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The American Law Institute NAFTA Insolvency Project

Jay Lawrence Westbrook

Jacob S. Ziegel

SYMPOSIUM ARTICLES

THE AMERICAN LAW INSTITUTE NAFTA INSOLVENCY PROJECT

*Jay Lawrence Westbrook & Jacob S. Ziegel**

I. INTRODUCTION

As the North American continent continues to expand its free trade policies, the need for compatible approaches to insolvency proceedings has come to the forefront. The American Law Institute (ALI) Transnational Insolvency[1] Project (the Project) is one important part of the process of integrating the economies of the three countries signatory to the North American Free Trade Agreement (NAFTA).[2] It is intended to produce a framework for close cooperation, and some integration, in the management of insolvencies having effects in more than one of the NAFTA countries. The attention given the problem of bankruptcy in the privatizing economies of Eastern Europe illustrates the necessity of creating structures for management of insolvencies as part of any free-market economy. The experiences of the United States, which took 100 years to satisfy the constitutional mandate of a national bankruptcy law, and of

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* Jay Lawrence Westbrook is the Benno C. Schmidt Chair of Business Law at the University of Texas School of Law. Jacob S. Ziegel is Professor Emeritus in the Faculty of Law, University of Toronto. Westbrook is profoundly grateful to have at last a co-author whose name is later in the alphabet.

1. We use the term "insolvency" broadly to mean a condition of financial difficulty, rather than in the traditional, technical sense of "balance-sheet" or "unable-to-pay" insolvency. This broader use is increasingly common internationally, as reorganization receives greater attention in the field. It should be noted that the United States Bankruptcy Code does not require a showing of insolvency for a voluntary bankruptcy, and permits a showing of divestment by a custodian as an alternative to unable-to-pay insolvency, even in involuntary cases. 11 U.S.C. §§ 301, 303(h) (1994).

2. North American Free Trade Agreement, *done* Dec. 17, 1992, Can.-Mex.-U.S., 32 I.L.M. 296.

the European Union (EU), which has taken 25 years to propose a first step toward cooperation in insolvency matters, illustrate the difficulty of such a task.

The paradigm case for the Project is the bankruptcy of a company with headquarters in one of the NAFTA countries and with suppliers, lenders, operations, assets, employees, and stockholders in all three. That is the sort of financial, operational, and marketing integration to which the NAFTA aspires, but under present procedures such an insolvency may create a confusion of conflicting laws, parallel litigation, and overlapping jurisdictional claims. The result might be to make reorganization impossible and liquidation even more disappointing than is generally true. The ALI's objective is to promote improved harmonization in the treatment of international insolvencies among the NAFTA countries and to create procedures for coordinating administrations and achieving agreement on various legal issues.

The Project begins with three self-imposed constraints. It intends to treat primarily, if not exclusively, the insolvency of corporations and other business enterprises engaged in commercial operations, rather than individuals. The reason is that the task is sufficiently difficult if limited to a commercial context, where nothing more than money and jobs are at stake, rather than more fundamental questions about personal exemptions, discharge, domestic relations, and custody of children. Second, the Project excludes the insolvencies of nonprofit organizations and financial institutions.[3] Again, the reason is to avoid the substantial additional issues raised by the continued operation of charitable groups and of highly regulated financial industries.[4] The third constraint is that the Project

3. There are certain sectors that have not been excluded, but may not be specifically addressed, including the securities industry and railways.

4. We do appreciate that the administration of insolvent financial institutions, operating internationally, teaches important lessons equally relevant for the handling of other business insolvencies. For example, in the liquidation of Bank of Credit and Commercial International (BCCI), much delay was caused through the failure of the British and Luxembourg courts to agree on a protocol for the joint administration of the BCCI estate similar to the protocol adopted in the Maxwell Communications plc liquidation. Additional problems arose—again paralleling familiar scenarios in international insolvencies not involving financial institutions—because a substantial number of countries, including the United States, insisted on giving priority to local claims against local assets despite the fact that the funds of the BCCI conglomerate were hopelessly commingled. *See* Hal S. Scott,

will focus on measures that can be adopted without extensive legislation or formal treaty arrangements, although it is hoped that experience with the texts that the Project generates may ultimately serve as the basis for governmental action.

There are two phases to the Project. The first step has been to develop summary statements of the insolvency laws of each of the three countries, statements specially tailored to an international audience. Advisory committees have been formed in each country and reporters appointed.[5] The reporters have produced draft statements of their domestic laws.[6] Those

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Multinational Bank Insolvencies: The United States and BCCI, in CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW 733, 739-42 (Jacob S. Ziegel ed., 1994).

5. UNITED STATES—Reporter: Jay L. Westbrook, The University of Texas School of Law, Austin, Texas. Consultant: Rafael A. Porrata-Doria, Jr., Temple University School of Law, Philadelphia, Pennsylvania. Advisers: John A. Barrett, Houston, Texas; Douglass G. Boshkoff, Indiana University School of Law-Bloomington, Bloomington, Indiana; Sidney B. Brooks, United States Bankruptcy Court for the District of Colorado, Denver, Colorado; Richard F. Broude, New York, New York; Leif M. Clark, United States Bankruptcy Court for the Western District of Texas, San Antonio, Texas; Ronald DeKoven, New York, New York; Carl Felsenfeld, Fordham University School of Law, New York, New York; James L. Garrity, Jr., United States Bankruptcy Court for the Southern District of New York, New York, New York; Richard A. Gitlin, Hartford, Connecticut; Daniel M. Glosband, Boston, Massachusetts; Marjorie E. Gross, New York, New York; Dianna P. Kempe, Hamilton, Bermuda; Carolyn Dineen King, United States Court of Appeals for the Fifth Circuit, Houston, Texas; Kenneth N. Klee, Los Angeles, California; Lynn M. LoPucki, Washington University School of Law, St. Louis, Missouri; Ralph R. Mabey, Salt Lake City, Utah; Timothy E. Powers, Dallas, Texas; Harry C. Sigman, Los Angeles, California; Gerald K. Smith, Phoenix, Arizona; Deborah F. Stiles, New York, New York; Elizabeth Warren, Harvard University Law School, Cambridge, Massachusetts.

CANADA—Advisory Group Coordinator and Co-reporter: E. Bruce Leonard, Toronto, Ontario. Co-reporter: Jacob S. Ziegel, University of Toronto, Faculty of Law, Toronto, Ontario. Consultant: Richard H. McLaren, University of Western Ontario, Faculty of Law, London, Ontario. Advisers: David E. Baird, Toronto, Ontario; Albert Bohémier, Faculté de Droit, Université de Montréal, Montréal, Québec; Michael A. Fitch, Vancouver, British Columbia; Jean-Yves Fortin, Montréal, Québec; Yoine Goldstein, Montréal, Québec; J.D. Honsberger, Toronto, Ontario; Douglas I. Knowles, Vancouver, British Columbia; R. Gordon Marantz, Toronto, Ontario.

MEXICO—Chair and Co-reporter: Miguel Angel Hernandez Romo, Mexico, D.F., Mexico. Co-reporter: Carlos Sanchez-Mejorada y Valesco, Mexico, D.F., Mexico. Advisers: Roberto Martínez Guerrero, Mexico, D.F., Mexico; Dario U. Oscós Coria, Mexico, D.F., Mexico; Hector Rojas, Mexico, D.F., Mexico; Alejandro Sayago Becerril, Mexico, D.F., Mexico; José Luis Siqueiros, Mexico, D.F., Mexico. *See* AMERICAN LAW INSTITUTE, THE AMERICAN LAW INSTITUTE ANNUAL REPORTS: SEVENTY-THIRD ANNUAL MEETING, MAY 14-17, 1996, at 130-33 (1996).

6. *See* AMERICAN LAW INSTITUTE, TRANSNATIONAL INSOLVENCY PROJECT: IN-

statements are being revised and approved by the distinguished experts on each advisory committee and then subjected to close questioning by the reporters and members of the advisory committees from each of the other countries. The result intended is not merely an accurate statement of the laws and procedures in each country, but one that truly speaks to the judges, academics, and practitioners in each of the other two countries. The reporters have described both stated doctrine and common practice, so that the statements reflect the actual functioning of these insolvency laws in the commercial societies that they serve. These statements are a crucial preparation for the second phase of the project, but they also will have considerable stand-alone value, practically and academically.

The second phase of the Project will build on this commonly held body of knowledge to create a series of suggested procedures for insolvency proceedings. For example, it is expected that the Project will seek to create a system for cross-filing claims involving a common debtor, as well as a structure for an international claims facility that will permit creditors, especially small creditors, to file claims in their own languages without having to retain separate foreign counsel. Another goal is to obtain agreement on a procedure that might permit automatic or semi-automatic moratoria (stays) in all three countries when an insolvency proceeding is filed in any of them. The standing of insolvency trustees and administrators in foreign courts and progress toward common choice-of-law rules on key issues will no doubt receive careful discussion as well. Although some clarification and expansion of existing legislation may be required, particularly in Mexico, it is hoped that it will be sufficiently flexible to allow judicial discretion and the forging of creative solutions. The expectation is that a number of other agreed procedures can be adopted primarily by judicial action and by agreement of the parties involved in each case. The fact that these procedures have been recommended by panels of

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TERNATIONAL STATEMENT OF UNITED STATES BANKRUPTCY LAW (Discussion Draft, Apr. 17, 1996) [hereinafter UNITED STATES DRAFT]; AMERICAN LAW INSTITUTE, TRANSNATIONAL INSOLVENCY PROJECT: INTERNATIONAL STATEMENT OF CANADIAN BANKRUPTCY LAW (Council Draft No. 1, Nov. 26, 1996) [hereinafter CANADIAN DRAFT]; AMERICAN LAW INSTITUTE, TRANSNATIONAL INSOLVENCY PROJECT: INTERNATIONAL STATEMENT OF MEXICAN BANKRUPTCY LAW (Preliminary Draft No. 1, Sept. 11, 1996) [hereinafter MEXICAN DRAFT].

distinguished experts in each country, under the sponsorship of the ALI, should make them broadly acceptable in all three countries.

As of November 1996, drafts have been prepared from all three jurisdictions and each of the three drafts have received at least some interrogation from the other two national bodies. We hope and expect to have approval of the United States and Canadian drafts by the Spring of 1997. We may have approval of the Mexican draft by then as well, although prospective legislative developments—now abated—unavoidably delayed that draft a bit behind the other two. On that basis, we look forward to beginning the Phase II discussions in the Spring of 1997. Because Phase II represents a new departure for the ALI, it will be necessary to invent the structures by which the committees and reporters will address its issues, as well as to begin consideration of proposed procedures.

II. THE PROBLEMS TO BE SOLVED

At the core of any law-reform project is the identification of the legal obstacles that must be overcome, so much of the analysis that follows is devoted to the problems that arise from the differences in the insolvency systems in the three countries. We must also be mindful, however, of important nonlegal factors that bear upon the task.

For example, many aspects of the economic integration contemplated by the NAFTA are profoundly influenced by the differences in the size and stages of economic development of the three countries. To start with, the Gross Domestic Products (or equivalent) of the three countries in 1994 were US$6.94 trillion for the United States, US$729 billion for Mexico, and US$640 billion for Canada.[7] Differences of that magnitude obviously create significant differences in economic, legal, and financial perspectives. On the other hand, the economies of the three countries were closely lashed together even before the NAFTA was approved.

7. *See* THE WORLD ALMANAC AND BOOK OF FACTS 1997, at 134 (1996).

A. Differences in Structure and Culture

Even when we turn to legal matters, the differences are not limited to differences in legal doctrine. The three countries have substantially different legal structures and contrasting legal cultures. Most obviously, Mexico has a civil law system while Canada and the United States are predominantly common-law jurisdictions, although each of them also has a member state with a civil-law tradition.[8] On the other hand, the United States and Mexico are probably closer to each other in regarding debtors as the primary beneficiaries of insolvency law, while Canada has a greater regard for the interests of creditors. With regard to creditors secured by personal property, however, there is a more even distribution of concern, with Mexico the least friendly and Canada the most friendly. The United States is between the two on the spectrum of concern for secured creditors, but closer to Canada. The United States and Canada have very modern systems of consensual secured credit, based for the most part on article nine of the Uniform Commercial Code (U.C.C.),[9] while Mexico has a rather old-fashioned, possession-oriented system for personal property security interests.

There is also the obvious contrast between civil and common law systems, although the difference between them is not simply a matter of the role of precedent. For one thing, Mexico has a system of *jurisprudentia* that contemplates the creation of binding caselaw rules under certain circumstances.[10] More profound than the different roles of precedent may be the differing role and career path of a typical judge. In Mexico, as in many civil-law jurisdictions, judges are civil servants for whom judging is a lifetime career.[11] By contrast, most judges in Can-

8. The civil law tradition is particularly important in Canada, where for two centuries this tradition has been an integral part of Québec's struggle to retain its distinctive linguistic and cultural personality. It has also strongly influenced federal legislative policies, though less so in the insolvency area because pre-confederation Québec did not have an autonomous civilian insolvency law of its own.

9. U.C.C. §§ 9-101 to 9-507 (1994). For the Canadian aspects, see Jacob S. Ziegel, *The New Provincial Chattel Security Regimes*, 70 CAN. BAR REV. 681 (1991); *cf.* Martin Boodman & Roderick Macdonald, *How Far is Article 9 of the Uniform Commercial Code Exportable? A Return to Sources?*, 27 CAN. BUS. L.J. 249 (1996) (discussing Québec's reaction to article 9).

10. *See* MEXICAN DRAFT, *supra* note 6, at 6.

11. *See id.* at 5.

ada and the United States have been active lawyers for many years before appointment or election to the bench.[12] In the common-law jurisdictions, there is considerably more willingness to give judges broad discretion to act as circumstances warrant in a particular case, while civil lawmakers often feel a need to prescribe rules to govern judicial action. In part, this difference reflects the broader experience and greater prestige of judges in the common-law jurisdictions, and a consequent willingness to entrust them with broader discretionary powers.[13]

The judicial structures in each jurisdiction, and their interaction with the political cultures, are also very different. Mexico is a federation of states, but highly centralized.[14] Canada's provinces have considerable autonomy and federal law is primarily enforced through provincial courts,[15] but the judges of the superior courts in the provinces are appointed by the federal government.[16] Additionally, the Supreme Court of Canada is the final court of appeal from all superior courts on questions of provincial as well as federal law,[17] thus giving Canadian common law a strong doctrinal unity. The United States is again in between, with a strong system of state law and judges, but a completely separate federal court system.

In insolvency matters, all three jurisdictions have the same basic statutory structure, with state or provincial laws

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12. The judiciary in both common-law countries also includes a substantial infusion of former academics and lawyers in government service, but many of these lawyers have also had a broader experience outside the judiciary and its administration.

13. We recognize this may be an overgeneralization since some civil-law jurisdictions (such as France and Germany) also endow their judges with wide discretionary powers through the invocation of open-ended concepts of good faith, abuse of rights, and unconscionability. Nevertheless, we believe the textual comparison is valid so far as the role of judges in insolvency matters in the NAFTA jurisdictions is concerned.

14. *See* MEXICAN DRAFT, *supra* note 6, at 2.

15. *See* CANADIAN DRAFT, *supra* note 6, at 5. Some parts of federal law, but not insolvency law, are administered in the Federal Court of Canada, which has both concurrent and exclusive jurisdiction in public and private law areas subject to federal regulation.

16. *See* Constitution Act, 1867, 30 & 31 Vict., ch. 3, § 96 (U.K.) (formerly British North America Act, 1867), *reprinted in* R.S.C. 1985, App. II, No. 5, § 96 (Can.).

17. *See id.* § 101, *reprinted in* R.S.C. 1985, App. II, No. 5, § 101 (Can.); Supreme Court Act, R.S.C. 1985, ch. S-26, §§ 35-43 (Can.).

governing most questions of contract and property, but with a federal insolvency law. However, in Mexico it is usually the state courts that actually exercise the joint jurisdiction over insolvency cases that its law gives to state and federal courts.[18] In Canada, the superior provincial courts exercise insolvency jurisdiction,[19] and in the United States, the federal courts have insolvency jurisdiction exclusive of the state courts, although state court actions often play a role in the insolvency process.[20]

The three countries also differ in the degree of specialized administration of insolvency, with Mexico the least specialized and the United States the most. In Mexico, there are specialized bankruptcy courts only in Mexico City.[21] In Canada there are no bankruptcy courts as such, but in Toronto, Canada's largest city, there is a "commercial list" of judges who handle most bankruptcy matters.[22] The United States has an extensive network of specialized bankruptcy courts throughout the country as part of its federal court system.[23] Given that bankruptcy in every country is a highly technical subject, these varying degrees of specialization invariably have an effect on the elaboration of insolvency laws.

There are a host of other ways in which differing legal cultures are found in each of the NAFTA countries. A striking example is the role of formalism in Mexican procedure. Mexican law places great emphasis on the completion of formal legal steps in the proper way,. and a party can suffer a severe loss of substantive rights because of a failure to conform to the formal requirements of the law.[24] Points of procedure that a U.S. or Canadian lawyer might brush aside as immaterial can assume great importance in a Mexican proceeding. Another example is the emphasis in the United States on successful reorganization, an emphasis that is found nowhere in the stat-

18. *See* MEXICAN DRAFT, *supra* note 6, at 10.

19. *See* Bankruptcy and Insolvency Act, R.S.C. 1985, ch. B-3, § 183(1), amended by S.C. 1992, ch. 27 (Can.). The reasons for Canada's integrated court structure are historical and derive from the fact that all superior court judges appointed under the royal prerogative are part of the royal system of justice, exercising plenary powers unless otherwise provided.

20. *See* UNITED STATES DRAFT, *supra* note 6, at 14.

21. *See* MEXICAN DRAFT, *supra* note 6, at 11.

22.. *See* CANADIAN DRAFT, *supra* note 6, at 91, 92 n.148.

23. *See* UNITED STATES DRAFT, *supra* note 6, at 14-15.

24. *See* MEXICAN DRAFT, *supra* note 6, at 21.

ute but clearly animates both Congress and the bankruptcy judges.[25] It is impossible to understand the actual functioning of the U.S. bankruptcy system without appreciating that cultural imperative. Another important difference lies in the degree of judicial or governmental involvement in the administration of bankruptcy cases. Here the United States and Mexico have more in common with each other than with Canada in maintaining a close, step-by-step supervision, whereas in Canada straight commercial liquidations are primarily creditor driven with minimum judicial involvement (in many cases none), unless there are complaints about the trustee's conduct or there are appeals from the trustee's decisions.[26]

B. Differences in Substantive Law

Not surprisingly, there are also many differences in substantive law among the three NAFTA countries. Two important instances will illustrate some of the major problems: secured credit and priorities for employee and tax claims.

Although there are many differences of detail, all three countries provide reasonably effective means of securing consensual debts by mortgages or *hipotecas* on real (immovable) property.[27] As noted above, Canada and the United States have similar statutory systems of secured credit for personal property. Most of the Canadian provinces[28] have adopted Personal Property Security Acts (PPSAs) that were derived from article 9 of the U.C.C.[29] In various respects, the PPSAs are

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25. *See* UNITED STATES DRAFT, *supra* note 6, at 55-56.

26. There is, however, an important exception under the Canadian Companies' Creditors Arrangement Act, R.S.C. 1985, ch. C-36, § 11, where the courts exercise both broad control and close supervision. *See* CANADIAN DRAFT, *supra* note 6, at 85-87.

27. *See* UNITED STATES DRAFT, *supra* note 6, at 174-76; CANADIAN DRAFT, *supra* note 6, at 171-73; MEXICAN DRAFT, *supra* note 6, at 67-69.

28. Namely, all the common law provinces, with the exception of Prince Edward Island and Newfoundland.

29. *See, e.g.*, Personal Property Security Act, R.S.N.B. 1993, ch. P-7.1 (amended 1995) (Can.); Personal Property Security Act, R.S.M. 1987, ch. P35, *repealed by* Personal Property Security Act, R.S.M. 1993, ch. 14 (Can.); Personal Property Security Act, R.S.O. 1990, ch. P.10 (Can.); Personal Property Security Act, R.S.B.C. 1989, ch. 36 (amended 1990) (Can.); Personal Property Security Act, R.S.A. 1988, ch. P-4.05 (amended 1991) (Can.); Personal Property Security Act, R.S.Y.T. 1986, ch. 130 (Can.); Personal Property Security Act, S.S. 1993, ch. P-6.2 (Can.). Nova Scotia's PPSA was enacted in early 1996 but is still awaiting proclamation. Per-

improved and modernized versions of article 9 and it is likely (and certainly to be hoped) that the current revision process in the United States will bring article 9 even closer to the PPSAs as some of the Canadian innovations are adopted south of the border.[30]

On the other hand, historical and cultural factors ensure that the role of secured credit in these two countries remains distinctly different. The Canadian tradition is British and, in addition to such specific security devices as pledge, conditional sale, chattel mortgage, and the security assignment of receivables, has for more than a century recognized a "floating charge" covering the entirety of a company's assets and the appointment of a private or court-appointed receiver to take over the company when it defaults on its secured obligations. Until recently, a relatively small number of federally incorporated banks did the bulk of the commercial secured lending in Canada. They were assisted in this activity by long-standing federal provisions designed to facilitate inventory, agricultural, and fisheries forms of financing.[31] It is only very recent reforms that have brought all secured creditors under the control of a

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sonal Property Security Act, S.N.S. 1995-1996, ch. 13 (Can.). For the pre-1991 history of the article nine-style legislation in Canada, see Ziegel, *supra* note 9, at 686-99.

The new Québec Civil Code, which came into effect on January 1, 1994, borrows some features of the common law personal property security legislation in conferring general recognition on non-possessory security interests in movables, but the borrowing is incomplete and the new Québec regime is very complex. See Boodman & Macdonald, *supra* note 9, at 260-64, for an interesting attempt to rationalize the Québec approach.

30. Some of the most important differences between article 9 and the Canadian PPSAs are: (1) all the PPSA provinces have from the beginning adopted a centralized and computerized registry system for all financing statements; (2) many of the provincial registries permit electronic registrations; (3) particularly in Ontario, the collateral description requirements are much simpler than in article 9; (4) in all the acts (with the exception of Ontario's), chattel leases for a year or more are treated as deemed security interests whether or not a lease meets the normal test of a security interest; (5) a security interest can be taken in a deposit with a financial institution and normally will be picked up automatically in a wrap-around security interest covering all of a business debtor's assets—the successor to the pre-PPSA fixed and floating charge of English origin; and (6) all the acts recognize the ability of a receiver appointed by the secured creditor under the security agreement to take possession of the collateral on the debtor's default and to enforce the security agreement. This last point is another aspect of the British legacy. For further details concerning most of these differences, see Ziegel, *supra* note 9, at 700-03.

31. *See* Bank Act, S.C. 1991, ch. 46, §§ 427-436 (Can.).

statutory regime in a reorganization context.[32]

In the United States, by contrast, creditors secured by personal property were long regarded with suspicion and have long been forced to share the suffering of other creditors in reorganization proceedings.[33] Article 9, now in effect in every state including Louisiana, a civil-law jurisdiction, imposes a fairly broad publicity requirement through registration,[34] and the Bankruptcy Code provides substantial incentives for prompt and accurate registration.[35]

As noted, Mexico has an old-fashioned system of secured credit as to personal property. Although there are devices for obtaining non-possessory security interests,[36] the system is oriented fundamentally to possessory security interests. The Mexican law provides a system of registration to protect certain security interests against third parties,[37] but the formalities and requirements vary from one category to another. The National Law Center for Inter-American Free Trade in Tucson is currently working on a project to assist Mexico in adapting an article 9 system to its needs, but no legislation has yet been adopted.[38]

Among other consequences, these considerable differences will make choice-of-law questions relating to security interests very important in a trans-NAFTA insolvency. For example, it has been proposed in the United States to change the current U.C.C. section 9-103 to make the debtor's "location," rather than the situs of the collateral, the proper place to file a financing statement for virtually all kinds of non-possessory security interests in collateral, tangible as well as intangible.[39] Thus all article 9 filings for a company incorporated in Delaware (under the current draft) would be made in that land

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32. *See* CANADIAN DRAFT, *supra* note 6, at 6; Jacob S. Ziegel, *Canada's Phased-In Bankruptcy Law Reform*, 70 AM. BANKR. L.J. 383, 390-91 (1996).

33. *See* UNITED STATES DRAFT, *supra* note 6, at 60.

34. U.C.C. § 9-302 (1994).

35. 11 U.S.C. §§ 544, 547(b)-(c) (1994).

36. *See* MEXICAN DRAFT, *supra* note 6, at 55-81.

37. *See id.* at 62 n.229, 67-68.

38. The initiative is a project of the National Law Center in Tucson, Arizona, under the leadership of Professor Boris Kozolchyk. Its principal consultant is a leading Canadian scholar, Professor R.C.C. Cuming of the University of Saskatchewan.

39. *See* U.C.C. §§ 9-301, 9-307 (Tentative Draft Feb. 1997); U.C.C. §§ 9-301, 9-307 (Tentative Draft Oct. 1996).

of file drawers, including filings relating to drill presses in a Vancouver factory and to trade fixtures in a Mexico City outlet store. The extent to which insolvency proceedings in the three countries would or would not recognize that choice-of-law rule would affect profoundly the possibilities of cooperation among them.

Aside from the place of registration, the conflicts rule for security interests will determine method of perfection and scope of security interest. In our example, if certain collateral physically located in Mexico requires possession for perfection, but filing is acceptable in Ontario, the same sorts of problems will arise. And do not even speak to us about a lease that might be considered a security interest![40]

A second area of difficulty is found in the payment priorities given in each country to employee and tax claims. In Mexico, employee claims trump even secured interests.[41] In all three jurisdictions, employee claims raise serious questions about nondiscrimination ("national treatment") for priority claims of all sorts.[42] For example, picture a U.S. debtor with employees in Canada and Mexico, as well as the United States. Will the Canadian and Mexican employees enjoy the same priority as the U.S. employees?[43] The territorial approach to transnational bankruptcy has until now obscured this issue, but it will become increasingly important as cooperation is achieved in such cases.

The problem is even more serious in the case of tax priorities. In most jurisdictions, the rule has been that foreign tax claims are not enforceable at all,[44] much less given the same priority as the local revenuers. If the exemplary U.S. debtor owed taxes in Ontario, would the Canadian tax authorities consent to any cooperative arrangement that gave them less than full priority in the distribution of the proceeds of the Canadian property? If the Canadian property was insufficient

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40. *See, e.g.*, Compliance Marine, Inc. v. Campbell (*In re* Merritt Dredging Co.), 839 F.2d 203 (4th Cir. 1988).

41. *See* MEXICAN DRAFT, *supra* note 6, at 26-27.

42. *See generally* Jay L. Westbrook, *Universal Participation in Transnational Bankruptcies*, *in* INTERNATIONAL AND COMPARATIVE COMMERCIAL LAW: ESSAYS IN HONOUR OF ROY GOODE (Ross Cranston ed., forthcoming 1997).

43. *See* 11 U.S.C. § 507(a)(3)-(4) (1994).

44. *See* UNITED STATES DRAFT, *supra* note 6, at 114. *But see* QUÉBEC CIVIL CODE art. 3162 (Can.) (recognizing foreign tax claims on a reciprocity basis).

to pay the tax claims and the Canadian revenue authorities made a claim in the U.S. proceeding, would the court recognize the claim at all? What are the chances the U.S. court would give the Canadian claim the same status as an Internal Revenue Service claim? These are serious questions without clear answers. Further complications arise where, as is true in Canada, tax legislation creates a deemed trust or imposes a superpriority lien on the debtor's property for unremitted taxes.[45] Would a U.S. court recognize these provisions if some of the encumbered assets were subsequently removed to the United States?

It is hard to imagine that any scheme of international cooperation can succeed if it is seriously offensive to labor unions or the revenue authorities in the cooperating jurisdictions, so these problems will require solution if the Project is to achieve its goals.

III. BALANCING UNIVERSALISM AND TERRITORIALITY

A critical challenge facing the ALI project is how to reconcile the competing values of universalism and territoriality with respect to the recognition of insolvency proceedings among the NAFTA partners. The universalist theory, it will be recalled, argues strongly in favor of recognizing proceedings initiated in the jurisdiction which has the closest, or at least a close, connection with the debtor corporation.[46] The territorialist approach, on the other hand, allows each state to administer the assets in its territory with little regard to what is happening elsewhere. Few would deny that the universalist approach is much more equitable, and more compatible with the NAFTA goals. The ability to apply a single bankruptcy system, regardless of where the debtor's assets and creditors are located, is *probably* indispensable for the successful completion of a business reorganization.[47] Nevertheless, as recent

45. *See, e.g.*, Income Tax Act, R.S.C. 1985 (5th Supp.), ch. 1, as amended, § 224(1)-(2), 227(4)-(5) (Can.); Bankruptcy and Insolvency Act, R.S.C. 1985, ch. B-3, § 67(2)-(3), as amended by S.C. 1992, ch. 27 (Can.); *see also* Jacob S. Ziegel, *Secured Transactions in Personal Property and the Federal-Provincial Conflict in Canadian Bankruptcy Law*, 46 S.C. L. REV. 877, 882-90 (1995).

46. *See* Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 469-71 (1991).

47. We recognize that there are some recent reorganizations which appear to

European developments involving the Istanbul Convention[48] and the draft EU Convention[49] show, the territorialist philosophy continues to hold a powerful grip and will not be easy to loosen in the NAFTA context.

This becomes clear when we consider the current position of each of the three NAFTA partners. Only the United States, in section 304 of the Bankruptcy Code, explicitly accepts the principle of universality.[50] Even there, it is hedged about with so many safeguards in favor of U.S. creditors that it is not difficult for a skeptical bankruptcy judge to thwart a section 304 petition.[51] It is more accurate, therefore, to characterize section 304, as does the ALI U.S. report, as incorporating only a modified form of universalism.[52]

Canadian law, too, as heir to 19th century British precedents, claims to adhere to a modified universalism. However, the claim must be accepted cautiously, given the remarkably unsettled state of the Canadian jurisprudence, especially with respect to the recognition of U.S. reorganization proceedings[53]

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contradict this claim; for example, the Maxwell Communications plc and the Olympia & York Developments Ltd. reorganizations. However, although both cases were reorganizations from a procedural perspective, they had the effect of liquidating the debtor's assets, although the subsidiaries were for the most part sold on a going-concern basis. The same is true of another still more recent Canadian-U.S. reorganization involving the company Everfresh Beverages. *In re* Proposal of Everfresh Beverages, Inc., No. 32-077978, 1995 Ont. C. J. LEXIS 4572 (Ont. Gen. Div. Dec. 20, 1995) (endorsement of order) (Farley, J.); *In re* Everfresh Beverages, Inc., Ch. 11 Case Nos. 95 B 45405, 95 B 45406 (Bankr. S.D.N.Y. Dec. 20, 1995) (order approving the stipulation regarding cross-border insolvency Protocol).

48. European Convention on Certain International Aspects of Bankruptcy, June 5, 1990, arts. 16-28, Europ. T.S. No. 136, at 13-16 (provisions relating to secondary bankruptcies).

49. European Union Convention on Insolvency Proceedings, Nov. 23, 1995, arts. 27-38, 35 I.L.M. 1223, 1231-33 (provisions relating to secondary bankruptcies). *See generally* Ian F. Fletcher, *The European Union Convention on Insolvency Proceedings: An Overview and Comment, with U.S. Interest in Mind*, 23 BROOK. J. INT'L L. 25 (1997); Manfred Balz, *The European Union Convention on Insolvency Proceedings*, 70 AM. BANKR. L.J. 485 (1996).

50. 11 U.S.C. § 304(a) (1994).

51. *See, e.g.*, Koreag, Controle et Revision S.A. v. Refco F/X Assocs. (*In re* Koreag, Controle et Revision S.A.), 961 F.2d 341 (2d Cir. 1992) (use of constructive trust device to give U.S. asset to U.S. creditor); Interpool, Ltd. v. Certain Freights of the M/V Venture Star, 102 B.R. 373 (D.N.J. 1988) (refusal to defer to Australian bankruptcy because of difference in Australian law); *In re* Papeleras Reunidas S.A., 92 B.R. 584 (Bankr. E.D.N.Y. 1988); *In re* Toga Mfg., Ltd., 28 B.R. 165 (Bankr. E.D. Mich. 1983). *See generally* Douglass G. Boshkoff, *Some Gloomy Thoughts Concerning Cross-border Insolvencies*, 72 WASH. U. L.Q. 931 (1994).

52. UNITED STATES DRAFT, *supra* note 6, at 108-09.

53. *See* CANADIAN DRAFT, *supra* note 6, at 125-53. With respect to recognition

and the many exceptions to the principle of recognition.[54] The international insolvency provisions in the bankruptcy amendment bill currently before the Canadian Parliament[55] only modestly removes the existing hurdles while leaving others untouched. Part XIII of Bill C-5 clearly gives the foreign representative status before a Canadian court to seek the court's assistance—to impose a stay against hostile proceedings against the debtor and its assets and to collect the assets and administer the estate, to give the more important examples—and also allows the representative to commence secondary insolvency proceedings in Canada. On the other hand, Part XIII is pointedly silent in dealing with the representative's entitlement to remove assets out of Canada, does not prohibit secondary proceedings in Canada after insolvency proceedings have begun in the jurisdiction of the debtor's principal place of jurisdiction, and does not recognize a debtor in possession under Chapter 11 of the U.S. Code as satisfying the definitional requirement of a "foreign representative" in Part XIII.[56]

Of the three NAFTA countries, Mexico still adheres most closely to the territorialist school, although as non-Mexican academics we are ill-positioned to express any but the most circumspect views on the Mexican law. The draft Mexican ALI report[57] tells us that the Mexican bankruptcy code only contains two articles dealing with international bankruptcies[58] and apparently there is very little, if any, jurisprudence interpreting either of them. It seems clear, however, that a foreign insolvency is not entitled to recognition per se in Mexico. Like-

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of foreign insolvency proceedings in Québec, see *id.* at 141-44.

54. *See id.* at 128-37.

55. An Act to Amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act and the Income Tax Act, Bill C-5, 2d Sess., 35th Parl., pt. XIII, §§ 268-275 (Mar. 4, 1996) (Can.), *reprinted in* CANADIAN DRAFT, *supra* note 6, at 186-89. Bill C-5 was given final Parliamentary approval on April 15, 1997. *See Status of House Business: Government Bills (No. 8)* (visited Apr. 29, 1997) <http://www.parl.gc.ca/status/status1-e.html>.

56. *See* CANADIAN DRAFT, *supra* note 6, at 150-53; Ziegel, *supra* note 32, at 410-15.

57. MEXICAN DRAFT, *supra* note 6, at 43-44.

58. Ley de Quiebras y Suspensión de Pagos [Law of Bankruptcy and Suspension of Payments], arts. 13-14, *translated in* 1 COMMERCIAL & INVESTMENT LAW: LATIN AMERICA, doc. 7.1, at 7.1-5 (Andrea Bonime-Blanc ed., 1996); *see* MEXICAN DRAFT, *supra* note 6, at 44.

wise, a liquidation of the Mexican-based assets by the foreign representative will be governed by the Mexican bankruptcy code including, we assume, its provisions concerning the ranking of creditors and the distribution of the proceeds.

Can three such seemingly divergent national approaches be reconciled? We believe they can, although, to be sure, it will require considerable patience, ingenuity, and a building-block approach.

Despite the cautiousness of Bill C-5, recent Canadian judgments have shown a strong commitment to international comity[59] and a willingness to cooperate with U.S. bankruptcy courts where insolvency proceedings are pending in both jurisdictions.[60] We also believe there is a better than even chance that, given the opportunity, the Supreme Court of Canada will dismantle some of the most objectionable judicially created barriers of an earlier age.

Similarly, notwithstanding the temptations to parochialism in section 304, courts in the United States have quite frequently cooperated with foreign insolvency proceedings.[61]

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59. *See* De Savoye v. Morguard Invs. Ltd. [1990] 3 S.C.R. 1077 (Can.); *Re* Olympia & York Devs. Ltd. [1996] 29 O.R. (3d) 626 (Can.) (Blair, J.); *In re* Antwerp Bulkcarriers N.V. [1996] I.C.R. 96 (Super. Ct. Bankr., Montreal June 28, 1996) (Can.) (Guthrie, J.); *see* CANADIAN DRAFT, *supra* note 6, at 93-94.

60. *See* CANADIAN DRAFT, *supra* note 6, at 104 n.194, 107 n.205.

61. *See, e.g., In re* Maxwell Communications Corp., Ch. 11 Case No. 91 B 15741 (Bankr. S.D.N.Y. Jan. 15, 1992) (Brozman, J.) (order appointing examiner); *In re* Maxwell Communications Corp., Ch. 11 Case No. 91 B 15741 (Bankr. S.D.N.Y. July 14, 1993) (Brozman, J.) (order confirming plan); *In re* Brierley, 145 B.R. 151, 164 (Bankr. S.D.N.Y. 1992) (decision in related case describing cooperation in Maxwell Communications case); *In re* Axona Int'l Credit & Commerce Ltd., 88 B.R. 597 (Bankr. S.D.N.Y. 1988) (avoiding transfers to United States creditors and returning proceeds to Hong Kong primary proceeding for distribution), *aff'd*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991); *In re* Ocana, 151 B.R. 670 (S.D.N.Y. 1993); *In re* Rubin, 160 B.R. 269 (Bankr. S.D.N.Y. 1993); *In re* Culmer, 25 B.R. 621, 629 (Bankr. S.D.N.Y. 1982); *see also* Philadelphia Gear Corp. v. Philadelphia Gear de Mexico S.A., 44 F.3d 187, 193-94 (3d Cir. 1994) (district court must consider staying a suit over Mexican joint venture upon request of Mexican court where joint venture company's bankruptcy is pending); Blanco v. Banco Industrial de Venezuela S.A., 997 F.2d 974 (2d Cir. 1993) (forum non conveniens deferral to Venezuelan insolvency proceeding, although with certain conditions); Allstate Ins. Co. v. Hughes, 174 B.R. 884, 891 (S.D.N.Y. 1994) (enforcing limitation on arbitration and collection rights pursuant to U.K. scheme of arrangement); Pravin Banker Assocs. v. Banco Popular del Peru, 165 B.R. 379 (S.D.N.Y. 1994) (delay of United States suit in deference to Peruvian insolvency proceeding); Carnival Cruise Lines, Inc. v. Oy Wartsila A.B., 159 B.R. 984 (S.D. Fla. 1993) (United States suit against bankrupt Finnish boat company dismissed,

Reaching consensus with our Mexican friends may prove more complex and may not be possible without some amendments to the Mexican bankruptcy code. Nevertheless, NAFTA has created such a powerful impetus, and such favorable trade winds are blowing across the American continent, north and south, that we are cautiously optimistic about the outcome there as well.

IV. ROLE OF JUDGES

It must be emphasized that no reform project in this area will succeed unless it is accompanied by efforts to help judges become comfortable with the judges and laws in the other two jurisdictions. The international statements produced by the Project should help in that regard, by giving the bench authoritative descriptions of foreign insolvency laws approved by leading experts in the countries concerned and designed to "speak" to knowledgeable lawyers in the judges' own countries. The participation of judges in the Project will itself contribute to their knowledge of foreign law.

Beyond these effects, however, it will be important for judges to be exposed to these materials in conferences and symposia and to have an opportunity to meet and talk with their counterparts in the other NAFTA countries. For several years, the International Association of Insolvency Practitioners (INSOL) has conducted transnational judicial colloquia that bring together interested judges from all over the world. INSOL's approach can serve as a model for the kind of education and communication process that will be essential to success in the NAFTA project.

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forum non conveniens, without a § 304 filing); *In re* Spanish Cay Co., 161 B.R. 715 (Bankr. S.D. Fla. 1993) (deference to Bahamian bankruptcy proceeding); Victrix S.S. Co. S.A. v. Salen Dry Cargo A.B., 825 F.2d 709 (2d Cir. 1987); Cunard S.S. Co. v. Salen Reefer Servs. A.B., 773 F.2d 452, 458 (2d Cir. 1985); Caddel v. Clairton Corp., 105 B.R. 366 (Bankr. N.D. Tex. 1989); *In re* Gercke, 122 B.R. 621 (Bankr. D.D.C. 1991). *See generally* Evan D. Flaschen & Timothy B. DeSieno, *Section 304 and Related Provisions—United States Treatment of Foreign Insolvencies*, 1990 ANN. SURV. BANKR. L. 369; Evan D. Flaschen, *Section 304 and Related Provisions—United States Treatment of Foreign Insolvencies*, 1989 ANN. SURV. BANKR. L. 259; Stefan A. Riesenfeld, *Transnational Bankruptcies in the Late Eighties: A Tale of Evolution and Atavism*, *in* COMPARATIVE AND PRIVATE INTERNATIONAL LAW 409 (David S. Clark ed., 1990); Richard A. Gitlin & Evan D. Flaschen, *The International Void in the Law of Multinational Bankruptcies*, 42 BUS. LAW. 307 (1987).

V. CONCLUSION

It seems clear that regional agreements may be the best first step in solving many of the problems of legal harmonization and cooperation coincident to the globalization of trade and investment. The NAFTA countries represent one of the largest trade areas in the world. The ALI initiative is an innovative approach to private-sector law reform that may have an important impact on the evolution of transnational bankruptcy law and on the development of international law in many other fields as well.