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SYMPOSIUM ARTICLES

CLAIMS AND PRIORITIES IN ANCILLARY PROCEEDINGS UNDER SECTION 304

*Daniel M. Glosband and Christopher T. Katucki**

I. INTRODUCTION

Resolution and, optimistically, payment of creditor claims is the *sine qua non* of bankruptcy proceedings in all countries. Particular claims, however, might fare differently under the insolvency laws of different countries. When the assets and creditors of a debtor are scattered around the globe, a bankruptcy in any venue will likely create conflicts about the proper treatment of claims. Each country which houses assets may be patriotically inclined toward local creditors at the expense of a single reorganization proceeding administered by the courts of the debtor's domicile. Conversely, bankruptcy administration in one central forum can result in hardship to foreign creditors through geographical inconvenience and the application of unfamiliar foreign insolvency laws.

Since the dawn of transnational commerce, courts and commentators have struggled with the tension between protecting local claims in local bankruptcy proceedings and promoting international cooperation by ceding control of local assets to a foreign trustee.¹

Cultivation of a contemporary United States philosophy for the treatment of claims, local and foreign, secured and unsecured, in a multinational bankruptcy began with the enact-

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1. See, e.g., Goldie, *The Challenge of Transnational Expectations and the Recognition of Foreign Bankruptcy Decrees — The United States Adjustment*, 1987 BRIT. Y.B. INT'L L. 303, 303-04 [hereinafter Goldie]; Lowell, *Conflict of Laws as Applied to Assignments for Creditors*, 1 HARV. L. REV. 259, 264 (1888).

ment of section 304 of the Bankruptcy Code.² While reported decisions under or related to section 304 are neither uniform nor conclusive, they illuminate a gentle swing of the United States pendulum toward respect for foreign proceedings, steadied by a concern for protection of local claims.

II. UNITED STATES TREATMENT OF DOMESTIC CLAIMS

In domestic bankruptcy proceedings under the United States Bankruptcy Code, claims are divided into three general categories — secured, priority, and unsecured.³

Secured claims are those for which the claimant has obtained a lien on all or part of the debtor's property. Liens include consensual liens such as security interests and mortgages as well as liens and attachments obtained by court proceedings.⁴ Unsecured claims are general obligations of the debtor.

A secured creditor is entitled to be paid to the extent of the value of its collateral.⁵ If the value of the collateral is greater than the claim, the secured creditor will be paid in full and any surplus will be available for unsecured creditors. If the value of the collateral is less than the claim, any portion of the claim in excess of the value of the security will be considered an unsecured claim for purposes of distribution from any unencumbered assets.

If there are assets which are not subject to or are not completely encumbered by a lien, then certain unsecured claims are entitled to payment from such assets before the claims of general creditors. Denominated "priorities" or "priority claims," these are ennobled rights to payment that embody Congress' view of public policy favoring certain types of unsecured claims over others. Priority claims include, for example: (1) administrative expenses; (2) prepetition wage and employee benefit claims to the extent of \$2,000 per individual; (3) claims by farmers against bankrupt grain elevator operators and by fishermen who sell fish to a doomed fish storage or processing facility, up to

2. 11 U.S.C. § 304 (1988).

3. See generally R. GITLIN & R. MEARS, 2 INTERNATIONAL LOAN WORKOUTS AND BANKRUPTCIES ch. 17 (1989) [hereinafter R. GITLIN & R. MEARS]; G. TREISTER *et al.*, FUNDAMENTALS OF BANKRUPTCY LAW ch. 6 (2d ed. 1988); S. Lowe, *INSOL '85: International Insolvency Conference*, ch. 7 (1985). See 11 U.S.C. § 101(4) (1988) (definition of claim).

4. 11 U.S.C. §§ 101(35)-(38) (1988).

5. 11 U.S.C. § 506(a) (1988).

\$2,000 for each farmer or fisherman; (4) consumer deposit claims, up to \$900 per claimant; and (5) unsecured claims for specified taxes.⁶ Administrative expenses are the costs and expenses of operating the debtor in bankruptcy proceedings and include "actual, necessary costs and expenses of preserving the estate,"⁷ such as wages, rent, taxes, and the fees and expenses of attorneys, accountants, and other professionals hired by the debtor, trustee, and creditors' committee. General unsecured claims are paid from any assets which remain after priority claims are fully satisfied.⁸

In a liquidation proceeding under chapter 7 of the Bankruptcy Code, a trustee collects and liquidates the assets of the debtor and distributes the proceeds in accordance with the priority scheme outlined above. Secured creditors are paid first to the extent of the value of their collateral, followed by costs of administration and lower ranking priority claims. If funds remain, unsecured claims are paid pro rata, in proportion to the amount of their claim.⁹

In a chapter 11 reorganization proceeding, a party in interest proposes a plan for the reorganization of the debtor's financial affairs which specifies the proposed treatment of claims of creditors.¹⁰ While the plan must divide claims into homogeneous classes,¹¹ each secured creditor is typically in its own class unless its claim is part of a bond or trust indenture. Unless they consent to other treatment, holders of priority claims must be offered payment in full before a reorganization plan can be confirmed by the court.

Each class of creditors votes on a reorganization plan and must accept the plan by a majority of voting class members representing two-thirds in amount of class debt.¹² If one or more classes of claims which are impaired under the plan does not vote favorably, the court can confirm the plan over the wishes of a dissenting class if the plan protects the rights of a dissenting secured creditor class to the value of its collateral and is "fair

6. 11 U.S.C. § 507 (1988).

7. 11 U.S.C. § 503(b)(1)(A) (1988).

8. 11 U.S.C. § 726 (1988).

9. 11 U.S.C. § 726(b) (1988).

10. See 11 U.S.C. § 1123 (1988).

11. 11 U.S.C. § 1122 (1988).

12. 11 U.S.C. § 1126 (1988).

and equitable" to a dissenting class of unsecured creditors.¹³ To be "fair and equitable" the plan must honor an "absolute priority" rule similar to the distribution scheme for chapter 7 cases. That is, no class of claims junior in priority to a nonassenting, impaired class may receive any distribution under the plan until the nonassenting, impaired class has been paid in full.

Thus, in both chapter 7 and chapter 11 proceedings, United States law provides well-defined treatment of claims. Secured claims are satisfied to the extent of the value of collateral. Priority claims feed on remaining assets and unsecured claims share the leftovers.¹⁴

III. PHILOSOPHY OF TRANSNATIONAL BANKRUPTCY

Bankruptcy proceedings of a multinational debtor add a refractive layer of issues to the consideration of claims. Assets and creditors may be located in countries which have different laws regarding the avoidance of preferential or fraudulent transfers to creditors, the recognition of certain types of liens, priority accorded certain unsecured claims, or the recognition of foreign bankruptcy proceedings or foreign creditors.¹⁵ Within this kaleidoscope, the general theories of universality and territoriality have emerged as competitive philosophies for the administration of a multinational debtor and therefore for the treatment of claims against a multinational debtor.¹⁶

The doctrine of territoriality, or pluralism, follows the strict rule of sovereignty that the authority of one state, including its bankruptcy laws and proceedings, should be confined to the territory of that state. Under this theory, each nation conducts its own bankruptcy proceeding with respect to the assets located in its jurisdiction and ignores any foreign administration of the debtor. Territoriality has the advantage of producing results that are predictable and that preserve the integrity of the local system. Local laws and policies regarding the recognition and

13. 11 U.S.C. § 1129(b)(1) (1988).

14. R. GITLIN & R. MEARS, *supra* note 3, at 634.

15. Riesenfeld, *The Status of Foreign Administrators of Insolvent Estates: A Comparative Study*, 24 AM. J. COMP. L. 288, 289 (1976).

16. See generally E. SCOLES & P. HAY, CONFLICT OF LAWS § 23.16 (1982) [hereinafter E. SCOLES & P. HAY]; Goldie, *supra* note 1, at 304. Gitlin & Flaschen, *The International Void in the Law of Multinational Bankruptcies*, 42 BUS. LAW. 307 (1987) [hereinafter Gitlin & Flaschen]; Honsberger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W. RES. L. REV. 631 (1980) [hereinafter Honsberger].

treatment of claims, liens, and priorities are applied.

Territoriality not only sacrifices international cooperation but also necessitates the cost and inefficiency of a full bankruptcy proceeding in each country that houses assets.¹⁷ As a result, the reorganization of a multinational corporation may require the simultaneous management of several reorganization proceedings on different continents.¹⁸

Application of the territoriality theory may also result in the unfair or uneven treatment of creditors. Claims in one jurisdiction may receive a greater distribution because of the fortuitous presence of more assets within that jurisdiction.¹⁹ This system also encourages a race to the courthouse of countries housing assets, with the swifter creditors attaching assets of the debtor in countries where bankruptcy proceedings have not yet commenced²⁰ even though such attachments would not be tolerated in *any* country where a bankruptcy petition had been filed.²¹

Under the doctrine of universality, a single bankruptcy case of a multinational debtor is commenced in the country of its domicile or principal office. All assets of the debtor are administered in and all creditors submit claims to that jurisdiction. All claims are resolved and all distributions to creditors are made from a unified estate, with the result that creditors are treated uniformly. The fiduciary for the estate may use courts in other countries as auxiliaries to recover assets and obtain other appropriate relief in connection with the general administration of the case. The shortcomings of universality lie in the loss of local control over local assets and the creation of inconvenience and hardship for creditors in foreign states. Creditors may be forced to proceed under a foreign system of bankruptcy in a country which has no connection to the transaction giving rise to the

17. Boshkoff, *United States Judicial Assistance in Cross Border Insolvencies*, 36 INT'L & COMP. L.Q. 729, 738 (1987) [hereinafter Boshkoff].

18. See *Banque de Financement v. First Nat. Bank of Boston*, 568 F.2d 911 (2d Cir. 1977); Gallagher & Hartje, *The Effectiveness of § 304 in Achieving Efficient and Economic Equity in Transnational Insolvency*, 1983 ANN. SURV. BANKR. L. 1, 2, 15 (1983) [hereinafter Gallagher & Hartje].

19. See E. COLES & P. HAY, *supra* note 16, at § 23.16. Under 11 U.S.C. § 508(a) a claim asserted in a United States bankruptcy proceeding is reduced by the amount received by the claimant in a foreign proceeding.

20. See Gallagher & Hartje, *supra* note 18, at 13.

21. Honsberger, *supra* note 16, at 635 ("the domestic laws of all countries prohibit execution by a single creditor after an adjudication in bankruptcy").

claim.²² Neither universality nor territoriality has been wholeheartedly embraced by commentators or courts. Rather, the two doctrines are used as a framework for analysis of the many conflicting issues presented in the insolvency of a multinational debtor.

Most cases and commentators have focused on the fate of unsecured, nonpriority claims in contrasting territoriality and universality. When foreign creditors are treated comparably to domestic creditors, and suffer no prejudice by proving their claims in the central forum, then the goals of universality appear worthy. When issues of the priority of, or security for, claims intrude upon the analysis, local interests and international cooperation do not reconcile easily and instinctive support for universality begins to erode.²³ This leads to the practical conclusion that a state is likely to espouse a universal view if it is the central forum and is essentially "exporting" its bankruptcy laws. A foreign state will be more tentative in its embrace of universality when the central forum is in another state whose administration might adversely affect the local interests of the first state.²⁴ Thus, a country may be less likely to cede control of assets for administration in another country if, for example, the central forum does not recognize judicial liens which grant local creditors priority over unsecured claims²⁵ or does not accord priority treatment to foreign tax claims.²⁶

IV. PRE-CODE VIEW OF TRANSNATIONAL CASES

United States courts which have balanced the protection of local claims with the recognition of foreign bankruptcy proceedings have vacillated between universality, territoriality, and points in between.²⁷ As early as 1883, the United States Supreme Court leaned towards universality in deferring to Canadian insolvency proceedings in *Canada Southern Railway Co. v.*

22. Honsberger, *supra* note 16, at 634.

23. See Honsberger, *supra* note 16, at 634.

24. See Honsberger, *supra* note 16, at 636; Powers & Mears, *Protecting a U.S. Debtor's Assets in International Bankruptcy: A Survey and Proposal for Reciprocity*, 10 N.C.J. INT'L L. & COM. REV. 303, 306 (1985) [hereinafter Powers & Mears].

25. *In re Toga Manufacturing Limited*, 28 B.R. 165 (Bankr. E.D. Mich. 1983).

26. *Overseas Inns S.A. P.A. v. United States*, 685 F. Supp. 968 (N.D. Tex. 1988).

27. See generally Morales & Deutch, *Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity*, 39 BUS. LAW. 1573 (1984) [hereinafter Morales & Deutch]; Unger, *United States Recognition of Foreign Bankruptcies*, 19 INT'L LAW. 1153 (1985) [hereinafter Unger].

Gebhard.²⁸ Canada's Parliament enacted a law to reorganize the Canadian Southern Railway Co. and, as part of the reorganization, modified the rights of a certain class of bondholders, including bondholders residing in New York. The United States bondholders brought suit in New York challenging the modifications as an unconstitutional impairment of contract and the company raised as a defense the reorganization in Canada. In rejecting the United States bondholders' claims, the Supreme Court embraced universality, stating:

[I]t 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.²⁹ . . .

Unless all parties in interest, wherever they reside can be bound by the [bankruptcy reorganization,] the scheme may fail. All home creditors can be bound. What is needed is to bind those who are abroad. Under these circumstances, the true spirit of international comity requires that schemes of this character, legalized at home, should be recognized in other countries.³⁰

The broad view of comity articulated in *Gebhard* was limited by the subsequent landmark decision of *Hilton v. Guyot*³¹ where the Supreme Court viewed comity as a matter of discretion to be applied if United States policies were not violated. Following the rationale of *Hilton*, the Supreme Court in *Disconto Gesellschaft v. Umbreit*,³² upheld the ruling of a Wisconsin court requiring the claims of local creditors to be paid in full before assets were released to a foreign trustee for administration in a German bankruptcy. The Court reasoned that "what property may be removed from a State and subjected to claims of creditors of other States is a matter of comity . . . not a matter of absolute right."³³ This reasoning allowed the parochial conclusion that the Wisconsin court properly applied the "well-recognized rule" that "permits a country to first protect the rights of its own citizens in local property before permitting it to be taken out of the jurisdiction for administration" in a foreign

28. 109 U.S. 527 (1883).

29. *Id.* at 537.

30. *Id.* at 539.

31. 159 U.S. 113 (1895).

32. 208 U.S. 570 (1907).

33. *Id.* at 578-79.

proceeding.³⁴

Seventy years later *Disconto* was specifically discounted as the Second Circuit embraced universality in *Banque de Financement S.A. v. First Nat'l Bank of Boston*.³⁵ There, the Court of Appeals stressed the need for cooperation in foreign bankruptcy proceedings and wholly rejected the notion that local claims should first be paid before assets are turned over for administration in a foreign proceeding.³⁶ Local rights were considered properly protected if United States claims were treated on the same footing as other claims in the foreign proceeding.

The need for cooperation and predictability in international insolvency proceedings became painfully apparent with the failure of the Herstatt Bank of West Germany in 1974.³⁷ The lack of any controlling law or central forum to resolve intercontinental disputes produced a scramble for assets having a value in excess of \$150 million. Each creditor pursued its "own independent and disjunctive course, resulting in a transatlantic juridical calamity."³⁸ Ultimately, the parties agreed on an out-of-court settlement which was driven in part by the general belief among creditors that the legal system was incapable of bringing about "prompt" or "acceptable" results.³⁹ The failure of international insolvency law to produce a solution to the Herstatt collapse provided an impetus for the enactment of section 304 of the Bankruptcy Code.⁴⁰

V. SECTION 304 OF THE BANKRUPTCY CODE

Section 304 represents a cautious legislative step by the United States toward universality. United States courts are expressly authorized to act as local auxiliaries to a foreign bankruptcy proceeding and to honor requests by a foreign representative for the turnover of assets and other relief.⁴¹ Under section 304(b), the court may grant various kinds of relief:

34. *Id.* at 582.

35. 568 F.2d 911 (2d Cir. 1977).

36. *Id.* at 921.

37. See generally Becker, *International Insolvency: The Case of Herstatt*, 62 A.B.A.J. 1290 (1976) [hereinafter Becker].

38. Morales & Deutch, *supra* note 27, at 1574.

39. Morales & Deutch, *supra* note 27, at 1574; Becker, *supra* note 36, at 1295.

40. Unger, *supra* note 27, at 1167.

41. Under the bankruptcy code, "foreign representative" means a duly selected trustee, administrator, or other representative of an estate in a foreign liquidation or reorganization proceeding. 11 U.S.C. § 101(20) (1988).

1. *Injunctive*: The court may enjoin actions against the debtor with respect to property involved in the foreign proceeding, or against such property, including actions to enforce judgments or create or enforce liens against such property;⁴²
2. *Turnover*: The court may order the turnover of property or its proceeds to the foreign representative;⁴³
3. *Other*: The court may order other appropriate relief.⁴⁴

Granting of relief is not automatic, but is conditioned on consideration of criteria detailed in section 304(c). The court is to evaluate the request for section 304(b) relief "by what will best assure an economical and expeditious administration of such foreign estate" consistent with the following principles:

1. Just treatment of all claimants;⁴⁵
2. Protection of United States creditors against prejudice and inconvenience;⁴⁶
3. Prevention of preferential or fraudulent transfers of property of the estate;⁴⁷
4. Substantial conformity to the United States Bankruptcy Code order of distribution of proceeds; and⁴⁸
5. Comity.⁴⁹

The doctrine of comity, which previously formed the linchpin of any analysis for the recognition of foreign insolvency proceedings, is apparently but one factor for consideration. The doctrine of universality articulated in section 304 is limited by a continued concern for local interests; the court is directed to weigh the rights of United States creditors in considering the request of the foreign representative for relief.⁵⁰

VI. CASES UNDER SECTION 304

The "ultimate test"⁵¹ of a state's commitment to universality comes when the foreign representative requests a turnover of

42. 11 U.S.C. § 304(b)(1)(A) (1988).

43. 11 U.S.C. § 304(b)(2) (1988).

44. 11 U.S.C. § 304(b)(3) (1988).

45. 11 U.S.C. § 304(c)(1) (1988).

46. 11 U.S.C. § 304(c)(2) (1988).

47. 11 U.S.C. § 304(c)(3) (1988).

48. 11 U.S.C. § 304(c)(4) (1988).

49. 11 U.S.C. § 304(c)(5) (1988).

50. *But see In re Culmer*, 25 B.R. 621, 629 (Bankr. S.D.N.Y. 1982) (all criteria set forth in section 304(c) "have historically been considered within a court's determination whether to afford comity to a proceeding in a foreign nation").

51. Boshkoff, *supra* note 17, at 745.

assets. The court is faced with the stark choice of whether to protect local creditor rights or to relinquish control to a foreign administration. Notwithstanding section 304 and its articulation of specific standards, the few cases where turnover was at issue are disparate in result. Courts have taken both territorial and universal approaches in the treatment of secured and unsecured claims, leading to the conclusion that no firm conclusions can yet be drawn about how claims will be treated in any particular instance. The cases analyzed below, starting with a discussion of decisions exhibiting territorial tendencies, all attempt in some fashion to weigh and balance local and international interests. Although the cases profess respect for foreign proceedings, local interests receive the protection of the courts in a variety of circumstances.⁵²

One of the earliest cases decided under section 304 is also a high water mark for territoriality. In *In re Lineas Areas de Nicaragua, S.A.*,⁵³ the court permitted the turnover of assets to a foreign representative subject to the condition that the representative's authority did not extend to removing the debtor's assets from the United States, and those assets would be applied primarily to satisfy debts owing to the debtor's United States creditors.⁵⁴ This decision harkens to the result in *Disconto*, but *Lineas Areas* has little precedential impact because the foreign trustee consented to the condition that United States claims be honored first.

Protection for United States creditors for more justifiable reasons occurred in *In re Banco Nacional de Obras y Servicios Publicos, S.N.C.*,⁵⁵ where the United States bankruptcy court retained jurisdiction over certain labor claims arising in connection with the insolvency of Aeromexico. At issue was whether prebankruptcy conduct by the union and the airline created a collective bargaining agreement with United States employees. The Mexican trustee opposed resolution of the matter by the United States court on the ground that individual union members could press their claims before the bankruptcy court in Mexico.

52. According to Professor Boshkoff, "[t]here is little reason to hope for co-operation from American courts in any but the most routine and non-controversial situation. Optimism is not yet justified." Boshkoff, *supra* note 17, at 747.

53. 13 B.R. 779 (Bankr. S.D. Fla. 1981).

54. *Id.* at 780.

55. 91 B.R. 661 (Bankr. S.D.N.Y. 1981).

Ruling in favor of the union, the bankruptcy court was greatly influenced by the unique and complex nature of United States labor law and the severe inconvenience individual union members would suffer if the basic labor contract issue was litigated in Mexico.⁵⁶ However, in deference to international comity, the United States court ruled that upon resolution of the labor contract issue, the Mexican bankruptcy court could exercise jurisdiction to determine the allowability and priority of the union claims under Mexican bankruptcy law.⁵⁷

The result in *Banco Nacional* is equitable. At least one author has suggested that the local bankruptcy court should in the first instance rule on disputed local claims.⁵⁸ Such a proposal has significant merit if, as in *Banco Nacional*, the legal issues are matters of local law, the dispute relates to United States conduct, and the hardship on smaller creditors in travelling to a foreign jurisdiction is disproportionately greater than requiring the foreign representative to appear in the United States.⁵⁹

Two notorious decisions which ostensibly eschew universality to protect United States claims are *In re Toga Manufacturing Ltd.*⁶⁰ and *Interpool Ltd. v. Certain Freights of M/V Venture Star*.⁶¹ *Toga* involved a secured claim; *Interpool* addressed creditor claims generally. Both cases protected United States claims in controversial situations.

In *Toga*, a United States creditor named Peter T. Hesse Enterprises, Inc. (Hesse) obtained a valid judgment against a Canadian company and lawfully garnished certain debts owed to the Canadian company. Six months later, the Canadian company became a debtor in insolvency proceedings in Canada and the Canadian trustee filed a petition under section 304 seeking turnover of the garnished funds which had been paid into Michigan state court. The United States court found that Hesse would be considered a general unsecured creditor in the foreign proceeding while under United States bankruptcy law, Hesse would be a secured creditor with respect to the garnished funds.⁶² The court

56. *Id.* at 667.

57. *Id.* at 668, n.7.

58. Lam, *Bankruptcy Code Section 304(b)(3): "Other Appropriate Relief" For Multinational Bankruptcy*, 16 BROOKLYN J. INT'L L. 479, 490 (1990).

59. See Gallagher & Hartje, *supra* note 18, at 18.

60. 28 B.R. 165 (Bankr. E.D. Mich. 1983).

61. 102 B.R. 373 (D.N.J. 1988), *appeal dismissed*, 878 F.2d 111 (3d Cir. 1989).

62. *Toga*, 28 B.R. at 168-69.

concluded that the "substantially unequal treatment" Hesse would receive under Canadian law violated "well-defined and accepted policies" of the United States. As a result the request for turnover of the garnished funds was denied and the secured claim of the United States creditor was protected.

Interpool involved a choice between administering assets in United States or Australian bankruptcy proceedings in circumstances where United States administration appeared more favorable to United States unsecured creditors. Australian liquidation proceedings of KKL Kangaroo Lines (KKL), an Australian company which operated a liner service between Australia and the United States, were pending when the Australian liquidator sought ancillary relief under section 304 for turnover of assets located in the United States for administration in Australia. At the time of filing, KKL's property in the United States included rights in an arbitration proceeding valued at between \$3 million and \$40 million. Following the filing of the section 304 petition, several unsecured United States creditors filed an involuntary bankruptcy petition against KKL in the United States bankruptcy court and the two matters were consolidated along with other actions involving KKL.⁶³

Central to the dispute in the United States was the agreement by the Australian liquidator to distribute the first \$6 million received on the United States arbitration award to a foreign entity, known as Wah Kwong, in satisfaction of a purported loan. The Australian court having jurisdiction over the liquidation approved the agreement on an *ex parte* basis.

The United States court was troubled by the lack of prior notice to creditors of this agreement, even though no notice was required by Australian law.⁶⁴ Also bothersome were the "substantial allegations of insider machinations" by Wah Kwong and the lack of an equitable subordination remedy under Australian law similar to that provided by United States bankruptcy law.⁶⁵ Without ruling on the issue, the United States court observed

63. At a preliminary stage of the proceedings, the United States court apparently authorized payment of certain lien claims and certain administrative costs from funds collected in the United States during the pendency of the proceedings. *Interpool*, 102 B.R. at 375.

64. *Interpool*, 102 B.R. at 378-79. See also Hughes, *An Australian Perspective on Interpool*, 2 INT'L INSOLVENCY & CREDITORS' RTS. REP. 32 (1990) [hereinafter Hughes] (noting that in Australia, the court is charged with protecting rights of creditors).

65. *Interpool*, 102 B.R. at 380.

that there was sufficient evidence to require further investigation by a bankruptcy trustee of Wah Kwong's conduct to determine whether such conduct justified subordination of its claim to the claims of other creditors. Based on the perceived differences between United States and Australian law, the United States court declined to grant the liquidator's section 304 petition and instead granted the involuntary bankruptcy petition, ordering the administration of KKL's United States assets under the laws of the United States.

The *Toga* decision has been criticized as overly protective of a local creditor and characterized as an "emasculat[i]on" of section 304.⁶⁶ Its result, however, is defensible as striking a proper balance between domestic and international policies.⁶⁷ Hesse's lien rights would have been ignored under Canadian law, a result contrary to the history of section 304 which suggests that a foreign trustee should not be able to defeat a valid local creditor's lien on local property.⁶⁸

Moreover, lien rights are property rights that are created by local law and operate only as to local assets. Their nature may vary from jurisdiction to jurisdiction.⁶⁹ Unlike the universal principle of equal treatment of unsecured claims, there is no universal precept guiding the treatment of secured claims that are valid and unavoidable under local law but which may have no counterpart under the laws of the foreign forum. If international cooperation is to work in practice, the salutary principles underlying the concept of universality must be sufficiently flexible to yield to substantial local concerns and expectations.⁷⁰ If lien rights are determined under the law of the situs of the asset,

66. Gallagher & Hartje, *supra* note 18, at 21; In Matter of Axona International Credit & Commerce Limited, 88 B.R. 597, 611 (Bankr. S.D.N.Y. 1988), *aff'd*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991).

67. Gitlin & Flaschen, *supra* note 16, at 321.

68. See Report on the Comm'n on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. Part II 73 (1973). The Commission Report provides that the preliminary draft of section 304 "does not override the general United States rule of conflicts of law that foreign trustees may not defeat rights acquired by local creditors through levy on local assets." See also Honsberger, *supra* note 16, at 653, 655. But see Gallagher & Hartje, *supra* note 18, at 13-14 (contending conflicts standard no longer valid).

69. See generally R. GITLIN & R. MEARS, *supra* note 3.

70. Universality "will never gain acceptance" unless the central forum takes into consideration the laws and policies of the local forum regarding preferential and fraudulent transfers, exempt assets and allowability and rank of claims. Powers & Mears, *supra* note 24, at 306 n.14.

the *Toga* court's conclusion is neither surprising nor xenophobic.⁷¹

The *Interpool* result is less justifiable as it refuses on more general grounds to recognize the law of a sister common law jurisdiction.⁷² Due process and public policy issues properly play a role in determining whether to recognize a foreign judgment.⁷³ In *Interpool*, however, there was no suggestion that Australian creditors as a whole were to be favored to the detriment of foreign unsecured creditors, that the settlement directly affected specific claims of United States creditors, that the liquidation law in Australia was generally offensive to United States principles of justice, or that the liquidators' actions were tainted by fraud or misconduct. Instead, there was an articulated suspicion that either the Australian law or courts simply were not up to United States standards.

No two countries' insolvency laws are the same, and United States creditors are not entitled to a carbon copy of the United States Bankruptcy Code in proceedings abroad.⁷⁴ The requirement that a foreign proceeding replicate United States law regarding notice, the powers available to the trustee, or some other particular will eliminate rather than enhance recognition of foreign proceedings.⁷⁵ If the *Interpool* approach proliferates, it is questionable whether Australian laws, or the laws of any other foreign state, will receive recognition in the United States.⁷⁶

71. Different considerations would apply if the lien was preferential under local law or the law of the central forum. *In re Culmer*, 25 B.R. 621, 629 (Bankr. S.D.N.Y. 1982); Honsberger, *supra* note 16, at 654.

72. See *Clarkson Co. v. Shaheen*, 544 F.2d 624, 629-630 (2d Cir. 1976) (exceptions to comity to be "construed especially narrowly when alien jurisdiction is . . . a sister common law jurisdiction with procedures akin to our own.")

73. See *Goldie*, *supra* note 1, at 344-45. See also *Remington Rand Corp. v. Business Systems, Inc.*, 830 F.2d 1260, 1266-68 (3d Cir. 1987).

74. See *In re Gee*, 53 B.R. 891, 904 (Bankr. S.D.N.Y. 1985); *Gitlin & Flaschen*, *supra* note 16, at 322; *Gallagher & Hartje*, *supra* note 18, at 21 ("Americans dealing with foreigners are not ipso facto entitled to American law but merely the even-handed application of foreign law so long as that law does not offend American public policy").

75. See *Hughes*, *supra* note 64.

76. See *Hughes*, *supra* note 64. United States decisions have recognized foreign insolvency proceedings in a variety of jurisdictions. See, e.g., *Cunard S.S. Co. v. Salen Refeer Services AB*, 773 F.2d 452 (2d Cir. 1985) (Sweden); *In re Gee*, 53 B.R. 891 (Bankr. S.D.N.Y. 1985) (Cayman Islands); *In re Culmer*, 25 B.R. 621 (Bankr. S.D.N.Y. 1982) (Bahamas). A cautious but more receptive approach to recognition of foreign law is found in *In re Banco de Descuento*, 78 B.R. 337 (Bankr. S.D. Fla. 1987). There, the United States creditor opposing turnover asserted that the terms of a labor settlement approved in Ecuador were designed to provide favorable treatment to certain groups of Ecuadorian creditors. The court, although prepared to defer to the Ecuador insolvency

Juxtaposed with *Toga* and *Interpool* is *In re Culmer*⁷⁷ which manifests a much more accommodating view of foreign proceedings. Distinctly universal in its outlook, *Culmer* has been described as a "model application" of section 304.⁷⁸

Culmer involved the liquidation of Banco Ambrosiano Overseas Limited (BAOL) in the Bahamas. A section 304 petition was filed in the United States court seeking turnover of United States assets to the Bahamian liquidator. At the time of commencement of liquidation proceedings in the Bahamas on August 9, 1982, BAOL maintained several bank accounts at financial institutions in the Southern District of New York, two banks asserted setoff rights to funds on deposit and a foreign creditor had levied on United States property of BAOL.⁷⁹ Following commencement of the foreign proceedings, other creditors had taken action against BAOL assets in the United States. The United States court, influenced by the lack of any significant nexus between BAOL and the United States and by the race to levy on assets in the United States, granted the liquidators' request for turnover.

[T]he Bahamas has by far the greatest interest in BAOL's liquidation since neither the United States nor the State of New York has any governmental or public interest in BAOL's liquidation. Indeed, two of BAOL's major creditors, European and Schroder, have supported the Bahamian liquidation In contrast, only a handful of creditors who have purported to obtain preferences in this district have opposed transferring all of BAOL's assets for distribution in the Bahamian liquidation. To allow these opposing creditors to preclude the relief requested would grant them preferences to which they are not entitled either in a Bahamian liquidation, or in a United States Bankruptcy. This Court is thus not obliged to protect the positions of fast-moving American and foreign attachment creditors over the policy favoring uniform administration in a foreign court.⁸⁰

proceedings based on the laws of Ecuador as written, reserved turnover of the assets pending review of the foreign law as applied in that proceeding. *See also* Drexel Burnham Lambert Group, Inc. v. Galadari, 777 F.2d 877, 881 (2d Cir. 1985) (remands for evidentiary hearing on the substance of insolvency law of Dubai, United Arab Emirates as Dubai decree is "first attempt to frame an insolvency law [and] our courts have had no experience with Dubai bankruptcy practices.")

77. 25 B.R. 621 (Bankr. S.D.N.Y. 1982).

78. R. GITLIN & R. MEARS, *supra* note 3, at 94.

79. *Culmer*, 25 B.R. at 624-25.

80. *Id.* at 628-29 (citations omitted).

In reaching its decision, the court reviewed key provisions of Bahamian law, rejected creditor contentions that the law afforded preferred treatment to domestic creditors, and, in contrast to *Interpool*, adopted an extremely deferential comity standard: "[w]hether or not Bahamas law is identical in application to American law, there is nothing inherently vicious, wicked, immoral or shocking to the prevailing American moral sense in the Bahamian laws outlined above."⁸¹

In granting the turnover request, the court issued no specific ruling on the validity of the attachments, noting instead that the issue could be "raised and considered in the Bahamian liquidation." However, based on a concession by the liquidator, the banks asserting setoff rights were permitted to hold the disputed funds pending a determination of their rights in the Bahamas proceeding.⁸²

Following the *Culmer* lead, universality received very hospitable treatment to the detriment of attaching creditors in *In re Axona Int'l Credit & Commerce Ltd.*⁸³ There the court permitted a foreign representative to creatively use United States proceedings in order to obtain turnover of assets for a foreign debtor's bankruptcy estate.

Axona International Credit & Commerce, Ltd. (Axona) was a Hong Kong bank that maintained substantial deposits with United States banks but did not conduct business in the United States. In November 1982, with the financial collapse of Axona, attachments of \$3.8 million on United States deposits were obtained by three banks while another bank moved deposits among branches and affiliates to repay a \$3 million loan.

Winding up proceedings began in Hong Kong in February 1983. The Hong Kong liquidator thereafter commenced a full involuntary bankruptcy proceeding against Axona in the United

81. *Id.* at 631. The oft quoted standard was first set forth in *Cornfeld v. Investors Overseas Services, Ltd.*, 471 F. Supp. 1255, *aff'd*, 614 F.2d 1286 (2d Cir. 1979).

82. *Culmer*, at 634 n.6. A rationale similar to *Culmer* was applied in *In re Lines*, 81 B.R. 267 (Bankr. S.D.N.Y. 1988), with respect to Bermuda law. At issue was a United States creditor's claim to a trust fund established under New York law as a condition to the operation of the debtor's reinsurance company. The trust fund was on deposit in a United States bank and served as security for the claims of United States insureds. The bankruptcy court declined to determine whether the creditor had rights to the fund, deciding instead to leave that issue for determination by the Bermuda court.

83. 88 B.R. 597 (Bankr. S.D.N.Y. 1988), *aff'd*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991). At the Bankruptcy Court level, *Culmer* and *Axona* were both decided by Judge Lifland.

States⁸⁴ in order to take advantage of a United States bankruptcy trustee's avoidance powers under the Bankruptcy Code.⁸⁵

After the recovery of over \$7 million in preference claims, the United States bankruptcy trustee and the Hong Kong liquidators jointly petitioned the United States bankruptcy court for suspension of the United States bankruptcy proceedings under section 305 of the Bankruptcy Code and for turnover of the recovered assets to the Hong Kong liquidators for administration under Hong Kong law.⁸⁶ No separate section 304 petition was filed. One bank opposed this action on constitutional and statutory grounds, arguing primarily that the liquidators should not be permitted to use the two step process of: (1) filing an involuntary petition to take advantage of United States avoidance laws; and (2) seeking suspension of that case in favor of the foreign proceeding.

The court found that the bank would be fairly treated in the Hong Kong proceedings: "[w]hether or not Hong Kong law is identical to American law, Hong Kong law is not repugnant to our ideas of justice, and is inherently fair and regular. As a result, comity should be accorded in the instant matter."⁸⁷ The court characterized the objections of the bank as nothing more than a "grandiloquent exercise," and permitted the assets to be repatriated to Hong Kong for administration.

Creditors asserting secured status by virtue of their attachment of United States assets were also relegated to foreign proceedings, and the seized assets turned over to the foreign representative for administration, in the cases of *Cunard Steamship*

84. A foreign representative may commence an involuntary bankruptcy proceeding under section 303(b)(4) of the Bankruptcy Code.

85. Case law suggests that such powers are not available to a foreign representative by commencement of an ancillary proceeding under section 304 of the Bankruptcy Code. See *In re A. Tarricone, Inc.*, 80 B.R. 21 (Bankr. S.D.N.Y. 1987); *In re Comstat Consulting Services, Ltd.*, 10 B.R. 134 (Bankr. S.D. Fla. 1981); *Axona*, 88 B.R. at 607 n.17; Hon-berger, *supra* note 16, at 654.

86. 11 U.S.C. § 305 (1988) provides in part as follows:

(a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if —

(1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or

(2)(A) there is pending a foreign proceeding; and

(B) The factors specified in section 304(c) of this title warrant such dismissal or suspension.

(b) A foreign representative may seek dismissal or suspension under subsection (a)(2) of this section.

87. *Axona*, 88 B.R. at 611 (citations omitted).

Company Ltd. v. Salen Reefer Services AB,⁸⁸ and *Victrix Steamship Co., S.A. v. Salen Dry Cargo A.B.*⁸⁹ These cases, however, do not raise significant territorial issues as they involve attachments by foreign creditors in United States courts after the foreign proceedings were commenced. The courts were not faced with a concern of protecting local interests.⁹⁰ The decisions were also decided solely on comity grounds as the foreign representative did not seek relief under section 304, although either approach should have produced similar results.⁹¹

A third example of a universal approach toward the treatment of unsecured claims was exhibited in *In re Gerke*,⁹² a decision involving the foreign insolvency proceedings of Dominion International Group Plc. under the United Kingdom Insolvency Act of 1986. A civil suit seeking damages for breach of a \$45 million acquisition agreement had been commenced in the United States against Dominion prior to commencement of the foreign proceeding. Pursuant to section 304, the foreign representative sought a stay of the suit and of an order entered in the proceedings that the defendant produce documents in discovery. The parties conceded that the United Kingdom law was "substantially in accord with the Bankruptcy Code on the order of distribution of proceeds."⁹³ Finding that any delay in the civil suit would not prejudice the plaintiff, the court issued the stay. However, because Dominion had contested the document pro-

88. 773 F.2d 452 (2d Cir. 1985).

89. 825 F.2d 709 (2d Cir. 1987).

90. R. GITLIN & R. MEARS, *supra* note 3, at 96 n.51; Gitlin & Flaschen, *supra* note 16, at 321. A different scenario was presented in *In re Papeleras Reunidas, S.A.*, 92 B.R. 584 (Bankr. E.D.N.Y. 1988). There, the Court denied a section 304 petition seeking to dissolve an attachment on United States assets obtained by a United States creditor after liquidation proceedings were commenced in Spain. Special circumstances justify the result in that case. The liquidators had made misrepresentations to the Court regarding their transfer of United States assets, failed to comply with an order that they provide an English translation of Spanish law regarding the validity of such liens and refused to allow the attaching United States creditor to participate in the Spanish proceeding as an unsecured creditor. The case, although territorial in its recognition of a postbankruptcy attachment, applies universal principles of justice in view of the apparent misconduct of the Spanish liquidators.

91. Section 304 is considered the "preferred" remedy for resolving comity disputes involving multinational bankruptcies. See *Refco F/X Associates, Inc. v. Mebco Bank, S.A.*, 108 B.R. 29, 31 (S.D.N.Y. 1989) (motion to dismiss complaint on ground of international comity denied pending foreign representative's institution of proceeding under section 304).

92. 122 B.R. 621 (Bankr. D.C. 1991).

93. *Id.* at 629-30.

duction motion in the United States trial court and lost, the Bankruptcy Court held that it would be unfair for it to reconsider that issue and ordered Dominion to comply with the production order.⁹⁴

The decisions discussed above address secured and unsecured claims. No cases decided under section 304 have specifically focused on the treatment of priority claims in the context of a turnover request. One recent comity case, however, does consider priority claim issues.

In *Overseas Inns S.A. P.A. v. United States*,⁹⁵ the court declined on comity grounds rather than under section 304 to recognize a Luxembourg bankruptcy proceeding which demeaned the priority status of a United States tax claim. The debtor, Overseas Inns S.A. P.A. (Overseas), a Luxembourg corporation, had agreed to entry of a judgment in the United States Tax Court in the amount of approximately \$1 million in favor of the Internal Revenue Service. While the Tax Court matter was pending, Overseas filed for bankruptcy in Luxembourg. The plan of reorganization, approved by the Luxembourg court in February 1979, classified the Internal Revenue Service's claim as an unsecured claim and proposed to pay a twenty-four percent dividend to unsecured creditors. The Internal Revenue Service received a copy of the plan but did not file an objection or proof of claim.

Overseas made, and the Internal Revenue Service accepted, payments under the plan totalling \$179,135.76. In June 1981, notwithstanding apparent acquiescence to the Luxembourg plan, the Internal Revenue Service levied on installment payments owed by a United States company to Overseas. Overseas filed suit asserting that the levy was improper and that the Internal Revenue Service was bound by the plan of reorganization.

In its opinion, the Court of Appeals acknowledged the principle of comity but noted its limitations where application would prejudice United States interests or policies. "[C]omity is more likely to be accorded foreign bankruptcy decrees when the foreign law is comparable to United States law."⁹⁶ According to the appellate court, under applicable United States law the tax claim would have been both secured and entitled to priority

94. *Id.* at 628.

95. 911 F.2d 1146 (5th Cir. 1990).

96. *Overseas Inns*, 911 F.2d at 1149.

treatment, assuring its payment ahead of unsecured creditors. Under the Luxembourg plan, the Internal Revenue Service was treated as a general unsecured creditor. Quoting the trial court, the appellate court was influenced by the "inexpungeable public policy"⁹⁷ of the United States favoring the payment of federal taxes. This policy was even more compelling in the matter at hand because the tax obligation arose in connection with business activities in the United States.

Overseas applies a rationale similar to that in *Toga*, protecting priority and secured claims to the extent they would have been recognized under United States law. *Overseas* may be more tolerable than *Toga* at an international level given the fixation most countries have with their tax revenues.

Other cases have touched on the foreign recognition of priority claims, although whether the particular priority scheme was identical to the United States statute is not clear.⁹⁸ In *Axona*, the court ordered that costs of United States administration, including taxes,⁹⁹ be paid in the United States bankruptcy proceeding before assets were turned over to the foreign representative.¹⁰⁰

Also of note is the Canadian decision of *In re Sefel Geophysical, Ltd.* in which United States priority claims received recognition.¹⁰¹ The Canadian insolvency law did not provide for recognition of foreign priorities and, according to the Canadian court, the doctrine of comity did not provide a proper framework of analysis to resolve creditor claims to priority status. However, the court was troubled by the equities, since the turnover of assets by the United States court for Canadian administration was premised on the United States court's conclusion that Canada would recognize the priority status of certain United States creditors. Finding that it would be "grossly unfair" and "manifestly unjust" to ignore the premises on which the United States court had released assets, the Canadian court applied principles of equity in order to protect United States

97. *Id.*

98. See *In re Culmer*, 25 B.R. 621, 631 (Bankr. S.D.N.Y. 1982).

99. *In re Axona Int'l Credit & Commerce Ltd.*, 88 B.R. 597, 602 n.7 (Bankr. S.D.N.Y. 1988), *aff'd* 115 B.R. 442 (S.D.N.Y. 1990) *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991).

100. *Axona*, 88 B.R. at 618.

101. Harding, *Re Sefel Geophysical Ltd.: A Canadian Approach to Some Specific Problems in the Adjudication of International Insolvency*, 12 DALHOUSIE L.J. 412 (1989).

priority creditors.¹⁰²

VII. CONCLUSION

Decisions considering claims in multinational insolvency cases are not wholly consistent in result. Prebankruptcy liens, particularly those that are not preferential in character, are susceptible to differing treatment by the courts in connection with a request for turnover of the assets to which they attach. Because of public policy considerations, administrative costs and United States priority claims are likely to be protected by a United States court before it releases assets to another jurisdiction. General creditors are likely to become forced converts to the doctrine of universality unless the court suspects skuldugery, however subjectively defined, in the foreign proceeding or if the court finds significant inconvenience to unsecured creditors. To its credit, section 304 at least provides a structure and a forum for the consideration of the rights of United States and foreign creditors relative to the administration of the United States assets of a foreign insolvent. Within that discrete structure and forum, as in most others, the application of judicial discretion permits both necessary flexibility and the occasional aberration.

102. *Id.* at 417 (quoting *In re Sefel Geophysical, Ltd.* (1988) 62 Atla L.R.2d 193, 202 (Q.B.)).

