" of a specific sum of money against the debtor. 11 U.S.C. § 101(5); 11 U.S.C. § 502(b). As of the date of the filing of the petition, creditors hold a claim, similar to a federal judgment, against the estate, the payment of which is only dependent upon completion of the bankruptcy process.

Id. The importance of the filing date of the petition for purposes of determining the amount of a claim is also seen in § 502(b), which states in pertinent part that "if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount . . . ." 11 U.S.C. § 502(b).

> A 'creditor or indenture trustee' seeking to make a claim on a bankruptcy estate is instructed to file a proof of claim pursuant to 11 U.S.C. § 501. All claims are presumptively 'allowed' in full unless another party in interest in the proceedings files an objection. 11 U.S.C. § 502(a). If such an objection is made, as here, the Bankruptcy Court holds a hearing and reduces the allowable amount of the claim pursuant to the remainder of § 502.

In re Oakwood Homes Corp., 449 F.3d 588, 595 (3d Cir. 2006).

76. The need to fix the amount of claims as of a single date is also seen in the bankruptcy laws of countries around the world. *See* F.A. MANN, THE LEGAL ASPECT OF MONEY 342 (1992). Valuing the Canadian claims at a later date (such as the distribution date) would create a different but similar problem. Such a move would increase the U.S. dollar distribution to the Canadian creditors, but that would necessarily mean fewer U.S. dollars to distribute to the American creditors. As a result, they would certainly object.

77. *In re* Good Hope Chemical Corp., 747 F.2d 806, 809 (1st Cir. 1984) (citing Frontera Transp. Corp. v. Abaunza, 271 F. 199 (5th Cir. 1921)) (stating that the date of determination for the applicable exchange rate is a "harder question"). An American federal court must render judgment in U.S. dollars. *See* Trinh v. Citibank, N.A., 623 F. Supp. 1526, 1536 (E.D. Mich. 1985) ("Both parties agree, and the law is settled, that a United States District Court can award judgment only in dollars."). The requirement of expressing claims in U.S. dollars is also seen in § 502(b), which provides that if an objection is made to a claim, the court "shall determine the amount of such claim *in lawful currency of the United States* as of the date of the filing of the petition." 11 U.S.C. § 502(b) (emphasis added). The Seventh Circuit, however, disagrees:

> Foreign currency awards are rare in federal courts of the United States—this may be the first—because § 20 of the Coinage Act of 1792, 31 U.S.C. § 371 (1976), provided that '[t]he money of account of the United States shall be expressed in dollars . . . and all proceedings in the courts shall be kept and had in conformity to this regulation.' Congress repealed this section of the Coinage Act in 1982. . . . There is now no bar to judgment in the appropriate currency.

In the Matter of Oil Spill by the Amoco Cadiz off the Coast of France on March 16, 1978, 954 F.2d 1279, 1328 (7th Cir. 1992). The Eighth Circuit appears to agree with the Seventh Circuit. *See* Reliastar Life Ins. Co. v. IOA Re, Inc., 303 F.3d 874, 882 (8th Cir. 2002).

The repeal of § 20 of the Coinage Act and the ruling in *In re Oil Spill by the Amoco Cadiz* have created some uncertainty as to whether a federal court may award judgments in foreign currencies. *See In re Oil Spill by the Amoco Cadiz*, 954 F.2d at 1328; *Reliastar*, 303 F.3d at

applicable sections of the Bankruptcy Code require that the hypothetical Canadian claimants have their claims fixed as of the filing date of Debtor, Inc's petition and have their distribution in U.S. dollars. What started out as a local transaction and a local debt in Canadian dollars has turned into a different kind of claim—one to be paid in a foreign currency.[78] The Canadian claimants'

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882. This uncertainty is reflected in two decisions from the Southern District Court of New York. One district judge ruled that the court had such power. *See* Mitsui & Co., Ltd. v. Oceantrawl Corp., 906 F. Supp. 202 (S.D.N.Y. 1995). Another judge ruled that the court did not. *See* Sae Sadelmi S.P.A. v. Papua New Guinea Elec. Comm'n, No. 94 Civ. 2959 (SS), 1994 WL 669543, at *2 (S.D.N.Y. Nov. 29, 1994) ("An American court, however, can only enter a money judgment in U.S. dollars.").

78. The situation with these hypothetical Canadian claimants should be contrasted to a situation where a local creditor voluntarily becomes a creditor on a claim that is intended from the outset to be paid in a foreign currency. In such a situation, the creditor bears the risk of currency fluctuation. *See* Deutsche Bank v. Humphrey, 272 U.S. 517, 519 (1926); *see also* Zimmerman v. Sutherland, 274 U.S. 253, 255–56 (1927). The *Deutsche Bank* Court stated:

> An obligation in terms of the currency of a country takes the risk of currency fluctuations and whether creditor or debtor profits by the change the law takes no account of it. . . . Obviously in fact a dollar or a mark may have different values at different times but to the law that establishes it is always the same.

Deutsche Bank, 272 U.S. at 519.

Some supporters of universalism may argue that a creditor ought to bear foreign currency risk any time it transacts with a foreign corporation. To advance this view, the supporters would likely quote the following: "Such being the law, it follows that every person who deals with a foreign corporation impliedly subjects himself to such laws of the foreign government, affecting the powers and obligations of the corporation with which he voluntarily contracts, as the known and established policy of that government authorizes." Canada So. Ry. Co. v. Gebhard, 109 U.S. 527, 537 (1883). The dispute in *Canada Southern* arose when holders of bonds issued by the railroad company objected to the treatment of their bonds after the company ran into financial trouble. *Id.* at 528. The quoted passage is undoubtedly broad. However, the true breadth of its meaning can only be determined with reference to the facts of the case. These facts suggest a much narrower reach:

> The obligor of the bonds and coupons here sued on was a corporation created for a public purpose, that is to say, to build, maintain, and work a railway in Canada. It had its corporate home in Canada, and was subject to the exclusive legislative authority of the Dominion parliament. It had no power to borrow money or incur debts except for completing, maintaining, and working its railway. The bonds taken by the defendants in error showed on their face that they were part of a series amounting in the aggregate to a very large sum of money, and that they were secured by a trust mortgage on the railway of the company, its lands, tolls, revenues, etc. In this way the defendants in error, when they bought their bonds, were, in legal effect, informed that they were entering into contract relations not only with a foreign corporation created for a public purpose, and carrying on its business within a foreign jurisdiction, but with the holders of other bonds of the same series, who were relying equally with themselves for their ultimate security on a mortgage of property devoted to a public use, situated entirely within the territory of a foreign government.

Id. at 536–37. From these facts, it is clear that the creditors' claims were tied to Canada in a way that is materially different from an everyday situation where a foreign business enters the

exposure to the foreign exchange risk is involuntary and unavoidable as a matter of law.[79]

4. Hypothetical Three

Hypothetical Three concerns a debtor called Debtor AG. Debtor AG has its center of its main interests in the country of Weimar, which is the site of its headquarters and widget-making factory. Weimar, like the United States, has enacted the Model Law into its bankruptcy law.[80] Debtor AG leases a warehouse in New England where it stores an inventory of widgets. It distributes its widgets in the United States by hiring independent, local delivery companies. Because its widgets are shipped out as soon as they arrive in the American warehouse, it has no significant assets in the United States except for a local bank account with a balance of $1,000,000.

Suppose Debtor AG has $5,000,000 of unsecured claims against it held by the American delivery companies, and further suppose that the U.S. bank account is available for distribution to the unsecured creditors. Suppose that all of Debtor AG's assets in Weimar are fully encumbered by secured claims, with the sole exception of a bank account holding 50,000,000 Weimar marks. Suppose further that Debtor AG has 250,000,000 Weimar marks of unsecured claims against it held by Weimar delivery companies.

Suppose that Debtor AG becomes insolvent and files two separate bankruptcy filings on December 1, 2009, one in Weimar and the other in the United States. Pursuant to the Model Law, the Weimar bankruptcy trustee applies to the U.S. court for recognition of the Weimar proceeding as a foreign main proceeding.[81] The U.S. court grants the application and defers to the jurisdiction of the Weimar proceeding. Debtor AG then immediately transfers the money from its U.S. bank account to its Weimar bank account. On December 1, 2009, 50 Weimar marks are equal to one dollar. As a result, the Weimar bankruptcy estate is increased by 50,000,000 marks and there are 100,000,000 marks available for distribution to unsecured creditors.

The Weimar unsecured creditors file their proofs of claim, which total 250,000,000 Weimar marks. The American unsecured creditors file their proofs of claim, and their claims are converted to Weimar marks as of the petition date. As a result, $5,000,000 of unsecured claims are allowed in the amount of 250,000,000 Weimar marks. The estate would therefore hold 100,000,000

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domestic market to conduct its business.

79. This Article will later examine whether the risk may be avoided as a matter of fact. *See infra* Parts V and VI.

80. *See* MODEL LAW ON CROSS-BORDER INSOLVENCY (U.N. Comm'n on Int'l Trade Law 2007).

81. *See id.* pt.1, ch.III, arts.15–17. Article 15 of the Model Law states the requirements for recognition of a foreign proceeding. *Id.* pt.1, ch.III, art. 15. Article 16 gives the presumptions concerning recognition of a foreign proceeding. *Id.* pt.1, ch.III, art. 16. Article 17 outlines the "[d]ecision to recognize a foreign proceeding." *Id.* pt.1, ch.III, art. 17.

Weimar marks available for distribution to holders of 500,000,000 Weimar marks in unsecured claims, which equals a recovery of 20% for each unsecured creditor. There would be no problem if the distribution to the unsecured creditors occurred on the same date as the petition date because the American creditors would be able to immediately reconvert their 50,000,000 Weimar marks (20% x 250,000,000) back to $1,000,000. However, distributions are not made on the petition date.[82]

Suppose Debtor AG has its Weimar equivalent of a plan of reorganization confirmed with an effective date of November 1, 2013. Suppose further that the plan provides for a distribution of 20% to all unsecured creditors as of the effective date. This provision would mean that the American claimants receive their 50,000,000 Weimar marks on November 1, 2013. Suppose then that the American claimants reconvert their Weimar marks back to U.S. dollars. Suppose, however, Weimar has since experienced economic collapse and currency devaluation. The extent of the devaluation is so severe that as of November 2013, one dollar is worth one trillion Weimar marks. Thus, the American claimants would receive several orders of magnitude less than one penny in U.S. currency in exchange for the distribution of 50,000,000 Weimar marks.

Compare the staggering difference in the amounts. As of the petition date, the 20% recovery on the amount of the American unsecured claims in Weimar marks would be equal to $1,000,000. As of the distribution date, the 20% recovery on the amount of the American unsecured claims in Weimar marks is less than a penny. The time lag between the petition date and the distribution date results in a total loss for the American claimants.

5. The Factual Certainty of Hypothetical Three

The facts of Hypothetical Three are indisputably extreme, so extreme that a reader may wonder if it could actually happen. The answer is yes; it could happen. In fact, it has happened, and the occurrence of such extreme currency crises is actually a regular and frequent occurrence in historical terms.[83]

Hypothetical Three is based on the Weimar hyperinflation in post-World War I Germany.[84] As extreme as it was, the magnitude of the Weimar

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82. *See, e.g.*, 11 U.S.C. §§ 726, 1123 (2006).

83. *See infra* notes 84–88 and accompanying text (describing currency crises in Germany, Hungary, and Yugoslavia).

84. These dates and numbers are based on the actual rates of the Weimar hyperinflation between 1919 and 1923. *See* ARTHUR NUSSBAUM, MONEY IN THE LAW: A COMPARATIVE STUDY IN THE BORDERLINE OF LAW AND ECONOMICS (1950).

> In June, 1918, the dollar (parity 4.21 marks) had reached a level of 5.31 and by November, 1918, 7.43. In December 1919, the dollar was quoted at 46.77; in December, 1920, at 73; in December, 1921, at 191; in July 1922, at 493; in October, 1922, at 3180; in December, 1922, at 7589. . . . [D]ollar quotations in January, 1923, averaged 17,972; in February, 27,918; in March, 21,190; in April, 24,457; in May, 47,670; in June, 109,996; in July

hyperinflation is neither uncommon nor the relic of a bygone age. This type of economic collapse occurred numerous times in the twentieth century and even within the lifetime of today's law students.[85] It is just that most Americans are unaware of such events because of the comparative shelter provided by the U.S. dollar, which enjoys the status of the world's most accepted currency.[86] For example, the peak monthly inflation rate of the Weimar era was 32,400%, but Hungary experienced a monthly inflation rate in July 1946 that was twelve orders of magnitude greater than the highest Weimar rate.[87] More recently, Yugoslavia's monthly inflation rate in January 1994 was 313,000,000%, or four orders of magnitude higher than Weimar's highest rate.[88]

A reader may wonder about the use of such extreme economic horror stories to punctuate a point, and detractors may argue that such rare events say nothing about Chapter 15's viability. However, many would probably agree that an event is not rare if it occurs three times in one century in advanced European countries, with the most recent occurrence in the last decade.[89] More importantly, these are just the most extreme examples. Hyperinflation and currency collapse on a Weimar scale may not occur every decade, but hyperinflation and currency collapse on a lesser scale do. The following are a few modern examples.

a. Argentina

In January 2002, Argentina devalued its peso, abandoning its policy of maintaining the value of one peso to one U.S. dollar.[90] On January 29, 2002,

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> 353,412. Then the dollar quotations soared to astronomical heights: 4.6 millions in August; 150 millions on September 18; 1.2 billion on October 9; 12 billions on October 19; the trillion limit was attained on November 14.

Id. at 200.

It is possible to argue that interest rates on bank deposits would also have been rising along with hyperinflation, making more money available to distribute to unsecured creditors in Hypothetical 3. It is unlikely, however, that bank deposit rates would match the hyperinflation. Also, hyperinflation would likely trigger currency controls and render the fictional marks unconvertible.

85. *See* Steve H. Hanke, *The World's Greatest Unreported Hyperinflation*, GLOBE ASIA, May 2007, at 108. Professor Hanke is a professor of applied economics at Johns Hopkins University. *Id.*

86. *See* FEDERAL RESERVE BOARD, THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 51 (9th ed. 2005).

87. Hanke, *supra* note 85.

88. *Id.*

89. As of early 2008, hyperinflation was already taking place in the world. *See Zimbabwe Bank Issues $10 Million Bill - But It Won't Even Buy You a Hamburger in Harare*, DAILY MAIL, Jan. 19, 2008, http://www.dailymail.co.uk/news/article-508840/Zimbabwe-bank-issues-10million--wont-buy-hamburger-Harave.html. Zimbabwe is experiencing hyperinflation at an annual rate estimated between 25,000% and 150,000%. *Id.*

90. *See* Jim Lehrer, *Falling Peso*, ONLINE NEWSHOUR, Jan. 7, 2002,

one U.S. dollar was equal to 1.78 Argentine pesos.[91] On June 28, 2002, one U.S. dollar was equal to 3.85 Argentine pesos.[92] In other words, the Argentine peso lost more than half of its value against the U.S. dollar in less than five months.

b. Russia

On August 13, 1998, the Russian stock, bond, and currency markets collapsed.[93] A few days later, the Russian government devalued the ruble.[94] The effect was seen in the dramatic drop of the ruble against the U.S. dollar. In June 1998, approximately five rubles were equal to one U.S. dollar, but by September 1999, it required approximately 30 rubles to equal one U.S. dollar.[95]

c. Thailand

In July 1997, Thailand was forced to devalue its currency, the Thai baht.[96] On June 30, 1997, one U.S. dollar was equal to 24.70 Thai baht.[97] By January 30, 1998, one U.S. dollar was equal to 52.85 Thai baht.[98] In seven months, the Thai baht lost more than half of its value against the U.S. dollar.

d. Mexico

Mexico also suffered a currency crisis in the 1990s.[99] On December 20, 1994, Mexico devalued its peso.[100] On December 19, 1994, one U.S. dollar was equal to 3.45 Mexican pesos.[101] One year later on December 19, 1995, one U.S. dollar was equal to 7.67 Mexican pesos.[102] In one year, the Mexican peso lost more than half of its value against the U.S. dollar.

The lesson from these recent events is that Chapter 15's assumption regarding stable exchange rates is easily and frequently disturbed. Indeed,

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http://www.pbs.org/newshour/bb/latin_america/jan-june02/argentina_1-07.html.

91. *Exchange Rates*, WALL ST. J., Jan. 30, 2002, at C9.

92. *Exchange Rates*, WALL ST. J., Jul. 1, 2002, at C10.

93. Abbigail J. Chiodo & Michael T. Owyang, *A Case Study of a Currency Crisis: The Russian Default of 1998*, 84 FED. RES. BANK OF ST. LOUIS REV. 7 (2002), *available at* http://research.stlouisfed.org/publications/review/02/11/ChiodoOwyang.pdf.

94. *Id.*

95. *Id.* at 11 fig.3.

96. *See Thailand: The Crisis Starts*, BBC NEWS, Nov. 26, 1997, http://news.bbc.co.uk/1/hi/special_report/1997/asian_economic_woes/34487.stm.

97. *Exchange Rates*, WALL ST. J., Jul. 1, 1997, at C18.

98. *Exchange Rates*, WALL ST. J., Feb. 2, 1998, at C27.

99. *See* Joseph A. Whitt, Jr., *The Mexican Peso Crisis*, ECON. REV., Jan.–Feb. 1996, at 1, www.frbatlanta.org/filelegacydocs/J_whi811.pdf.

100. *Id.*

101. *Exchange Rates*, WALL ST. J., Dec. 20, 1994, at C16.

102. *Exchange Rates*, WALL ST. J., Dec. 20, 1995, at C17.

stability may be the exception and not the norm. To the extent a reader is not familiar with these relatively recent events in Argentina, Russia, Thailand, and Mexico, it is because he or she has been cocooned by exclusive transactions in U.S. dollars. However, that protection will disappear as a matter of law by operation of Chapter 15.

Contemporary economic conditions further demonstrate this problem. Euro banknotes and coins were first introduced into circulation on January 1, 2002.[103] At that time, one euro was worth 0.90 U.S. dollars.[104] By the beginning of January 2008, the value of one euro had risen to 1.47 U.S. dollars.[105] This change in value was the result of cyclical, long-term forces—the ordinary functioning of national economies. Thus, dramatic movements in the foreign exchange market happen over time, even in the absence of cataclysmic shocks.

The universalists may argue that the rise and fall of currency values make no difference and that Chapter 15 and the Model Law are unaffected. Currencies go up and down in value, and that fluctuation is just a fact of life. However, bankruptcy law, to a large extent, is about the treatment of creditors.[106] Can Chapter 15 work if foreign creditors are paid in pieces of paper that have fallen significantly in value against their local currencies? The universalists may not particularly care about this question, but the creditors certainly will. Creditors who find themselves in this situation will likely have their concerns dismissed by those who believe that supposed global efficiencies outweigh creditor concerns. However, the creditors' objection to such treatment may find support in Chapter 15's public policy exception.[107]

III. THE PUBLIC POLICY ISSUE RAISED BY FOREIGN EXCHANGE FLUCTUATIONS

Chapter 15 applies unless its application would violate public policy.[108] Section 1506 of Chapter 15 provides in its entirety: "Nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."[109] Would the creditors in Hypotheticals Two and Three be able to invoke this public policy exception? Would it violate a country's public policy

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103. *See* National Bank of Belgium, A Brief History of the Euro, http://www.nbb.be/pub/Home.htm?l=en (follow "Notes and coins" hyperlink; then follow "A brief history of the euro" hyperlink) (last visited Nov. 7, 2008).

104. *Exchange Rates*, WALL ST. J., Jan. 3, 2002, at C16.

105. *Exchange Rates*, WALL ST. J., Jan. 3, 2008, at C12.

106. 11 U.S.C. § 1501(a)(3) (2006) (stating that one objective of Chapter 15 is to "[p]rotect the interests of all creditors").

107. *See id.* § 1506.

108. *Id.*

109. *Id.*

to force its local creditors into a foreign proceeding where their recovery will be materially diminished due to foreign exchange fluctuations?

The answer (like the answer to most legal questions) is that it depends. The easy case may be presented in a Weimar-like situation. Although this author has not located a reported bankruptcy case that directly addresses this issue, the Second Circuit has expressly acknowledged that forcing a party into a foreign forum where its claim might become worthless due to currency fluctuations might violate American public policy.[110] In *Finanz AG*, the plaintiff sought to recover on certain promissory notes allegedly guaranteed by the defendant.[111] The plaintiff filed a state court action, which was removed to federal court.[112] At the time of the American litigation, the defendant was subject to an extrajudicial liquidation proceeding in Brazil.[113] The district court granted the defendant motion's to dismiss the federal court action in favor of the Brazilian proceeding.[114]

On appeal, the plaintiff argued that it would violate American public policy to force it into the Brazilian proceeding because of the loss it would suffer due to the conversion of its claim from U.S. dollars to Brazilian reals.[115] The Second Circuit rejected this argument, but at the same time recognized its potential merit.[116] The court stated:

> It may well be that this practice places the risk of currency fluctuation on Finanz. Nonetheless, the United States applies a similar practice in its bankruptcy proceedings, *see* 11 U.S.C. § 502(b) (providing that, as a general matter, "the court, after notice and a hearing, shall determine the amount of such claim in *lawful currency of the United States as of the date of the filing of the petition*, and shall allow such claim in such amount" (emphasis added)), and it is not surprising that Brazil would utilize such a procedure to promote the orderly liquidation of claims. Of course, if the early conversion of a creditor's claims into foreign currency would render a debt unenforceable or valueless, we might have cause to conclude that a conversion procedure was fundamentally unfair. However, Finanz does not make this complaint, and that situation is not before us. Accordingly, we agree with the District Court that the conversion procedure in this case is not fundamentally unfair.[117]

Even though the court's observation is clearly dictum, it does acknowledge the reality that foreign exchange fluctuations may reach a point where it would violate public policy to force a creditor into a foreign proceeding where it must

110. *See* Finanz AG Zurich v. Banco Economico S.A., 192 F.3d 240, 250 (2d Cir. 1999).
111. *Id.* at 244.
112. *Id.*
113. *Id.* at 243.
114. *Id.* at 244.
115. *Id.* at 250.
116. *Id.*
117. *Id.* (citation omitted).

suffer material losses.[118] The court's language also suggests that a Weimar-type situation would trigger the public policy exception and that a U.S. court should protect American creditors from such a situation.[119]

The difficult question, of course, is how much harm to local creditors will be tolerated before the public policy exception will apply. Would Hypothetical Two's 25% diminution in recovery trigger the exception?[120] Although there appear to be no cases that directly address this issue, analogous case law suggests some likely parameters.

In re Hwang[121] involved a Korean company, Onse Telecom ("Onse"), which was in reorganization under Korean law.[122] While the Korean proceeding was pending, Onse was also a defendant in an American lawsuit brought by Oxyn Telecommunications, Inc. ("Oxyn").[123] Oxyn sought more than $100 million from Onse.[124] Onse's receiver made a motion in the U.S. bankruptcy court (under the now-repealed 11 U.S.C. § 304) seeking a permanent injunction to prohibit suits or enforcement of judgments against Onse in the United States.[125] Oxyn objected to the motion on the ground that it would suffer an economic hardship if required to pursue its claims in Korea.[126] One of Oxyn's arguments was that it would be required to pay a stamp duty of $133,000 if forced to litigate its claims in Korea.[127] The U.S. bankruptcy court described this argument as "disingenuous" in light of the fact that Oxyn had already spent more than $1.8 million in attorneys' fees and expected to spend over $2.6 million more.[128] The court granted the foreign representative's motion and enjoined the American litigation against Onse.[129]

One way to look at Oxyn's argument is that Oxyn faced a diminution of approximately 0.13% in its potential recovery as a result of being forced into a foreign forum ($133,000 / $100,000,000). *Finanz AG* suggests that a near

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118. *Id.* at 250.

119. *See id.*; *supra* Part II.B.4.

120. *See supra* Part II.B.2.

121. 309 B.R. 842 (Bankr. S.D.N.Y. 2004).

122. *Id.* at 843.

123. *Id.* at 843–44.

124. *Id.* at 844.

125. *Id.* at 844–45. Prior to Chapter 15, the Bankruptcy Code addressed transnational bankruptcies in a single Code section, 11 U.S.C. § 304, which was repealed and replaced by Chapter 15. *See* 11 U.S.C. § 304 (2000), *repealed by* Bankruptcy Abuse Prevention and Consumer Protection Act of Apr. 20, 2005, Pub. L. 109-8, title VIII, § 802(d)(3), 119 Stat. 146. Section 304 permitted foreign representatives in insolvency proceedings to file motions in U.S. bankruptcy court to protect the administration of the foreign proceeding. *Id.* One prominent commentator has stated that the case law under repealed § 304 applies to Chapter 15, except where it limits the relief available. *See* Westbrook, *Chapter 15 at Last*, *supra* note 22, at 720.

126. *In re Hwang*, 309 B.R. at 846–47.

127. *Id.* at 847.

128. *Id.*

129. *Id.* at 847–48.

100% diminution in value triggers the public policy exception,[130] while *In re Hwang* suggests that a 0.13% diminution does not.[131] This range, of course, is not much help in evaluating whether the creditors in Hypothetical Two fall under the protection of the public policy exception. Nonetheless, this analysis is helpful to the extent that it shows that limits do exist in terms of how much harm to a creditor will be tolerated and to the extent that it demonstrates that a range exists in the first place (even if the range is too wide to be helpful).

A public policy challenge will most likely be difficult to establish. In determining whether a foreign proceeding violates American public policy, U.S. bankruptcy law does not require that a distribution in a foreign proceeding be the same as the distribution in a hypothetical U.S. case or that American creditors receive the same treatment they would be entitled to under U.S. law.[132] The key issue is whether "fundamental standards of procedural fairness are observed."[133] Many, if not most, successful public policy challenges have been based on a lack of adequate notice in a foreign proceeding.[134]

Based on these principles, universalists would certainly argue that the problem of foreign exchange rates is a non-issue and does not even merit attention from the courts as a matter of law. They might concede that a dramatic hyper-inflationary event triggers a public policy issue, but they are not likely to concede the existence of any issue for a situation short of that. The present state of the case law may support that view, but should it? Most, if not all, creditors would probably agree that it makes a material impact if they receive 25% less in a foreign proceeding due to foreign currency fluctuations. For some, it could determine whether their business survives. The prejudice is aggravated by the fact that the creditors have been forced involuntarily into a foreign proceeding because of the Model Law.[135] If these are the stakes involved, it seems curious that the law would say that such circumstances do not present a legal problem.

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130. *See* Finanz AG Zurich v. Banco Economico S.A., 192 F.3d 240, 250 (2d Cir. 1999).

131. *See In re Hwang*, 309 B.R. at 842.

132. *In re* Bd. of Dir. of Multicanal S.A., 314 B.R. 486, 506 (Bankr. S.D.N.Y. 2004) (stating that the cases do not require that "U.S. creditors receive the precise recovery or treatment to which they would be entitled under Chapter 11").

133. *Id.* at 503.

134. *Id.* at 510; *see, e.g.*, Inter. Transactions, Ltd. v. Embotelladora Agral Regiomontana, S.A., 347 F.3d 589 (5th Cir. 2003) (comity denied due to insufficient notice).

135. The universalists would undoubtedly challenge this assertion by arguing that creditors (except for tort creditors) enter into transactions with foreign entities by choice and are free not to deal with foreign entities if they are concerned with the Model Law or Chapter 15.

A preliminary response to this argument is that if a purpose of the Model Law and Chapter 15 is to ease economic transactions in a global economy, the question is raised whether business is indeed easier for a person who has to factor in the possible application of a different foreign law for every new business relationship. *See* Westbrook, *Chapter 15 at Last*, *supra* note 22, at 713.

But more to the point, it is a mistaken assumption that people enter into transactions with foreign entities by informed choice. By way of illustration, one of the large grocery store chains in New England is Stop & Shop. *See* Stop & Shop, Welcome to Stop & Shop,

Even if most successful public policy objections are based on lack of notice, the law does not state that lack of notice is the only basis for a public policy objection.[136] The difficulty with articulating a reliable guideline is that anything involving "public policy" is by nature fuzzy and elusive. Given the absence of clear boundaries, it is equally legitimate to point to other policies of bankruptcy law when raising a public policy argument.

Bankruptcy courts must be "guided by what will best assure an economical and expeditious administration of the estate, consistent with just treatment of all creditors and equity security holders [and by] protection of local creditors and equity security holders against prejudice and inconvenience in processing claims and interests in the foreign proceeding."[137] "The guiding premise of the Bankruptcy Code, like its predecessor, the Bankruptcy Act, is the equality of distribution of assets among creditors."[138] It is the courts' "obligation to guard against 'forcing American creditors to participate in foreign proceedings in which their claims will be treated in some manner inimical to this country's policy of equality.'"[139]

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http://www.stopandshop.com (last visited Nov. 7, 2008). Where is its home country? It is probably unlikely that anyone asks this question while shopping there, but just suppose one wanted to know. One could go to the website, http://www.stopandshop.com, and look for an answer. On the website, one may click on "About Us" and learn that the business was founded in 1914 in Massachusetts and that today it is the one of the largest food retailers in New England. *See* Stop & Shop, The Company, http://www.stopandshop.com/about_us/company/index.htm (lasted visited Nov. 7, 2008). Although the website mentions that Stop & Shop is now owned by Ahold, it does not say where this company is located. *Id.* From the information listed on the website, one could reasonably conclude that U.S. law would always apply to any transaction with Stop & Shop.

However, if one goes to the website of Ahold, http://www.ahold.com, and clicks on "About us," one learns that Ahold's corporate center is in Amsterdam and that it owns the Stop & Shop supermarket chain. *See* Ahold, About Us, http://www.ahold.com/page/3554.aspx (last visited Nov. 7, 2008). In other words, the Stop & Shop website does not provide much information indicating that it is part of Ahold, a Dutch company. One needs to leave the Stop & Shop website in order to locate that important fact on the Royal Ahold website. In light of this one example involving a business that is part of the daily lives of perhaps millions of people, one wonders how many small creditors and counterparties of Stop & Shop know they are dealing with a foreign entity.

136. *See, e.g.*, Cunard S.S. Co. v. Salen Reefer Servs. AB, 773 F.2d 452, 455 (2d Cir. 1985) (granting comity to a Swedish bankruptcy proceeding and discussing public policy concerns); *In re Multicanal*, 314 B.R. at 503 (stating that "[t]he key issue is one of due process and the public policy of the forum").

137. *Cunard S.S. Co.*, 773 F.2d at 455 (quoting H. R. REP. NO. 95-598 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5968, 6281).

138. *Id.* at 459.

139. Remington Rand Corp. v. Bus. Sys., Inc., 830 F.2d 1260, 1271 (3d Cir. 1987) (quoting Banque de Financement S.A. v. First Nat'l Bank of Boston, 568 F.2d 911, 921 (2d Cir. 1977)); *see also* Phila. Gear Corp. v. Phila. Gear de Mex., S.A., 44 F.3d 187, 193 (3d Cir. 1994).

Are all creditors of similar standing given just treatment when some are involuntarily subjected to foreign currency risk and others are not? Are local creditors protected if they are ordered to pursue their claims in a foreign court where their claims become exposed to (and are prejudiced by) foreign currency risk? Is it fair and just when claims are impaired solely due to the fact that the creditor is foreign? The Bankruptcy Code incorporates "the equitable principle that the delay in liquidation and subsequent distribution necessitated by the bankruptcy process should result in neither gain nor loss for similarly situated creditors."[140] Does imposing foreign exchange loss on foreign creditors violate this principle?

The thorniness of these issues is compounded by the fact that the problems do not go away even if a court orders payments to creditors in their local currencies.[141] In Hypothetical Two, for example, the Canadian creditors could be protected if they were paid in Canadian dollars.[142] However, the trustee's cost of purchasing Canadian dollars, which have appreciated while the case was pending, with U.S. dollars necessarily means that there will be fewer U.S. dollars to distribute to the American claimants. Thus, the protection of the Canadian creditors harms the American creditors. Either way, a group of national creditors is hurt, and it is due to the depreciation of the U.S. dollar against the Canadian dollar.

IV. DO FOREIGN EXCHANGE LOSSES UNDERMINE THE ABSOLUTE PRIORITY RULE?

In addition to the broad public policy issues, foreign exchange fluctuations have the potential to create an issue concerning a fundamental bedrock principle of bankruptcy law—the "absolute priority rule." The absolute priority

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140. 4 COLLIER ON BANKRUPTCY ¶ 502.03[3][a], at 502-26.1 (15th ed. rev. 2007).

141. The justification for such an order is arguably based on *In re Oil Spill by the Amoco Cadiz off the Coast of France on Mar. 16, 1978*, 954 F.2d 1279, 1328 (7th Cir. 1992). The court observed:

> Judgment in a foreign currency is especially attractive when the commercial activity took place in that currency. Parties that conduct their dealings in francs, rubles, pesos, yuan, bolivars, or australs either accept the risk of changes in the value of that currency or have made provisions to hedge against that risk. Computing an award in cruzeiros and then converting to dollars creates a risk that the parties did not accept—the risk that the judge will select an inapt date or use a currency no one had included in hedging plans. Fights over conversion dates are inevitable whenever judges enter dollar awards to redress injuries denominated in other currencies. Thus the English rule should be used in the United States too—not because the choice-of-law provision in this contract requires it, but because it is the right rule for commerce. The court should enter the judgment in the currency the parties themselves selected for their dealings, the currency in which the loss is felt. All problems about conversion dates vanish, and the parties' hedging strategies (or lack thereof) proceed unimpeded.

Id. (citations omitted).

142. *See supra* Part II.B.2.

rule requires that "each member of a senior class of claims or interests must receive full compensation before members of a junior class could receive anything."[143] The effect of the rule is that, absent agreement, all creditors must be paid in full before any equity holder receives anything in a Chapter 11 reorganization (because creditors are senior to equity holders).[144]

With this in mind, a variation of Hypothetical Two raises an issue concerning the absolute priority rule. The facts of Hypothetical Two remain the same,[145] except for the following. Suppose Debtor, Inc.'s insolvency was caused by the tortious conduct of a competitor and the debtor-in-possession sues the competitor. Suppose the lawsuit is successful and the recovery permits full payment of all creditor claims in addition to providing some compensation for equity holders.

As of the petition date (June 30, 2004), the Canadian claimants held 5,000,000 Canadian dollars of unsecured claims, which were allowed in the amount of 3,750,000 U.S. dollars. On the effective date of the plan (September 28, 2007), they are paid the full amount of their claims—3,750,000 U.S. dollars. However, when they convert back to their home currency at the current exchange rate, they only receive 3,750,000 Canadian dollars rather than the 5,000,000 Canadian dollars that was the amount of their claim. The Canadian claimants' injury is compounded by the fact that Debtor, Inc.'s equity holders have received something, even though the Canadian claimants have not received a full recovery in their home currency. Is this a violation of the absolute priority rule? It may not be if the issue is weighed purely in U.S. dollar terms. However, it would certainly be understandable if the Canadians argued that a violation had occurred.

Such an argument was raised in *In re Garcìa Avila*.[146] The representative of Mexican debtors commenced an ancillary case under the repealed § 304 seeking an injunction of collection efforts in New York by a group of American creditors.[147] The creditors were institutional holders of bonds issued by the

143. WILLIAM D. WARREN & DANIEL J. BUSSEL, BANKRUPTCY 772 (7th ed. 2006). Section 1129(b)(1) provides that a debtor may "cram down" a reorganization plan over the objection of a creditor "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1) (2006). "The principles underpinning Section 1129(b)'s 'fair and equitable' requirement are rooted in the judicially created absolute priority rule." *In re* Armstrong World Ind., Inc., 320 B.R. 523, 532 (Bankr. D. Del. 2005); *see also* BARRY E. ADLER, DOUGLAS G. BAIRD & THOMAS H. JACKSON, BANKRUPTCY 520 (4th ed. 2007) (describing the absolute priority rule as "the bedrock of Chapter 11").

144. WARREN & BUSSEL, *supra* note 143, at 772. "The absolute priority rule requires that certain classes of claimants be paid in full before any member of a subordinate class is paid." *In re* Geneva Steel Co., 281 F.3d 1173, 1180 n.4 (10th Cir. 2002). "Under this rule, unsecured creditors stand ahead of investors in the receiving line and their claims must be satisfied before any investment loss is compensated." *Id.*

145. *See supra* Part II.B.2.

146. 296 B.R. 95 (Bankr. S.D.N.Y. 2003).

147. *Id.* at 99.

Mexican debtors.[148] The representative also requested that the U.S. court defer to the pending Mexican insolvency proceeding on the basis of comity.[149] The American creditors objected to the request and argued that they should not be forced to resolve their claims in the Mexican proceeding.[150] They argued that the distribution to creditors in that proceeding would violate the absolute priority rule because they would receive less than full value on their claims while equity holders would retain their equity interest.[151]

Creditors in *In re Board of Directors of Multicanal S.A.*[152] also objected to a foreign proceeding on the grounds of the absolute priority rule.[153] The debtor was an Argentinean cable company, and the objecting creditor was an American entity formed by an institutional investment manager to hold unsecured notes issued by the debtor.[154] The notes were held on behalf of institutional investors, including pension funds, charitable foundations, and universities.[155] The creditor objected to the treatment of the notes in a pending insolvency proceeding in Argentina[156] and argued that the treatment would violate the absolute priority rule because equity holders would retain a stake in the debtor.[157]

In both *In re Garcìa Avila* and *In re Multicanal*, the U.S. courts rejected the absolute priority rule objections and stated that such an objection to a § 304 proceeding is not supported by the lone fact that an American unsecured creditor may receive a smaller distribution in the foreign proceeding.[158] At the same time, however, the court in *In re Garcìa Avila* did recognize that "[i]f foreign law rendered the claim worthless, comity might be inappropriate."[159] This language would encompass a situation where a claim loses significant value due to a currency crisis.

Even though the initial round of objections based on the absolute priority rule have failed, such objections may find vitality if different kinds of unsecured creditors are involved. Both *In re Garcìa Avila* and *In re Multicanal* involved unsecured claims held by sophisticated institutional investors.[160] Such creditors are in a better position to understand the currency risks and are better able to address and allocate the risk at the outset of the transaction. But what if

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148. *Id.* at 101.
149. *Id.* at 108.
150. *Id.* at 109.
151. *Id.* at 111.
152. 314 B.R. 486 (Bankr. S.D.N.Y. 2004).
153. *Id.* at 506.
154. *Id.* at 491.
155. *Id.*
156. *Id.* at 499.
157. *Id.* at 506.
158. *In re* Garcìa Avila, 296 B.R. 95, 112 (Bankr. S.D.N.Y. 2003); *In re Multicanal*, 314 B.R. at 506.
159. *In re Garcìa Avila*, 296 B.R. at 112 n.24 (citing Finanz AG Zurich v. Banco Economico S.A., 192 F.3d 240, 250 (2d Cir. 1999)).
160. *Id.* at 101; *In re Multicanal*, 314 B.R. at 496.

the creditors are not institutional creditors? Such creditors might be in a more sympathetic position to invoke a broader reading of the "fair and equitable rule" under § 1129(b).[161] The rule may be interpreted to include the prohibition of unfair and unreasonable shifting of the risk assumed by the creditor in its original bargain with the debtor.[162] Such creditors could argue that their original bargain was made exclusively within the domestic jurisdiction with the promise that they would be paid in domestic currency. Thus, any other result would be an improper restructuring of the original bargain and its incorporated risks.

The problem is that in a Chapter 15 case with creditors from all over the world, the bankruptcy courts (and the universalists) may not just simply assume that money is money.[163] The value of the currency of payment becomes an issue, and when value is an issue:

> If a junior class receives or retains property on account of its prior claim or interest, then the value of what the dissenting senior class receives is important. If less tha[n] the allowed amount of the creditor's claim, absolute priority is violated unless no other junior class participates.[164]

A multinational bankruptcy raises numerous issues that are not present in a purely domestic bankruptcy. Chapter 15 would not exist otherwise. The introduction of new (and perhaps unanticipated) issues may require the courts to develop a more heightened awareness of these transnational issues.

V. ARE FOREIGN EXCHANGE FLUCTUATIONS A GENUINE PROBLEM IN BANKRUPTCY?

Skeptics may argue that any problems resulting from foreign exchange fluctuations are exaggerated and perhaps imaginary. Currencies constantly move up and down against each other. Yet the bankruptcy courts have not been flooded by creditors objecting to losses from currency fluctuations.[165] In

161. 11 U.S.C. § 1129(b)(1) (2006) (stating that "the court . . . shall confirm the plan . . . if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests"); *see also id.* § 1129(b)(2) (listing the requirements that make a plan "fair and equitable").

162. 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][b][C][ii], at 1129-107 (15th ed. rev. 2007).

163. The introduction of foreign creditors changes the context of the following statement from Collier: "Valuation of property received by the senior classes varies with the type of property involved. If cash is to be paid on the effective date, there is obviously no valuation problem." *Id.* ¶ 1129.04[4][a][C], at 1129-97. This statement is correct in a case where all the creditors use the same currency. In a multinational case, however, cash raises a valuation problem.

164. *Id.*

165. The author conducted a search in the Westlaw database of bankruptcy cases using the following search terms: "currenc! /s crisis collapse devalu!" No cases were located in which a creditor objected to a foreign bankruptcy proceeding because of foreign currency issues.

response to such criticism, two points should be noted. First, the problem of exchange rates is unavoidable. Second, the absence of foreign exchange problems in bankruptcy courts may be due to the fact that nations applied a territorial approach to bankruptcy prior to Chapter 15.[166] In other words, the territorial approach insulated creditors from foreign exchange issues, and the application of the Model Law will now expose creditors to these problems.

A. The Unavoidability of the Foreign Exchange Problem

Since 1973, economically advanced countries have operated under a global system of floating exchange rates.[167] Under this system, foreign exchange rates are determined by supply and demand in the foreign exchange markets, as opposed to a system where the rates are fixed at levels determined by national

However, the federal courts have seen cases involving parties hurt by severe currency fluctuations. *See, e.g.*, Deutsche Bank v. Humphrey, 272 U.S. 517 (1926) (issue arising from translation of monetary amount of claim from depreciated German marks to U.S. dollars); Hicks v. Guinness, 269 U.S. 71 (1925) (same); Allianz Versicherungs-Aktiengesellschaft Munich Reinsurance Co. v. S.S. Eskisehir, 353 F. Supp. 84, 87 (S.D.N.Y. 1972) (objection to proceeding in Turkey because judgment from Turkish court would result in a $466,000 loss due to devaluation of Turkish lira).

These cases underscore the inherent problem when claims incurred in one currency are paid in a different one. The issue of time and timing becomes crucial as the values of the currencies fluctuate against each other over time. For example, in *Humphrey*, the issue was whether the original claim for payment of German marks should be converted to U.S. dollars as of the date of the demand for payment or some other date such as the date of judgment. *Humphrey*, 272 U.S. at 517–18. This issue was crucial because the value of the mark fell significantly between the two dates. *Id.*

Because of currency fluctuation, the timing of currency conversion can be come the most important issue.

> Support may be found for at least seven different dates for converting foreign currency damages into the money of the forum: the time of making the contract, the time of breach or tort, the time of rescission, the time of commencing the suit, the time of trial, the time of judgment, and the time of collection.

Note, *Dollar Damage Awards to Foreign Plaintiffs: Conversion and Revaluation of Foreign Currencies*, 61 YALE L.J. 758, 759 n.5 (1952). A commonly accepted view is that:

> Where a breach of contract occurs in a foreign country the damages shall be reckoned in the money of that country at the date of breach and then converted into the money of the forum at the date judgment is entered; but where a contract to deliver foreign money in the country of the forum is broken, damages should be calculated in the money of the forum as of the time of breach.

Note, *Fluctuating Rates of Exchange and the Conflict of Laws*, 40 HARV. L. REV. 619, 622 (1927).

166. *See* 11 U.S.C. § 304 (2000), *repealed by* Bankruptcy Abuse Prevention and Consumer Protection Act of Apr. 20, 2005, Pub. L. 109-8, title VIII, § 802(d)(3), 119 Stat. 146.

167. Paul Krugman, *Exchange Rates*, *in* THE CONCISE ENCYCLOPEDIA OF ECONOMICS (1st ed.), http://www.econlib.org/library/Enc1/ExchangeRates.html (last visited Nov. 8, 2008). Paul Krugman is a Professor of Economics at Princeton University.

governments.[168] Thus the value of traded currencies fluctuates as long as foreign exchange markets are open.[169] The value of the traded currencies varies from trade to trade, and the change in value can be dramatic over time.[170] Because the value "floats" or changes over time, the value of a claim today in the currency of the local bankruptcy court will change over time when valued in the currency of a different country.[171]

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168. *Id.*

> A fixed, or pegged, rate is a rate the government (central bank) sets and maintains as the official exchange rate. A set price will be determined against a major world currency (usually the U.S. dollar, but also other major currencies such as the euro, the yen, or a basket of currencies). In order to maintain the local exchange rate, the central bank buys and sells its own currency on the foreign exchange market in return for the currency to which it is pegged.
>
> If, for example, it is determined that the value of a single unit of local currency is equal to USD 3.00, the central bank will have to ensure that it can supply the market with those dollars. In order to maintain the rate, the central bank must keep a high level of foreign reserves. This is a reserved amount of foreign currency held by the central bank which it can use to release (or absorb) extra funds into (or out of) the market. This ensures an appropriate money supply, appropriate fluctuations in the market (inflation/deflation), and ultimately, the exchange rate. The central bank can also adjust the official exchange rate when necessary.

Reem Heakal, *Floating and Fixed Exchange Rates*, INVESTOPEDIA, http://www.investopedia.com/articles/03/020603.asp (last visited Nov. 8, 2008).

Between 1870 and 1914, the major nations operated under a global fixed exchange rate that linked the value of their currencies to gold. *Id.* The floating versus fixed system is not an "either or" proposition. *Id.* Some countries may allow their currencies to float while other countries fix their exchange rates. *Id.*

169. Heakal, *supra* note 168.

170. *See id.*

171. *See* Ronald A. Brand, *Restructuring the U.S. Approach to Judgments on Foreign Currency Liabilities: Building on the English Experience*, 11 YALE J. INT'L L. 139 (1985). Under the old system of fixed exchange rates, currency values could remain stable over long periods. For example, from 1949 to 1966, the exchange rate between the British pound and the U.S. dollar did not change. Krugman, *supra* note 167. The exchange rate remained unchanged due to the major countries' adherence to the Bretton Woods system of fixed exchange rates, which lasted from 1946 to 1973. *Id.* Under a global fixed rate system, the concerns raised in this Article would be reduced. Fixed exchange rates, however, do not guarantee stability because:

> Fixed regimes . . . can often lead to severe financial crises since a peg is difficult to maintain in the long run. This was seen in the Mexican (1995), Asian and Russian (1997) financial crises: an attempt to maintain a high value of the local currency to the peg resulted in the currencies eventually becoming overvalued. This meant that the governments could no longer meet the demands to convert the local currency into the foreign currency at the pegged rate. With speculation and panic, investors scrambled to get out their money and convert it into foreign currency before the local currency was devalued against the peg; foreign reserve supplies eventually became depleted. In Mexico's case, the government was forced to devalue the peso by 30%. In Thailand, the government eventually had to allow the currency to float, and by the end of 1997, the bhat had lost its

This global system of floating exchange rates is the reality against which all transnational financial transactions take place,[172] including, of course, those transactions within the scope of transnational bankruptcy proceedings. Hence any transnational bankruptcy must take into account the effects of currency fluctuations, particularly when it comes to the issue of the fair treatment of creditors.

B. *The Absence (To Date) of Foreign Exchange Problems in Bankruptcy Cases*

If foreign exchange problems are unavoidable, why have U.S. bankruptcy courts not seen numerous cases presenting this problem?[173] One reason may be

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> value by 50% as the market's demand and supply readjusted the value of the local currency.

Heakal, *supra* note 168.

172. *See generally* Brand, *supra* note 171 (discussing the risks that currency fluctuations pose to transnational businesses).

173. It is beyond dispute that currency crises trigger severe economic distress. In Argentina, for example, the 2001 peso devaluation wiped out personal savings, rendered debts unserviceable, and closed businesses. *See* Howard La Franchi, *Life in Argentina's Free-Fall Economy*, THE CHRISTIAN SCI. MONITOR, Feb. 11, 2002, *available at* http://www.csmonitor.com/2002/0211/p01s03-woam.html%0A. This crisis generated litigation in U.S. bankruptcy courts (although none of them reached the stage where objections to foreign exchange treatment were raised). *See, e.g., In re* Bd. of Dir. of Telecom Arg., S.A., No. 06 Civ.2352 NRB, 2006 WL 3378687 (S.D.N.Y. Nov. 20, 2006); *In re* Compania de Alimentos Fargo, S.A., 376 B.R. 427 (Bankr. S.D.N.Y. 2007); *In re* Bd. of Dir. of Multicanal S.A., 314 B.R. 486 (Bankr. S.D.N.Y. 2004). In *In re Multicanal*, the court described the consequences of the currency crisis suffered by the debtor:

> Multicanal's restructuring can be traced to Argentina's recent economic collapse. In late 2001, following four years of economic recession, Argentina experienced 'the worst economic crisis in its history.' In November 2001, in response to a run on the Argentine banks, the government restricted access to bank deposits and instituted controls on foreign exchange. In February 2002, in further response, the Argentine government allowed the peso, which had been tied to the U.S. dollar on a one-to-one parity basis for the previous ten years, to float. Over the next four months the peso's value decreased approximately 75% relative to the U.S. dollar. Restrictions on access to U.S. dollars and the sharp devaluation of the peso made Multicanal's acquisition of programming from the United States much more expensive and hindered its ability to make interest payments on its substantial dollar-denominated debt obligations. This debt, representing substantially all of Multicanal's debt for money borrowed, includes Bank debt and five series of U.S. dollar-denominated notes (the "Notes") in an aggregate principal amount of U.S. $509 million. It also represents about 97% of Multicanal's total debt; as of December 31, 2003, trade debt represented only about 3% of Multicanal's outstanding debt . . . .On February 1, 2002, Multicanal defaulted on payments of principal and interest on certain of the Notes, and by April 2002 Multicanal had defaulted on payments due on all five series of Notes. It also defaulted on its Bank debt, which is also unsecured.

In re Multicanal, 314 B.R. at 492 (citations omitted).

that the problem is overblown and that this Article takes an unnecessarily and insupportably alarmist view of a theoretically possible but factually unlikely scenario. An alternative explanation may be that the bankruptcy courts have not seen this problem because the territorialist approach to transnational bankruptcy has been the traditional and predominant approach. One overlooked benefit to territorialism is the fact that local creditors have claims against local assets and are therefore paid in local currency.[174] Thus, the foreign exchange problem does not arise.

Even early efforts to address cross-border insolvencies implicitly acknowledged the foreign exchange problem.[175] More importantly, these early efforts also implicitly recognized that a territorial approach was necessary to avoid foreign exchange problems.[176] In the nineteenth century, a group of South American countries ratified the Treaty on International Commercial Law, which is known as the Montevideo Treaty of 1889.[177] In the middle of the twentieth century, a meeting was held to update and revise the 1889 treaty.[178] This meeting resulted in the Treaty on International Commercial Terrestrial Law and the Treaty on International Procedural Law, which became known as the Montevideo Treaties of 1940.[179] However, the Montevideo Treaties of 1940 were only ratified by Argentina, Paraguay, and Uruguay.[180]

The purpose of both sets of Treaties was to harmonize insolvency laws on a regional basis, not create a uniform substantive law for the ratifying countries.[181] Thus, in that respect, the Treaties were similar to the Model Law.[182] Also like the Model Law, the Treaties required each country to defer to the jurisdiction of the court located in the place of the debtor's commercial domicile.[183] This deference is comparable to the Model Law's recognition of a foreign main proceeding in the country where the debtor has its center of main interests.[184]

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174. *See generally* Chung, *supra* note 1, at 93 (describing territorialism).

175. *See generally* FLETCHER, supra note 27, at 273–314 (discussing the efforts of various countries, usually located in close geographic proximity to one another, to better regulate cross-border insolvencies through bilateral treaties.)

176. *Id.* at 277–78. For example, the Montevideo Treaty of 1889 provided that when a debtor has two or more commercial establishments in different countries, the courts of each country are able to retain bankruptcy proceedings in respect to each one of them. *Id.*

177. *Id.* at 276–77. This group included Argentina, Bolivia, Paraguay, Peru, and Uruguay. *Id.* at 276. Colombia acceded to the treaty in 1933. *Id.*

178. *Id.* at 276–77.

179. *Id.*

180. *Id.* at 277.

181. *Id.* at 276.

182. *See* MODEL LAW ON CROSS-BORDER INSOLVENCY pmbl. (U.N. Comm'n on Int'l Trade Law 2007) (stating the purpose and objectives of the Model Law).

183. FLETCHER, *supra* note 27, at 277 (noting that "[u]nder the principle of unity all the assets of the debtor, including those located in other states, are placed under the jurisdiction of the court of the commercial domicile by virtue of the opening there of insolvency proceedings").

184. MODEL LAW ON CROSS-BORDER INSOLVENCY pt.1, ch.1, art.20 (U.N. Comm'n on Int'l

A major difference, however, between the Model Law and the Montevideo Treaties is that the Montevideo Treaties expressly favored local creditors over foreign creditors.[185] For example, § 44 of the Montevideo Treaty of 1889 provides:

> The preferential rights of local creditors in the country in which bankruptcy has been opened, if acquired prior to its declaration, shall be respected even in the case where the property over which the preferential right can be asserted has been removed to another State in which a bankruptcy proceeding or civil action against the same bankrupt is currently in progress.[186]

Similarly, Article 20 of the Montevideo Treaty of International Procedural Law of 1940 provides:

> In the cases mentioned in Article 17, the local creditors, within a period of sixty days immediately after the last publication provided for in Article 19, may ask for insolvency proceedings against the debtor, with respect to property located in their own country. In these instances, just as in cases involving a single insolvency hearing which is held before the tribunals and according to the laws of the country of the debtor's domicile, the local creditors shall have preferential rights in regard to property located in the territory where their claims should be met.[187]

This explicit preference of local creditors over foreign creditors runs counter to one of the fundamental goals of the Model Law and Chapter 15. Section 1513(a) provides that "[f]oreign creditors have the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors."[188] Section 1513(b)(1) provides,

> Subsection (a) does not change or codify present law as to the priority of claims under section 507 or 726, except that the claim of a foreign creditor under those sections shall not be given a lower priority than that of

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Trade Law 2007) (stating the effect of a court's recognition of a foreign representative's petition for a foreign main proceeding).

185. *See* FLETCHER, *supra* note 27, at 278 (stating that bankruptcy proceedings pursuant to the Montevideo Treaties were to be conducted "without prejudice to the rights accorded to the local creditors").

186. *Id.* at 602 (unofficial translation by Professor Fletcher). At the time of the Montevideo Treaty of 1889, the bankruptcy laws of Argentina, Uruguay, Paraguay, and Peru differentiated between domestic and foreign creditors in the case of concurrent bankruptcies and granted domestic creditors a priority on the assets to be distributed in the domestic bankruptcy. *See* Nadelmann, *supra* note 28, at 69.

187. FLETCHER, *supra* note 27, at 605 (trans. by J. Irizarry y Puente and Gwladys L. Williams).

188. 11 U.S.C. § 1513(a) (2006).

general unsecured claims without priority solely because the holder of such claim is a foreign creditor.[189]

These provisions ensuring the non-discriminatory treatment of foreign creditors are a distinct feature of the Model Law and Chapter 15. As Professor Fletcher observes,

> Although the insolvency laws of many States make no overt distinction between the rights and status of domestic and foreign creditors, it is seldom the case that an express provision is included to confirm that foreign creditors enjoy full rights of participation in local proceedings on equal terms with their domestic counterparts. . . . Article 13 of the Model Law supplies the means to overcome this problem by generating an explicit provision in the law of the enacting State that foreign creditors have the same rights as local creditors regarding the commencement of, and participation in, an insolvency proceeding.[190]

Non-discriminatory treatment of foreign creditors would seem to be a desirable and necessary feature of any system intended to address transnational bankruptcies. Indeed, it seems peculiar that a multinational approach would expressly permit unequal treatment. Yet that is what the Montevideo Treaties permit.[191] This aspect of the Treaties has generated pointed criticism.[192] Professor Fletcher described the Treaties as "openly flawed by a discriminatory rule favouring local creditors."[193] He went on to observe that "[t]he reference to the exercise of rights in conformity with the local law thus becomes the basis for a perpetuation of the notorious tradition, under the laws of many Latin American states, of blatant discrimination against foreign creditors."[194]

Why would a treaty enshrine discrimination against foreign creditors?[195] Is it due to xenophobia? Is it due to irremediable provincialism?[196] The answer

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189. *Id.* § 1513(b)(1).

190. FLETCHER, *supra* note 27, at 476.

191. *See* Kurt H. Nadelmann, *Concurrent Bankruptcies and Creditor Equality in the Americas*, 96 U. PA. L. REV. 171, 180–84 (1948) (detailing the priority afforded local creditors under the Montevideo Treaties when concurrent domestic and foreign bankruptcy proceedings have been initiated) [hereinafter Nadelmann, *Concurrent Bankruptcies*].

192. *See id.* at 178–86.

193. FLETCHER, *supra* note 27, at 282.

194. *Id.*

195. The origin of both Treaties' discriminatory language is known to the following extent:

> It all started in 1857 when Eduardo Acevedo of Uruguay and Dalmacio Velez Sarsfield of Argentina included in their draft of a commercial code for the Province of Buenos Aires a provision to the effect that, when bankruptcy is declared within the country and abroad, in the domestic bankruptcy the creditors within the country shall be paid in full before creditors of the foreign bankruptcy may take part in the distributions. The provision became the law of Argentina and passed also into the law of Uruguay, Paraguay, and Peru.

Kurt H. Nadelmann, *A Report on the Montevideo Conference and Creditor Discrimination*, 100 U. PA. L. REV. 994 (1952). However, the source of the idea for the drafters is unknown. *Id.*

may be something less sinister and based on a practical reality, perhaps the reality of foreign exchange fluctuation.[197] One commentator has suggested that preference is given to local creditors to protect them from foreign exchange losses relating to a foreign insolvency proceeding.[198] The preference for local creditors would ensure that local assets would be available for their claims. The availability of local assets removes foreign exchange risk. Perhaps the Latin American countries were motivated less by ill will toward foreigners and more by the realities of currency fluctuations.

To be sure, it may be the case that the territorial approach limits the ability of creditors to maximize their returns in situations where a large part of the available assets are located in a different country. In such cases, the universalists would argue that the avoidance of foreign exchange problems is a heavy price to pay if what is lost is the ability to recover significantly more through a unified bankruptcy proceeding.[199] The universalists would argue that the creditor was cutting off its nose to spite its face. Whether this is true will, of course, depend on the facts of each individual case, and there will undoubtedly

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196. The most commonly accepted explanation seems to be that preference for local creditors is based on an explicit desire to protect local parties and that such protection is necessary because other jurisdictions protect their creditors. Kurt H. Nadelmann, *Foreign and Domestic Creditors in Bankruptcy Proceedings. Remnants of Discrimination?*, 91 U. PA. L. REV. 601, 612, 619 (1943).

197. Nadelmann, *Concurrent Bankruptcies*, *supra* note 191, at 179.

198. *Id.* at 179. Nadelmann acknowledges the argument that preference of local creditors may be needed for this reason, but immediately rejects it by asserting that the "hotchpot" rule by itself is sufficient to protect local creditors. *Id.* The "hotchpot" rule provides that:

> [A] creditor, who has recovered payment abroad and wants to prove in the domestic bankruptcy for any further claim he may have, must throw into the common fund what he has received in the foreign country. In other words, his share is calculated on the basis of an estate in which the money recovered abroad is included.

Id. at 172. Professor Fletcher, in turn, describes the "hotchpot" rule as follows:

> A creditor who seeks to participate in a process of distribution taking place under the law of a given jurisdiction must furnish a full account of any payment that has already been received in respect of the same claim in any foreign proceeding. On the basis of this disclosure, the creditor is not allowed to receive a payment of dividend after lodging proof of claim as long as the payment received by the other creditors of the same class is proportionately less than the payment the creditor has already received. By this means, *de facto* equality of treatment of creditors is maintained according to the rules of distribution followed in the jurisdiction where the Hotchpot rule is applied.

FLETCHER, *supra* note 27, at 485.

Nadelmann's argument, however, does not take into account that there will likely be a time lag, say, between the time of payment in Argentinian currency in an Argentinian proceeding and the valuation of that payment for purposes of the "hotchpot" rule in a Bolivian proceeding. What happens if the Argentinian and Bolivian currencies have fluctuated wildly against each in that time period? Thus, the "hotchpot" rule does not adequately address the foreign exchange problem.

199. *See infra* Part I.A and accompanying notes for a general description of the universalist approach.

be cases where local creditors may reap much larger benefits through a Model Law proceeding even if currency losses are sustained.

The key point, however, is that foreign exchange problems now need to be addressed due to the Model Law and Chapter 15, unlike when territorialism was the prevailing approach. Creditors are not indifferent to currencies; they do indeed care about the currency with which they are paid.[200] There has been little, if any, discussion in scholarly literature dealing with this issue, but any large Chapter 15 case will be forced to address the problem.

C. Is the Foreign Exchange Problem a Legal Problem?

Losses due to foreign exchange risk present a real-world, factual problem for creditors, but do these losses also give rise to a legal problem? In other words, does a foreign exchange loss provide the basis for a legal objection? The universalists would argue that as long as all unsecured creditors, local or foreign, receive the same pro rata distribution in the currency of the distribution, then equal treatment has been achieved because "[t]he principle of equality between identically situated creditors is fundamental under U.S. insolvency law."[201] And the universalists would argue that this principle is satisfied if all unsecured creditors receive the same percentage of recovery.[202] However, does the determination of equality end upon distribution in the home country's currency or does equality take into account losses from currency translation?

VI. THE IMPRACTICABILITY OF SOLVING THE FOREIGN EXCHANGE PROBLEM

The universalists may attempt to dismiss the foreign exchange problem by arguing that there is a quick and easy fix. They would, after all, correctly point out that multinational businesses deal with fluctuating currencies every day. The quick and easy fix would be for the bankruptcy trustee to buy futures

200. This concern over currency of payment is not just a matter of high finance for Wall Street professionals. In early 2008, the Taj Mahal stopped accepting U.S. dollars as payment for its entrance fee because of the dollar's decline in value. Michelle Higgins, *The Greenback is Losing Global Appeal*, N.Y. TIMES, Feb. 3, 2008, Travel, at 6. Some retailers in New York are attracting mainstream media attention because they recently began accepting euros as payment due to the euro's strength against the dollar. Tom Leonard, *Euros Do Nicely for New York Store Owners*, DAILY TELEGRAPH, Apr. 12, 2008, http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2008/02/08/wslump208.xml.

201. *In re* Bd. of Dir. of Multicanal S.A., 314 B.R. 486, 518–19 (Bankr. S.D.N.Y. 2004) (citing Mason v. Paradise Irrigation Dist., 326 U.S. 536, 541 (1946) and Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 219 (1941)). In determining whether to defer to a foreign insolvency proceeding, "a court must look to certain indicia of fairness, including 'whether creditors of the same class are treated equally in the distribution of assets.'" *Id.* at 519.

202. *See infra* Part I.A and accompanying notes for a general description of the universalist approach.

contracts in the foreign exchange markets to hedge against fluctuation. In a non-bankruptcy context, this solution was identified by a federal court in a case where parties objected to their awards on the grounds of foreign exchange losses.[203]

In re Oil Spill by the Amoco Cadiz generated numerous claims for damages resulting from an oil spill.[204] The court made the following observation regarding the ability to protect against foreign exchange fluctuations:

> As soon as the court announces the award, the parties may eliminate exchange risk by using the currency futures markets. For example, if PIL wants to hedge against the risk that the pound will fall against the dollar, it can buy a dollar futures contract, promising to pay in sterling. When Amoco satisfies the judgment with sterling, PIL can close its futures position and receive the dollar value of the award.[205]

The universalists would argue that this observation may be used as a roadmap by a bankruptcy trustee to protect foreign creditors. However, this solution falls significantly short of being a complete solution because, in certain instances, hedging risk is impracticable and, in others, it is impossible.

The ability to hedge does not solve the foreign exchange issue because it is impracticable. In many instances, a trustee will not know how much to hedge or which currency to hedge.[206] The following hypothetical illustrates this problem.

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203. *See In re* Oil Spill by the Amoco Cadiz off the Coast of France on Mar. 16, 1978, 954 F.2d 1279 (7th Cir. 1992).

204. *Id.* at 1288–89.

205. *Id.* at 1327.

206. In order to hedge foreign currency exposure, it is necessary to know the amount of currency to hedge and the period of time during which protection is needed. *See* PAUL BISHOP & DON DIXON, FOREIGN EXCHANGE HANDBOOK 317–24 (1992).

> In every futures contract, everything is specified: the quantity and quality of the commodity, the specific price per unit, and the date and method of delivery. The "price" of a futures contract is represented by the agreed-upon price of the underlying commodity or financial instrument that will be delivered in the future.

Futures Fundamentals: How the Market Works, INVESTOPEDIA, http://www.investopedia.com/university/futures/futures2.asp (last visited Nov. 9, 2008). An indication of the difficulties of hedging is described as follows:

> Another alternative for translation exposure hedging involves using profit or loss from foreign exchange contracts to offset a gain or loss on translation. There are, however, several possible problems. The first is that the translation exposure to be hedged is unknown at the time the contracts must be negotiated . . . . For this reason it is very difficult to achieve a zero-position hedge.

BISHOP & DIXON, *supra* note 206, at 378.

Another difficulty with forward contracts is posed by forecasting issues. For instance,

> [T]he forward price may already be part or all of the way from the current spot to where the future spot will be. Since the gain or loss on the contract depends on the difference between the forward and the future spot prices, it will be necessary to position many more units of currency in the forward contract than are exposed on translation. If this is the case,

Suppose the debtor is an American company seeking bankruptcy protection in the United States because it has been overwhelmed by tort claims from American, Canadian, and Mexican claimants. The debtor has obtained recognition of the American proceeding as the foreign main proceeding and the foreign claimants have been forced to pursue their claims in U.S. bankruptcy court.[207] The court establishes a procedure to resolve the claims. The debtor disputes liability and is confident that it can defeat some, but not all, claims. Suppose that the debtor has a viable future income stream that can be applied to the claims. How much in Canadian dollars and Mexican pesos should the trustee hedge? Will he or she need to hedge in Canadian dollars or Mexican pesos at all?

The inability to answer these questions is due to the fact that the claims are disputed. Will the court award the claimants 50% of their claimed amounts? Will half of the claimants be awarded anything? Of those who receive an award, how many will be Canadian, and how many will be Mexican? And what will be the amounts awarded to the Canadians or Mexicans? Without knowing these answers, how can the trustee hedge?[208] The problem is further compounded by the fact that there is no deadline by which the trustee must object to a claim.[209]

> then the hedge will only produce a zero outcome if the future spot turns out to be exactly as forecast. The success of the hedge depends, therefore, on forecasting (speculation) with respect to the future spot.

Id. Perhaps there are financial products, other than forward contracts, that reduce or eliminate such forecasting risk or that generally provide a more certain way to hedge. Regardless of the availability of other products, the trustee still needs to know how much to hedge and the time period to be covered.

207. 11 U.S.C. § 1509 (2006) (giving foreign representatives access to U.S. bankruptcy courts).

208. It requires expertise to know how to hedge in foreign exchange markets. *See* BISHOP & DIXON, *supra* note 206, at 329–36. Thus, a trustee will need to hire an expert, which is another administrative expense. *See id.* at 415 (extolling the benefits of outside assistance and consulting arrangements). Additionally, there is a price to pay for purchasing hedging instruments in the markets; hedging is not a cost-free exercise. *See* Douglas Cumming & Sophia Johan, *Hedge Fund Forum Shopping*, 10 U. PA. J. BUS. & EMP. L. 783, 796, 805 (2008) (describing the costs associated with hedging).

Moreover, a hypothetical involving only three countries may be oversimplified. The largest multinational businesses operate in dozens of countries. Is it practical or feasible for a trustee to hedge dozens of currencies? Moreover, creditor claims in some countries may be in the millions or billions of dollars, but claims in other countries may only be in the thousands of dollars. Does it make economic sense to hedge $100,000 in claims?

209. 4 COLLIER ON BANKRUPTCY ¶ 502.02[3][e], at 502-17 to -18 (15th ed. rev. 2007). Collier observes,

> Rule 3007 [of the Bankruptcy Rules] sets no time period within which the trustee must object to the allowance of a claim. A cutoff date would be inappropriate, for in many cases it may not be known until late in the administration of the case whether there will be any dividend and consequently, whether a useful purpose would be served by a trustee making an objection.

Suppose further that the amount available for distribution will depend on whether the trustee is able to avoid a security interest asserted by a large secured creditor. Suppose that the collateral at issue is worth millions of dollars and that the outcome of the § 544(a) challenge could significantly increase the amount available for unsecured creditors.[210] Again, the trustee would not know how much currency exposure to hedge because that amount will depend on the outcome of the avoidance litigation.[211]

There are financial products that are used every day to hedge currency risk.[212] However, it is unclear whether a bankruptcy trustee can effectively utilize these products to protect foreign creditors from currency risk.[213] In many cases, there will be a significant time lag between the filing date and the distribution date, and the duration of that period may be unknowable. Additionally, the trustee may not be in a position to know the amount to hedge, in large part because the amount may turn on the trustee's ability to prevail on claim objections, avoidance and preference actions, and the like.[214] At best, currency hedging may provide an incomplete and imperfect way to address foreign exchange risk.[215]

CONCLUSION

One of the claimed benefits of Chapter 15 is that it will simplify the administration of transnational bankruptcies.[216] "One court, one law" does seem to possess an intuitive simplicity, and simplicity (and the related notion of predictability) is what the UNCITRAL working group was trying to achieve

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Id.

210. *See* 11 U.S.C. § 544(a).

211. *See* BISHOP & DIXON, *supra* note 206, at 407–34 (explaining the various factors to be considered when deciding whether and how to hedge).

212. *See, e.g.*, PETER MOLES & NICHOLAS TERRY, THE HANDBOOK OF INTERNATIONAL FINANCIAL TERMS 270 (1999) (giving examples of hedging instruments).

213. RONALD I. MCKINNON, MONEY IN INTERNATIONAL EXCHANGE, THE CONVERTIBLE CURRENCY SYSTEM 87–88 (1979) (noting the difficulties and inherent risks of hedging).

214. *See* SAMUEL L. BUFFORD ET AL., INTERNATIONAL INSOLVENCY 96 (2001).

215. Currency hedging also raises a variety of issues concerning the involvement and competing interests of unsecured creditors in a case. Suppose a group of foreign unsecured creditors in a Chapter 15 case urged the trustee to hedge their currency exposure and agreed that any losses or gains from currency exposure would be allocated among them. It is an open issue whether the domestic creditors would agree to the hedge. Hedging costs money, and any money used to hedge would mean less available for distribution to the domestic creditors. This conflict of interests may result in the need to appoint separate committees of unsecured creditors in order to ensure adequate representation of the different creditor groups. *See* 11 U.S.C. § 1102(a)(2). Ultimately, the bankruptcy court will be called upon to resolve the dispute because any purchase of hedging instruments would likely be a use of the property of the estate other than in the ordinary course of business. *See* 11 U.S.C. § 363.

216. *See* Westbook, *Chapter 15 at Last*, *supra* note 22, at 714.

and urge upon national legislatures.[217] In order to achieve this goal, the working group did what it could to gloss over national differences.[218] As an example, the working group created its own terminology for the Model Law, so that the terminology would not be identified with any particular country.[219] However, there are limits to what a working group can do to change the world.

Insolvency law is just one small part of the global dynamic of international commerce. The effect of any attempt to adjust or tweak the insolvency issues will be limited by the much larger effects of the more important and overpowering foreign exchange issues.[220] The insolvency tail will not wag the foreign exchange dog.

Despite (or because of) the best intentions of any U.N. working group, "one court, one law" ultimately means that creditors from all over the world will assemble in one courtroom seeking repayment. Regardless of any working group's desires for harmonization and modernization, these creditors will care deeply about what they receive for their claims. They will want to know whether they will be paid and what pieces of paper will they receive. For many of them, the answers to these questions will be unsatisfactory. Even though many of them conduct their financial affairs in one currency (their local currency), their claims will be paid in a different currency. This is the result even if the original transaction creating the debt was purely local with the expectation that the repayment would be in local currency. Universalism's

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217. Block-Lieb & Halliday, *supra* note 24, at 476.

218. *Id.* at 478.

219. *Id.* at 498–99. "In addition to the obvious political advantage of avoiding identification of UNCITRAL's products with any particular legal system, this also has the juridical effect of detaching national actors, such as legislatures and judges, from standard interpretations of terms in their own legal traditions." *Id.* at 499.

220. *Id.* at 512. The overarching importance of foreign exchange issues was demonstrated by the need for, and issues surrounding, the creation of the euro. *See* EUROPEAN CENTRAL BANK, THE EUROPEAN CENTRAL BANK, THE EUROSYSTEM, THE EUROPEAN SYSTEM OF CENTRAL BANKS 5 (2006), http://www.ecb.eu/pub/html/index.en.html. The EU countries recognized that they would be unable to create a single market without a common currency. *Id.* at 8. The European Central Bank states:

> With the birth of the euro, foreign exchange transaction costs and foreign exchange risks were eliminated within the euro area. In the past, these costs and risks hindered competition across borders. Increased competition makes it more likely that available resources will be used in the most efficient way. With a single currency, investment decisions are much easier, as fluctuations in the exchange rate can no longer influence the return on investment across national borders within the euro area.

Id. at 9. In other words, if the goal is to promote and enhance international trade (which is UNCITRAL's stated mission), a common currency is essential to remove barriers. Tweaking cross-border insolvency rules is nothing more than making minor adjustments at the margins. More importantly, and as this Article has attempted to explain, attempting to internationalize insolvency law without taking into account the larger and more important fact that the world does not have a common currency may have the unintended effect of creating problems that did not exist before.

efforts to simplify matters by focusing on "one law" have the unavoidable effect of complicating matters by creating unwanted foreign exchange risk for creditors. If simplicity is the goal, whose life has been simplified?

Moreover, for a body of law that is presumably designed to address the most difficult financial circumstances, Chapter 15 is surprisingly fragile. It appears that the conditions must be "just right" for it to have viability. Foreign exchange rates must be stable in order to avoid prejudice to foreign creditors. If transnational insolvencies are created by currency crisis and collapse, Chapter 15 appears unsuited to address such situations. It is not even certain that Chapter 15 is able to deal with normal currency fluctuations. It is a curious position for a set of bankruptcy laws.