THE "DRAPEY OF ILLUSION" OF SECTION 304—
WHAT LURKS BENEATH: TERRITORIALITY IN THE
JUDICIAL APPLICATION OF SECTION 304 OF THE
BANKRUPTCY CODE*

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1. INTRODUCTION

Many nations have expressed interest in fostering cooperation in international bankruptcy.¹ To facilitate this cooperation, the U.S. Congress enacted section 304 of the United States Bankruptcy Code ("Section 304") which enables representatives of foreign bankruptcy proceedings to request the assistance of United States courts.² The U.S. Congress hoped that this legislation would serve as a model for other countries promulgating bankruptcy laws.³ This Comment will analyze how U.S. courts have applied section 304 to foreign bankruptcy proceedings over the past decade. It will focus on

* EDMUND BURKE, REFLECTIONS ON THE REVOLUTION OF FRANCE, (1790) (Burke argued that the traditions, privileges, sentiments, and imaginations of "gentlemen" (the aristocracy) created a necessary drapery in life over true human nature and naked reason. He contended that this drapery preserved a harmony of order, justice, and peace. Burke believed that with the French Revolution, "[a]ll the drapery of life is to be rudely torn off" and only a society of tyranny and chaos would remain.).

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cases involving U.S. creditors in which courts have decided whether to cede jurisdiction over U.S.-based assets to foreign insolvency proceedings. Many commentators have said that these cases exemplify the United States’ commitment to ensuring a unitary bankruptcy proceeding for cases involving international concerns. This Comment will question that assessment’s validity.

Close examination of the cases reveals that most U.S. courts will help facilitate a foreign proceeding only when the foreign representative assures the court that such proceedings will “substantially” mirror U.S. proceedings. Yet, observers have widely acknowledged that “no two countries’ insolvency laws are precisely the same or share the many unique and innovative features of the United States Code.”⁴ Thus, the majority of the cases in which the courts have advocated unitary bankruptcy proceedings serve only as a “drapery of illusion”—an outward commitment to international comity that disguises the protectionism lurking beneath. As soon as the foreign proceedings slightly compromise the interests of United States creditors, most United States courts quickly discard this drapery and reveal their strong commitment to protecting their principal concern, U.S. creditors. Although the United States Bankruptcy Code (“Code”) does not require that the interests of U.S. creditors supersede the interests of foreign creditors, a majority of the U.S. courts have applied Section 304 in this way.

While Congress may have intended that Section 304 would promote a model of international comity, the flexibility that section provided to U.S. courts has subverted the intent. In the majority of their decisions, U.S. courts have permitted the concept of territoriality to override that of universality. These decisions have seriously limited section 304’s potential as a model for international bankruptcy law.

SECTION 304 TERRITORIALITY

2. TERRITORIALITY V. UNIVERSALITY

Territoriality competes with universality as the preeminent theory of multinational bankruptcy administration. Under the territoriality theory, the country in which the litigant has its assets and which conducts the bankruptcy proceeding protects the local creditors' interests in the assets and does not recognize foreign bankruptcy adjudications. That country's adjudication does not affect the debtor's property beyond its borders because the territoriality theory "posits that bankruptcy laws should not be recognized beyond a state's borders." Thus, a debtor who has assets in more than one jurisdiction may find itself embroiled in more than one bankruptcy proceeding.

The territoriality theory's proponents say that the theory does not inconvenience local creditors because it does not require them to make claims in other jurisdictions. Those favoring territoriality also argue that a local court might protect local creditors to a greater extent than a foreign court. In addition, the territoriality theory prevents foreign states from giving "their own subjects particular advantages at the expense of others, especially, but not exclusively through the exercise of excessive jurisdiction."

Critics, however, cite several disadvantages of the territoriality theory. For example, if a debtor holds property in other countries, domestic jurisdiction does not reach that property. Hence, the debtor might dispose of or transfer domestic jurisdiction property to foreign countries in order to disadvantage local creditors; the local creditors have very little power to prevent or reverse such a transfer. If creditors want to obtain assets beyond the state's borders, they must go to the foreign countries in which the debtor holds property and try to

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attach the property. Also, the potential number of contemporaneous proceedings risks inconsistent results for the same debtor.9 Furthermore, a territorial approach appears "inconsistent with the general trend towards facilitating international and cross-border transactions."10

The universality theory states that all jurisdictions should recognize the most appropriate jurisdiction's bankruptcy laws. This unitary approach means that a debtor who has multinational creditors and assets will resolve all of its financial difficulties in one central forum.11 Throughout the last decade, commentators and jurists have debated how to make this difficult choice of forum.12 To resolve all of the debtor's financial difficulties in one forum, the trustee of the bankruptcy proceeding would marshall all of the debtor's assets and subject them to the central forum's jurisdiction. All other jurisdictions would act ancillary to and in aid of the bankruptcy proceeding in the central forum.13 Additionally, the trustee would require all the debtor's creditors, no matter what country they resided, to go to the central forum and prove their claims. Thus, for the universality theory to work, all other jurisdictions must recognize and enforce the original forum's adjudication.14

According to the universality theory, all the assets and creditors should be subject to the jurisdiction of one tribunal which would facilitate equitable distribution of the estate.15 "Ideally, all creditors are supposed to share equally in the

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9 See id.
12 See Article 15(2) Draft of the United States of America-Canada Bankruptcy Treaty (1979) (indicating that the countries choose an asset-based test to determine jurisdiction). See also EUR. CONVEN. ON CERTAIN INT'L ASPECTS OF BANKR., Model International Insolvency Cooperation Act (July 1990) (indicating that this convention based its jurisdictional determinations on where the debtor has "the centre of his main interests.").
13 See Westbrook, supra note 11.
14 See Unger, supra note 7, at 1154.
15 See id. at 1155.
assets of a debtor's estate.\textsuperscript{16} The universality approach achieves this goal more efficiently and simply than the territoriality approach because it obviates multiple adjudications in different jurisdictions. The universality theory would also eliminate any forum shopping problems which might otherwise plague the territoriality approach.\textsuperscript{17}

The detractors of the universality theory, however, point out that the universality theory inconveniences creditors who would have to go to a foreign jurisdiction to assert their claims. In addition, the foreign proceeding might apply different laws than those in the creditor's jurisdiction, which may have enhanced the creditor's rights.\textsuperscript{18} Ostensibly, these foreign laws would give the creditors who live in the foreign jurisdiction particular advantages over other creditors of the debtor.\textsuperscript{19} Universality depends on local cooperation from each territory for enforcement because it has no force of its own. Unfortunately problems achieving this cooperation continue to limit universality's effectiveness.\textsuperscript{20}

3. THE UNITED STATES TREATMENT OF FOREIGN BANKRUPTCIES BEFORE THE ENACTMENT OF SECTION 304

Historically, the United States has taken a very territorial approach in recognizing and applying foreign bankruptcy judgments to domestic property.\textsuperscript{21} The United States' bias in favor of U.S. creditors has led other nations to deem it the least cooperative of the major trading states.\textsuperscript{22} In In re Toga


\textsuperscript{18} See Unger, supra note 7, at 1155.

\textsuperscript{19} Dalhuisen, supra note 8, at 3-9.

\textsuperscript{20} Id. at §2.03[4]. \textit{But see EUR. CONVEN. ON CERTAIN INT'L ASPECTS OF BANKR.}, supra note 12.


\textsuperscript{22} See Gitlin & Flaschen, supra note 6, at 314; Stacey A. Morales & Barbara A. Deutsch, \textit{Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity}, 39 BUS. LAW. 1573, 1577
the bankruptcy court found that "[h]istorically the bankruptcy laws of our country have been hostile towards claims asserted by foreign trustees in bankruptcy against alleged estate property located in the United States."24

3.1. The Doctrine of Comity

Prior to enacting Section 304, the U.S. Congress had not provided official rules which U.S. courts could apply to resolve international jurisdictional bankruptcy conflicts. Absent such rules, the courts applied the vague doctrine of comity.26 The Supreme Court defined comity in the 1895 case, Hilton v. Guyot:28

"Comity," in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its law.27

Other U.S. courts have adopted the definition.28 The U.S. courts had no obligations to recognize foreign laws, judgments or proceedings; recognition depended on the circumstances of each case.29 With few exceptions,30 courts initially used comity as a shield to protect the interests of United States creditors.31


24 Id. at 167.
25 See Huber, supra note 5, at 757. See generally Harding, supra note 10, at 425, 426 (discussing the origin of comity).
26 159 U.S. 113 (1895).
27 Id. at 163-64.
28 Harding, supra note 10.
29 See Unger, supra note 7, at 1159.
30 See Huber, supra note 5, at 757, 758 (citing Canada Southern Ry. v. Gebhard, 109 U.S. 427 (1883)).
31 See Huber, supra note 5, at 757, 758 (citing Disconto Gesellschaft v. Umbreit, 208 U.S. 570 (1908) and In re Berthoud, 231 F. Supp. 529 (S.D.N.Y. 1916)).
3.2. United States Cases Which Have Applied the International Notion of Comity

Prior to the enactment of section 304, U.S. courts had occasionally strayed from taking a purely territorial approach. For example, the Supreme Court's 1883 decision, Canada Southern Ry. v. Gebhard,\footnote{Canada Southern Ry., 109 U.S. at 427.} reflected universalist thought. In that case, New York plaintiffs had brought an action in federal courts in New York to recover on the bonds of a failing Canadian railway corporation.\footnote{See id. at 531.} The Parliament of the Dominion of Canada had authorized the railway company to reorganize on the condition that a majority of the outstanding bondholders vote for the reorganization.\footnote{See id. at 530.} Under the reorganization plan, the railway substituted new securities for the old ones that the bondholders had held.\footnote{See id.} The Supreme Court held that the reorganization bound the United States holders who did not vote with the majority as long as the United States bondholders had the same right to participate in the railway reorganization as the Canadian bondholders had.\footnote{See id. at 539.} The Court stated that:

Unless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to have legalized 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.\footnote{Id.}

The Court recognized that a territorial approach could destroy the railway's reorganization plan. Therefore, the Court found that it should privilege creditor equality over protecting domestic creditors.\footnote{See Huber, supra note 5, at 758.}

Two other cases involving Canadian bankruptcy proceed-
ings have applied universality principles. The court in the first case, Clarkson v. Shaheen,39 allowed a Canadian trustee in bankruptcy to obtain records from a bankrupt company's New York office.40 The court held that "[t]hese exceptions [to the rule of comity] are construed especially narrowly when the alien jurisdiction is, like Canada, a sister common law jurisdiction with procedures akin to our own."41

It has been suggested that this case, and several others decided in the decade before enactment of section 304, represented a shift away from ... the absolute protection of domestic creditors' interests, and toward creditor equality as the primary goal to be achieved in the distribution of assets in transnational bankruptcies.42

In the second case, Cornfeld v. Investors Overseas Serv.,43 the court found it appropriate to defer to the Canadian liquidation proceeding as a matter of international comity even though the company had some of its assets in New York.44 That court granted comity because similar policies underlie the United States and Canadian bankruptcy laws. The court stressed that the Canadian proceedings would adequately protect the creditor.45

4. CONGRESS' ENACTMENT OF SECTION 304

In the pre-Section 304 era, a bankrupt's foreign representative could only acquire the bankrupt's U.S.-based assets through litigation in state or federal nonbankruptcy courts or through a full bankruptcy proceeding in the United States.46

39 544 F.2d 624 (2d Cir. 1976).
40 See id. at 632.
41 See id. at 629-30.
42 Leonard, Carfagnini & McLaren, supra note 1, at 28 (citation omitted).
44 See id.
45 See Huber, supra note 5, at 429.
46 Gitlin & Flaschen, supra note 6, at 316; see also 2 WILLIAM M. COLLIER, COLLIER ON BANKRUPTCY ¶ 304.01, at 304-4 (15th ed. 1985) (Other Code provisions pertain to foreign bankruptcy representatives. For example, Section 303(b)(4) mandates that a foreign representative who files a petition for an involuntary case may commence a full bankruptcy case with the bankruptcy court. Furthermore, Section 305 "authorizes a foreign representative to seek dismissal or suspension of proceedings in a case
A petition requesting a full bankruptcy proceeding creates an estate, triggers the automatic stay, makes available avoidance provisions, 47 and submits the petitioner to the full jurisdiction of any court in the United States for any other purpose. 48 A foreign representative requesting full U.S. bankruptcy proceedings would also have to consider that such proceedings generate exorbitant costs and greater delays for creditors. 49

Congress enacted Section 304 as part of the Bankruptcy Reform Act of 1978. 50 Congress intended to create a provision which could help solve the complex and increasingly important problems of what legal effect the U.S. courts should give to foreign bankruptcy proceedings. 51 Section 304 provides:

(a) A case ancillary to a foreign proceeding is commenced by filing with the bankruptcy court of a petition under this section by a foreign representative.

(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial the court may-

(1) enjoin the commencement or continuation of-

(A) any action against-

under the Code if a foreign insolvency proceedings is pending and the factors specified in section 304(c) so warrant.

47 COLLIER ON BANKRUPTCY, supra note 46, at 304-3.


(i) a debtor with respect to property in such foreign proceeding; or
(ii) such property; or
(B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
(2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
(3) order other appropriate relief.
(c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—
(1) just treatment of all holders of claims against or interests in such estate;
(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
(3) prevention of preferential or fraudulent dispositions of property of such estate;
(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
(5) comity; and
(6) if appropriate, the provisions of an opportunity for a fresh start for the individual that such foreign proceeding concerns.\(^{52}\)

Section 304 presents the foreign representative with a choice of commencing a full bankruptcy case in the United States or of “filing a limited petition in order to administer assets of the foreign estate located in the United States and to prevent dismemberment of those assets by local creditors.”\(^{53}\)

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\(^{53}\) Leonard, Carfagnini & McLaren, supra note 1, at 28. Because Section 304 does not commence a full bankruptcy proceeding, the petition does not create an estate, trigger an automatic stay, make available the Code’s avoidance provisions, or culminate in a discharge. COLLIER ON BANKRUPTCY, supra note 46, at 304-3. The foreign trustee also does not submit herself
Therefore, the court does not submit the foreign representative to U.S. jurisdiction for any other purpose, except "to administer assets located in this country, to prevent dismemberment by local creditors of assets located here, or for other appropriate relief."\(^{54}\)

4.1. The Legislative Intent Behind Section 304

Section 304's history reflects a legislative intent to give courts flexibility in applying Section 304(c).\(^{55}\) Section 304(c) states that assurance of "an economical and expeditious administration" of the bankrupt's estate should guide the court in determining whether to grant relief under subsection (b) of the section.\(^{56}\) Section 304(c) enumerates six factors to direct the court in tailoring its decision concerning whether to grant relief. The legislature has described subsection (c)'s purpose as follows:

These guidelines are designed to give the court the maximum flexibility in handling ancillary cases. Principles of international comity and respect for the judgments and laws of other nations suggest that the court be permitted to make the appropriate orders under all of the circumstances of each case, rather than being provided with inflexible rules.\(^{57}\)

The legislature explicitly intended the six Section 304(c) factors to act as six guidelines which a court should weigh and consider to maximize the court's latitude in ruling on a foreign representative's petition. In general, U.S. courts have failed to view these six factors as guidelines. Instead, they have treated each factor as a separate test that petitioners must meet as a prerequisite to a judicial grant of Section 304 relief. Courts have granted relief only when a foreign proceeding has

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\(^{54}\) COLLIER ON BANKRUPTCY, supra note 46, at 304-3.

\(^{55}\) In re Culmer, 25 B.R. 621, 627, 628 (Bankr. S.D.N.Y. 1982); Gitlin & Flaschen, supra note 6, at 316, 317.


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passed all six tests.\textsuperscript{58}

4.2. In General—Judicial Application of Section 304(c)

The courts' categorization of subsection (c)'s six factors as prerequisites to granting relief breeds an inherent tension between affording domestic creditors maximum protection and favoring the main proceeding in a foreign country to further creditor equality. Requirements of "just treatment of all holders of claims,"\textsuperscript{59} "prevention of preferential or fraudulent dispositions,"\textsuperscript{60} and "comity,"\textsuperscript{61} which favor the universality theory may directly conflict with "distribution of proceeds . . . substantially in accordance with the order prescribed by this title"\textsuperscript{62} and "the provision of an opportunity for a fresh start"\textsuperscript{63} which favor the territoriality approach.\textsuperscript{64} Even though one court has stated that "[t]he central examination which [the court] must undertake in order to comply with Section 304(c) is whether the relief petitioners seek will afford equality of distribution of the available assets."\textsuperscript{65} In fact, most courts have used Section 304(c)(4) as a threshold test which petitioners must meet before the court will continue to examine Section 304(c)'s other factors. As a result, commentators have described Section 304(c)(4) as a "device to protect the interests of United States claimholders [and as] a major obstacle to the foreign representative."\textsuperscript{66}

Some consider Section 304 an implied recognition of the universality concept.\textsuperscript{67} Others argue that "Section 304 thus represents a cautious step towards adoption of the universality

\textsuperscript{58} Huber, supra note 5, at 748.
\textsuperscript{60} Id. § 304(c)(3).
\textsuperscript{61} Id. § 304(c)(5).
\textsuperscript{62} Id. § 304(c)(4).
\textsuperscript{63} Id. § 304(c)(6).
\textsuperscript{64} "Congress declined to resolve these conflicts," but instead wanted to allow the courts to consider all the factors according to the facts of each case thus giving the courts maximum flexibility. COLLIER ON BANKRUPTCY, supra note 46, ¶ 304.04 at 304-10; see also Harding, supra note 10, at 431; and Westbrook, supra note 11.
\textsuperscript{65} In re Culmer, 25 B.R. 621, 628 (Bankr. S.D.N.Y. 1982).
\textsuperscript{66} Huber, supra note 5, at 754; see also Leonard, Carfagnini and McLaren, supra note 1.
\textsuperscript{67} Huber, supra note 5, at 746, 747.

https://scholarship.law.upenn.edu/jil/vol13/iss2/3
theory of multinational bankruptcy administration.\textsuperscript{68} This Comment will explore the major cases which have interpreted Section 304. It will argue that while the majority of U.S. courts claim to employ universality in dealing with foreign bankruptcy proceedings, the majority of cases reveal that the courts only apply universality when they have assurance that foreign law will treat U.S. creditors virtually the same way that filing in the United States would have. In general, the courts revert back to their historical territoriality approach when the foreign bankruptcy proceedings would treat the U.S. creditors and the U.S.-based assets even slightly differently than a U.S. proceeding would treat them.

5. THE JUDICIAL APPLICATION OF SECTION 304

To properly understand how the courts have applied Section 304 to foreign bankruptcy proceedings, one must closely analyze the relevant cases and, more specifically, the facts of each case and how these facts affected the court's decision. The facts have particular importance because "the United States has not formally adopted either the universality or territoriality theory to the exclusion of the other, but has adopted principles of both. The determination of which theory to apply in any given case largely depends on the circumstances of each situation."\textsuperscript{69}

Three lines of cases have developed since Congress enacted Section 304. The first line of cases has deferred to the foreign proceedings in favor of a unitary approach.\textsuperscript{70} The second line of cases has deferred to the foreign proceeding, but only after laying down specific conditions that such proceedings must satisfy. These conditions usually contain a promise to apply

\textsuperscript{68} Daniel M. Glosband & Christopher T. Katucki, Section 304 Of The United States Bankruptcy Code: Cases Ancillary To Foreign Proceedings at 5. (Paper presented to the ABA Annual Meeting in Toronto, Ontario, Canada, on Aug. 8, 1988) (unpublished manuscript) [hereinafter Section 304].

\textsuperscript{69} Unger, supra note 7, at 1155.

some aspect of U.S. law to the distribution.\textsuperscript{71} The third line of cases, however, has refused to defer to foreign proceedings because those courts found that U.S. creditors would receive unfair treatment in the foreign proceedings or that, for public policy reasons, a U.S. court should adjudicate their claims.\textsuperscript{72} The specific details of the first and second line of cases manifest that in most cases the courts only defer to foreign proceedings when they receive assurances. These assurances uniformly provide that the outcome of the U.S. creditors' claims would almost exactly mirror the outcome that would have resulted in a U.S. bankruptcy proceeding.\textsuperscript{73} Most courts do not defer to foreign proceedings when such proceedings would not treat U.S. creditors the same way that a U.S. proceeding would treat them. This rule appears to apply even where such deference would best serve all of the creditors.\textsuperscript{74}

Thus, while “Section 304 is working to promote a universal approach to insolvency administration,”\textsuperscript{75} several recent cases demonstrate that the courts, because of their caution and distrust of universality, have refused to fully recognize foreign insolvency proceedings.\textsuperscript{76} This judicial reluctance indicates that the United States can never fully adopt a universality approach if the courts continue to view Section 304(c)(4) as a threshold test which they should interpret very narrowly.


\textsuperscript{73} See infra notes 77-101 and 107-135 and accompanying text.

\textsuperscript{74} See infra notes 136-177 and accompanying text.

\textsuperscript{75} Glosband & Katucki, Section 304, supra note 68, at 10.

\textsuperscript{76} Daniel M. Glosband & Christopher T. Katucki, Current Developments in International Insolvency Law and Practice, 45 BUS. LAW. 2273, 2274 (1990) [hereinafter Current Developments].

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5.1. Decisions Which Have Unconditionally Deferred to Foreign Insolvency Proceedings

*In re Culmer* numbers among the earliest Section 304 decisions to defer to a foreign insolvency law and proceeding and to allow the foreign liquidator to obtain possession of the bankrupt's U.S. assets. This case involved an international bank scandal which led to the liquidation of Banco Ambrosiano Overseas Limited ("BAOL"). The liquidation commenced in the Bahamas on August 16, 1982. The foreign bankruptcy court entered a decree which stayed any creditor actions against the debtor's assets. At the time of the liquidation, BAOL had accounts at banks and financial institutions in New York. On August 9, 1982, a U.S. district court granted petitioner's request for an attachment of the bankrupt's New York accounts. On September 8 and 10, 1982, BAOL's liquidators filed a Section 304 ancillary petition in order to (1) enjoin all attaching creditors from further proceedings against BAOL assets; (2) enjoin all others from initiating proceedings against BAOL assets; (3) enjoin the creation, perfection, and enforcement of any lien against such assets; and (4) direct all claimants to BAOL property to return all BAOL deposits (and other property which they now hold in their hands or which they may receive) to the Bahamas for administration in BAOL's liquidation proceedings.

This case presented the court with the issue of whether to permit the transfer of BAOL's New York assets to the Bahamas so that BAOL's Bahamian liquidators could disperse them. The court interpreted Section 304's wording and legislative history to conclude that "the central examination which it must undertake in order to comply with Section 304(c) is whether the relief petitioners seek will afford equality of distribution of the available assets." Despite this explicit affirmation of the centrality of equality of distribution of the available assets, the court stressed that the foreign proceeding

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78 Glosband & Katucki, *Section 304*, supra note 68, at 12.
79 Gitlin & Flaschen, *supra* note 6, at 321 (noting the similarity between this decree and the United States bankruptcy automatic stay).
80 Culmer, 25 B.R. at 623.
81 Id. at 628.
would treat those creditors of the bank who objected to this transfer, and specifically the one lien creditor in the United States, no differently than if the petitioner had brought the bankruptcy proceeding in the United States. The court found that the foreign proceeding—which would deem the lien creditor unsecured in this case—would approximate a U.S. proceeding for the following reasons. The avoidance rules of Section 547 of the Code state that a U.S. trustee may avoid any transfer of the debtor's interest in property made during the debtor's insolvency on or within 90 days before the date of filing of the bankruptcy petition. In this case, the creditors attached BAOL's New York assets only seven days before the liquidators filed their original bankruptcy petition and after the foreign bankruptcy court had entered a decree similar to the Code's automatic stay. Consequently, the U.S. court would have avoided the attachment and adjudged the creditors unsecured if the foreign representatives had originally filed their bankruptcy petitions in the United States. Thus, a U.S. court also would not have granted the creditors preferred status in a U.S. bankruptcy proceeding. The court argued that "[t]o 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." The court also ensured that "relief is also proper under Section 304(c)(4) in that the distribution of BAOL's estate in the Bahamas will be substantially in accord with the order and priorities proscribed by Title 11 of the United States Code." The court further emphasized its exercise of international comity in this case and that "[a]nalysis of this principle [of comity] has traditionally favored its regular application unless egregiously unjust consequences would flow from its implementation."

The similarity of the probable results from a Bahamian or

82 Id. at 629.
84 Id. § 547(b)(4)(A).
85 Gitlin & Flaschen, supra note 6, at 321, 322.
86 Culmer, 25 B.R. at 629.
87 Id. at 631.
88 Id. at 633.
a U.S. proceeding undercuts Culmer’s precedential value in terms of adopting universality. Although Culmer proclaims that the courts should rely on universality in determining whether to grant Section 304 relief “unless egregiously unjust consequences would flow from its implementation,” that court’s decision to submit the bankrupt’s assets to a foreign proceeding would not have even slightly discriminated against the creditors. As described above, both a Bahamian and a U.S. proceeding would have treated the creditors as unsecured creditors and paid them pro rata. Because the court did not have to compromise the U.S. creditor’s interests, its expression of universalistic rhetoric lacks substantial precedential value and certainly does not signify the United States’ total commitment to the distribution of the available assets from a unitary proceeding.

Cunard S.S. v. Salen Reefer Serv. stands as another case which explicitly endorses universality without compromising U.S. creditors’ interests. In Cunard, the creditors obtained attachments against the foreign debtor’s assets after the foreign bankruptcy proceedings had begun. The U.S. court found that “Cunard is not a secured creditor of Salen, but a general creditor,” and that “Cunard initiated this action and obtained the attachment after Salen had filed its petition for bankruptcy.” The court found “no compelling policy reason for a general creditor whose claim is subject to arbitration to receive a preference over other creditors.” The court declared its certainty that it had adjudged the law of the foreign bankruptcy proceeding “entirely consistent” with U.S. law.

The Cunard court provided very general reasons as to why U.S. courts should grant Section 304 relief. The court’s arguments manifest its adherence to universality: “[t]he granting of comity to a foreign bankruptcy proceeding enables the assets of a debtor to be dispersed in an equitable, orderly, and systematic manner, rather than in a haphazard, erratic or

89 Id.
90 Id. at 460.
91 773 F.2d 452 (2d Cir. 1985); 49 B.R. 614 (S.D.N.Y. 1985).
92 Cunard, 773 F.2d at 459.
93 Id.
94 Id. at 460.
piecemeal fashion.”\(^9\) These statements evidence the court’s firm belief in the paramountcy of achieving a unitary bankruptcy proceeding. When one examines the case as a whole, however, it becomes obvious that the court devoted most of its opinion to explaining that permitting the foreign liquidators to obtain the U.S. assets would not compromise the local creditors’ rights.\(^8\) Thus both the Culmer and Cunard courts expressly recognized subsection (5) comity as Section 304(c)’s main “guideline” that the courts apply. In actuality, however, it appears that the courts mainly focused on subsections (2)—in order to protect the claim holders in the United States against prejudice—and (4)—in order to ensure the distribution of the proceeds “substantially in accordance with the order [the Code] prescribe[s] . . . .”

In In re Lines,\(^9\) a case which scholars commonly cite as an example of the United States’ tendency toward universalism,\(^8\) the court emphasized protecting U.S. claimholders. Lines involved the liquidation of River Plate, a reinsurance company in Bermuda. To sell reinsurance in New York, River Plate had established a $1.5 million trust in a New York bank as security for its customers. Reinsurance Company of America (“RCA”) held a U.S. policy which River Plate had issued. RCA had satisfied the policy’s conditions for payment of $600,000 from the trust after the winding up proceedings commenced in Bermuda. The River Plate’s joint liquidators

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\(^9\) Id. at 458.

\(^8\) The Cunard court contended that:

The Principles of Swedish bankruptcy law are not dissimilar to those of our Bankruptcy Code. Swedish law requires that upon declaration of bankruptcy, an interim trustee or administrator be appointed and notice sent to all creditors. A meeting of creditors is scheduled and legal actions by creditors are stayed. In addition, the court has the power to issue orders preventing the debtor from dissipating or absconding with assets.

Id. at 459. The court ensured the local creditors further that:

Cunard has not demonstrated that the laws or public policy of the United States would be violated or in any way infringed by according comity to the Swedish bankruptcy proceedings . . . There is no indication that Cunard will be treated in any manner inimical to our policy of equality.

Id. at 460, 461.


\(^8\) Glosband & Katucki, Section 304, supra note 68.
filed a Section 304 petition to preliminarily enjoin RCA from pursuing the trust's assets. The court, noting comity's applicability, granted the preliminary injunction: "[c]omity surely requires that the Bermuda Court be given the opportunity to rule on the central issue of RCA's claim."\(^9\) Conversely, in the same breath, the court assured the U.S. claimholders that "the undisputed evidence is that the Bermuda Court will interpret the Agreement under New York law, as the Agreement provides, if there is any doubt as to its meaning."\(^10\)

The court also noted that it would distribute the proceeds accordingly. As in Culmer and Cunard, the Lines court did not have to worry about the possibility that the distribution of the proceeds might compromise the U.S. claimholders—because in this case, the Bermuda court would interpret the agreement under New York law.\(^11\)

### 5.1.1. Decisions Which Did Not Involve the Return of Assets

Two other decisions, Angulo v. Kedzep \(^12\) and In re Gee,\(^13\) express principles of the universality theory but do not involve "the essence of Section 304, the return of assets to a central bankruptcy administration."\(^14\) In Angulo, the trustee of a Canadian liquidation, after unsuccessfully trying to obtain evidence from the liquidated company's Houston area former officers and employees, commenced an ancillary Section 304 case in U.S. bankruptcy court for the purpose of discovery. In determining whether to grant such relief, the court only looked to one of the Section 304(c) factors—comity. The court noted that it needed to decide what "will best assure an economical and expeditious administration of this estate."\(^15\)
Commentators have consistently pointed to this case as evidence that U.S. courts rely on a universalist theory which favors a unitary administration in the foreign proceeding rather than protection of U.S. creditors' claims. Because this case did not involve the issue of whether to defer to a foreign proceeding and give U.S. assets to a foreign liquidator, the courts did not have to risk compromising U.S. creditors in the interest of the equitable distribution of assets to all creditors.

In *In Re Gee*, the liquidator of a foreign liquidation proceeding in the Cayman Islands filed a Section 304 petition seeking discovery and the turnover of the defunct Cayman Islands reinsurance company's books and records. In response, the company's shareholders petitioned under Chapter 11 of the Code. The U.S. bankruptcy court granted the liquidator the relief it had requested and dismissed the Chapter 11 proceeding. The *Gee* court noted that "[a]lthough comity is only one of six factors to be considered in determining whether to grant relief, it often will be the most significant." The court further found that "exceptions to the doctrine of comity are narrowly construed." Despite this affirmation of comity's centrality, a substantial portion of the decision explained that the laws of the foreign proceeding would not prejudice or inconvenience the local shareholders and that the Cayman Islands' laws of distribution were substantially in accord with those of the Code. Thus, while the court proclaimed that it should treat comity as the most significant factor, it devoted less time to comity in its decision than it did to demonstrating that the Cayman Islands' laws would protect the shareholders.

5.2. Decisions Which Have Conditionally Deferred to Foreign Insolvency Proceedings

Not all courts advocate focusing on the international comity factor to foster universality. In fact, some courts "have been more cautious about, and in [several cases] distrustful of, universality, and have declined to fully recognize the foreign

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106 2 COLLIER ON BANKRUPTCY, supra note 46, ¶ 304.04.
107 *In re Gee*, 53 B.R. at 901.
108 Id. at 902-04.
insolvency proceeding at issue.\textsuperscript{109} The foregoing statement describes two groups of cases. In one group of cases, U.S. courts turned over the local assets to the foreign liquidator, but only on the condition that the foreign proceeding apply some aspect of U.S. law or that the U.S. courts apply some aspect of U.S. law first before turnover. In the second group of cases, the courts refused to turn over local assets because they found that in doing so the court would violate public policy, prejudice local creditors, and violate the Section 304(c)(4) requirement that distribution of proceeds closely mirror the order that the Code mandates.

The first group consists of four cases which have conditioned Section 304 relief on the foreign proceeding's or U.S. proceeding's application of some aspects of U.S. law—\textit{In re Lineas Aereas De Nicaragua},\textsuperscript{110} \textit{In re Banco Nacional De Obras Y Servicios Publicos},\textsuperscript{111} \textit{In re Axona Int'l Credit & Commerce}, and \textit{In re Koreag}.\textsuperscript{112} In \textit{Lineas}, a Nicaraguan debtor's trustee sought turnover of all the debtor's U.S. property and injunctive relief against U.S. litigation adverse to the debtor or the debtor's property. The court gave the trustee possession of the U.S. assets and granted injunctive relief on three conditions. First, the court required that the trustee not remove the assets located in the United States. Second, the court required that the trustee first must use the local assets to satisfy debts to U.S. creditors. Finally, the court required that the trustee not encumber, assign, or abandon any of the debtor's U.S. assets.\textsuperscript{113}

In the second case, \textit{In re Banco}, agencies of the Mexican government owned a Mexican company which operated Aeromexico, Mexico's national airline. Aeromexico conducted business in Mexico and the United States and employed 350 workers in the United States. The International Association

\textsuperscript{109} Glosband \& Katucki, \textit{Current Developments}, supra note 76, at 2274.


\textsuperscript{111} 91 B.R. 661 (Bankr. S.D.N.Y. 1988).


\textsuperscript{113} \textit{In re Lineas}, 10 B.R. at 790.; Glosband \& Katucki, \textit{Section 304}, supra note 68, app. III.
of Machinists and Aerospace Workers ("IAM") represented Aeromexico's U.S. workers. Partly as a result of labor problems in the United States, the Mexican company commenced a bankruptcy proceeding under Mexican bankruptcy law.\textsuperscript{114} The Mexican bankruptcy court allowed the Mexican company to reject any labor contracts between itself and various unions including the IAM. The U.S. bankruptcy court—at the Mexican trustee's request—issued a broad injunction. The IAM wanted to modify the injunction to empower the U.S. court to apply U.S. labor law and determine whether a collective bargaining agreement existed on the date of the Mexican company's bankruptcy, and, if so, what rights flowed from it. The court ruled in favor of the IAM because of the peculiar nature of labor law.\textsuperscript{115} The peculiar nature stems from the history of U.S. labor law as "an area in which traditional contract principles are not strictly applied and in which policy considerations abound."\textsuperscript{116} The court felt that requiring the union members to litigate their claims in Mexico, and allowing Mexico's courts to apply U.S. labor law, would "severely prejudice[]" the union members.\textsuperscript{117} The court further explained that if the U.S. courts found the dispute minor or found that no collective bargaining agreement existed, then under notions of comity, the foreign proceeding would determine where to liquidate the employees's claims.\textsuperscript{118} The court ruled that the Mexican bankruptcy court would retain jurisdiction to determine whether to allow union claims under Mexican bankruptcy law and then to rank those claims. In essence, "the U.S. bankruptcy court cut the baby in half by retaining U.S. jurisdiction over the U.S. labor issue while remitting distribution issues to the Mexican

\textsuperscript{114} In re Banco, 91 B.R. at 663 (The Mexican company commenced its bankruptcy case in Mexico only a few days after the IAM commenced an action in the Southern District of New York against the company for declaratory and injunctive relief. IAM commenced the latter suit because the company notified IAM that the two no longer had a collective bargaining agreement.).

\textsuperscript{115} "American labor law is an area which is sui generis." In re Banco, 91 B.R. at 664.

\textsuperscript{116} Id. at 667, 668.

\textsuperscript{117} Id. at 667.

\textsuperscript{118} Id. at 668.
bankruptcy proceedings for decision.\footnote{119}

In the third case, \textit{In re Axona}, the court conditioned Section 304 relief on the application of U.S. law to the distribution of the proceeds.\footnote{120} This case involved Axona, a bank registered in Hong Kong. While Axona did not engage in the banking business in the United States, it did maintain substantial deposits there.\footnote{121} In the midst of Axona's collapse, three banks attached $3.8 million dollars in a U.S. bank account which Axona controlled.\footnote{122} Through complex self help maneuvers, one of the three banks caused Axona to repay a three million dollar loan on the day Axona collapsed.\footnote{123} First, Axona faced Hong Kong winding-up proceedings.\footnote{124} Subsequently, the Hong Kong liquidators commenced an involuntary Chapter 7 case against Axona in the United States so that they could make use of the Code's avoidance powers which filing an ancillary proceeding under Section 304 would not provide.\footnote{125} After collecting over seven million dollars, both the U.S. trustee and the Hong Kong liquidators jointly petitioned the U.S. bankruptcy court to suspend the involuntary Chapter 7 case and direct the turnover of the estate's assets to the Hong Kong liquidators for distribution in the Hong Kong winding-up proceeding.\footnote{126} The U.S. court granted the relief and returned the matter and the assets to the foreign proceed-
ing pursuant to specific terms. The court imposed the following three terms to protect the U.S. trustee and the U.S. claimholders:

1. All administrative expenses as defined in Section 507(a) of the Bankruptcy Code incurred in connection with this case, as allowed by this Court, shall be paid by the Trustee out of the assets of this estate.
2. All other allowed claims filed in this case entitled to priority under Section 507(b) of the Bankruptcy Code, if any, shall be paid by the Trustee out of the assets of this estate.
3. The Trustee shall retain the sum of $500,000 to complete the administration of this estate.

Finally, the In re Koreag, Controle et Revision, S.A. court allowed turnover of U.S.-based assets to a foreign bankruptcy proceeding on condition that the U.S. courts first apply local law to determine whether the foreign bankrupt owned these assets. In that case, the petitioner, the Official Liquidator of Mebco Bank, S.A. ("Mebco"), a Swiss bank, wanted to liquidate and distribute Mebco's assets pursuant to Swiss law. Prior to the liquidation, Mebco and Refco F/X Associates, Inc. ("Refco"), a New York dealer in foreign currencies, had established an arrangement under which Mebco delivered funds to Refco. More specifically, that arrangement required Refco to deliver foreign currency and U.S. dollars to Mebco's account at a bank in Europe in exchange for Mebco's simultaneous delivery of U.S. dollars and foreign currency of comparable value to Mebco's account at Swiss Bank Corporation in New York ("Swiss Bank-New York") with instructions to the bank to credit Refco's account at Citibank in New York. The Swiss Banking Commission of Switzerland decided to liquidate Mebco and as a result, Swiss Bank-New York decided to stop all payments out of Mebco's account, including those which were intended as performance for Refco's currency.

127 Id. at 618.
128 Id.
130 130 B.R. at 709.
131 Id. at 708.
exchange. After Refco learned of this information, it sued Mebco in the Southern District of New York to obtain an ex parte order of attachment of Mebco's account at Swiss Bank-New York. Refco argued it had a right to attach Mebco's account because Refco transferred approximately 6.9 million dollars and 4.1 million dollars of foreign currency (the "Disputed Funds") into Mebco's European bank account, but Mebco did not make reciprocating transfers from Mebco's account at Swiss Bank-New York to Refco's account at Chemical Bank in New York. In addition, Refco motioned to confirm the attachment. In response, the petitioner filed a Section 304 petition and sought to enjoin Refco from reaching the Disputed Funds and to turn over the Disputed Funds to petitioner for administration in the Swiss proceedings.\textsuperscript{132}

In response to petitioner's section 304 petition, Refco argued that the bankruptcy court must determine whether the Disputed Funds were the debtor's property before the court could turnover these funds pursuant to section 304. In order to determine jurisdiction under section 304, the bankruptcy court stated it only needed to look at whether "(1) a foreign proceeding was commenced against the debtor; (2) the petitioner is a foreign representative entitled to file the action under section 304; and (3) 'the debtor had certain assets within the judicial district where the petition was filed.' "\textsuperscript{133} The petitioner clearly met the first two requirements. The bankruptcy court applied Swiss law to determine whether Mebco had assets in the district in the United States where the petition was filed and found that Mebco satisfied the third requirement.\textsuperscript{134}

The heart of the case, however, concerned the creditor's different rights under U.S. and Swiss law—New York law would deem Refco a secured creditor, while Swiss law would consider Refco unsecured. Nonetheless, the bankruptcy court placed great weight on comity in applying Section 304(c):

> [this court] need not address the merits of Refco's claim that under the Code and New York laws it holds a

\textsuperscript{132} Id. at 709.

\textsuperscript{133} Id. at 711 (quoting In re Trakman, 33 B.R. 780, 783 (Bankr. S.D.N.Y. 1985)).

\textsuperscript{134} Id. at 712.
secured claim because that is not the test under Section 304. The test is whether the proceedings in Switzerland comport with fundamental notions of fairness not that the foreign bankruptcy laws are a mirror image of our own.\textsuperscript{135} The bankruptcy court granted summary judgment to petitioner and thus turnover of the Disputed Funds.\textsuperscript{136} Thus, the bankruptcy court departed from the majority of Section 304 cases because it upheld universality despite the fact that in doing so it risked compromising the interests of a U.S. creditor.

The bankruptcy court’s order, however, did not survive the court of appeal’s scrutiny. The district court affirmed the bankruptcy court order but stayed enforcement of the order in order to permit Refco to apply to the court of appeals. Refco appealed and the district court granted a further stay requiring Swiss Bank-New York to hold the Disputed Funds pending final determination of Refco’s appeal.\textsuperscript{137} Refco appealed on two grounds. First, Refco argued that, according to section 304(b)(2), the Disputed Funds were not property of Mebco’s estate. Therefore, Refco stated that the bankruptcy and district courts should not have ordered turnover of these funds. Second, Refco argued that even if the Disputed Funds were Mebco’s estate’s property, the bankruptcy and district courts incorrectly applied section 304(c)’s six factors and for that reason alone the courts should not have ordered turnover of the property.\textsuperscript{138}

The court of appeals found that New York law not Swiss law governed the determination of who owned the Disputed Funds.\textsuperscript{139} The court of appeals found that “[d]espite connections to both jurisdictions we conclude that New York has a superior interest,”\textsuperscript{140} with respect to determining who owns the Disputed Funds and that “New York’s primary interest is

\textsuperscript{135}Id. at 713, 714 (citation omitted).
\textsuperscript{136}Id. at 716.
\textsuperscript{137}In re Koreag, Controle et Revision, S.A., 961 F.2d at 348 (2d Cir. 1992).
\textsuperscript{138}Id.
\textsuperscript{139}Id.
\textsuperscript{140}Id. at 351.
in defining and protecting the property interests of its citizens and those who do business there. Thus, the court of appeals vacated the district court's order. In applying New York law, the court of appeals found that Refco owned 6.9 million dollars of the Disputed Funds and that the district court should not turnover this amount to the petitioner. The court of appeals remanded the case, however, to determine under New York law who owned the Disputed Funds's remaining 4.1 million dollars.

Because the court of appeals remanded the case to determine who owned the remaining amount of the Disputed Funds, it stated that it was not necessary to address whether turnover of these funds was improper because the bankruptcy and district courts only addressed comity to the exclusion of the other section 304(c) factors. The court, however, did note that "neither the Code nor the legislative history accords superior weight to the comity factor."

Although the court of appeals did not address whether the bankruptcy and district court's improperly emphasized comity over the other factors of section 304(c), it did stress that comity is not the decisive factor that a court should consider. In addition, by vacating the bankruptcy and district court's order and holding that New York law would apply in the determination of the ownership of the Disputed Funds, the court of appeals indirectly placed a condition on U.S. deference to the Swiss proceeding. The indirect condition protected the U.S. creditor, Refco, by determining that Refco owned at least 6.9 million dollars of the Disputed Funds and exposed the court of appeal's territorial nature. Thus in this case, although the universality doctrine won the battle in the bankruptcy court, the territoriality doctrine won the war by the indirect condition the court of appeals placed on the turnover.

In imposing conditions on the transfer of U.S. assets, these four cases reveal that U.S. courts invariably focus on and privilege the interests of the U.S. creditors. The first three decisions also expose the courts' belief that to fully protect the

141 Id. (emphasis added).
142 Id. at 356.
143 Id. at 358.
144 Id.
U.S. creditors, the courts must ensure that foreign proceedings will not treat U.S. creditors differently in any important ways than the Code would treat them.\textsuperscript{145} Thus, these decisions contradict the legislative intent behind Section 304.\textsuperscript{146}

5.3. Decisions Which Have Not Deferred to Foreign Bankruptcy Proceedings

Not all of the Section 304 cases have ruled in favor of the foreign representative. In fact, in several cases the U.S. courts have found that a transfer of the assets would violate the interests of the U.S. claimholders. These cases demonstrate the persistence of the U.S. judicial endorsement of territoriality.

Concern over the foreign liquidators’ questionable conduct in \textit{In re Papaleras Reunidas}\textsuperscript{147} influenced the court’s decision not to grant Section 304 relief. Thus the court prevented Spanish liquidators from obtaining possession of U.S. assets to distribute according to a Spanish liquidation proceeding. In that case, Adams served as a U.S. distributor of cigarette rolling paper, which a Spanish manufacturer, Papeleras, produced. Adams had obtained a judgment in the U.S. District Court for the Northern District of Illinois against Papeleras for more than $1.4 million on a breach of contract claim.\textsuperscript{148} After the Spanish liquidation proceeding commenced, Adams moved to attach the Papeleras’ trademarks registered in the United States.\textsuperscript{149} The Spanish liquidators opposed this motion and, in doing so, represented to the court that they had not planned to sell the trademarks.\textsuperscript{150} The district court granted Adam’s motion but stated that it would set aside the lien if the liquidators could provide the court with certain Spanish law provisions. The court asked the liquidators to furnish provisions which rendered the lien on the trademarks improper and which established that the Spanish proceeding would recognize

\textsuperscript{145} Hughes, \textit{supra} note 4, at 32.
\textsuperscript{146} See \textit{infra} notes 55-58 and accompanying text.
\textsuperscript{147} 92 B.R. 584 (Bankr. E.D.N.Y. 1988).
\textsuperscript{148} \textit{Id.} at 585, 586.
\textsuperscript{149} \textit{Id.} at 588.
\textsuperscript{150} \textit{Id.}
Adams as a creditor. The liquidators failed to present the Spanish law to the court. Consequently, the lien continued. Despite their representations to the contrary, that same month the liquidators sold the trademarks to Bambu in Madrid. In fact, the court later learned that the liquidators and Bambu had negotiated for the transfer before the liquidators opposed Adams’ motion. Adams, reacting to this transfer, filed suit in the district court alleging that Papeleras’ liquidators had fraudulently conveyed the trademarks. Two months later, the Spanish liquidators brought a Section 304 ancillary proceeding to prevent Adams from seizing and garnishing the balance of the payments due Papeleras from Bambu for the trademarks.

The court denied relief because the liquidators had not given Adams' notice of the Spanish proceeding and Spanish law does not classify judgment lien creditors as secured creditors but instead defines them as general unsecured creditors. The court noted that “the laws of both countries with respect to the distribution of funds in an insolvency proceeding are also markedly different.” Thus granting the liquidators' request for relief would have violated Section 304(c)(4)—distributing funds substantially in accordance with the Code’s scheme. The court also voiced concern regarding the liquidators’ conduct in transferring the trademarks to Bambu.

The Papeleras court disagreed with the Gee and Culmer courts regarding comity's paramountcy over the other five Section 304(c) factors when deciding whether to grant Section 304 relief. Instead the court contended that:

[The legislative history reflects that when Representative Don Edwards introduced the final bill to the House, he stated: “Section 304(c) is modified to indicate that the court shall be guided by considerations of comity in

151 Id.
152 Id.
153 Id.
154 Id. at 589.
155 U.S. law, however, would classify Adams as a judgment lien creditor, a classification which would entitle Adams to priority over unsecured creditors. See U.C.C. § 9-301(b) (West 1991).
156 In re Papeleras Reunidas, S.A., 92 B.R. at 593.
addition to the other factors specified therein." Bankruptcy Reform Act of 1978, Pub. L. No. 95-598. Thus, it is best to equally consider all of the variables of § 304(c) in determining the appropriate relief in an ancillary proceeding.¹⁵⁷

The court explained that if only one factor, "the economical and expeditious administration of [the] estate" existed, the court might have given the local assets to the Spanish liquidators. After reasoning that it had to consider Section 304(c)’s other five factors which "overwhelmingly dictate[d]" that the court deny the relief, the court did not allow the Spanish liquidators to receive the proceeds. Therefore, the court resolved the conflict inherent in Section 304(c) in favor of a territorial approach based on the facts of this case.¹⁵⁸

Courts can employ comity to oppose rather than favor deference to the foreign judicial proceeding. *Overseas Inns*¹⁵⁹ exemplifies this use of comity. There the court stressed that "[i]t is a settled principle of comity that deference need not be given to foreign judgments in the face of significant countervailing public policy reasons."¹⁶⁰ The case involved a Luxembourg corporation, Overseas, who at the time of their bankruptcy in Luxembourg, owed the Internal Revenue Service ("IRS") approximately one million dollars. According to the debtor’s reorganization plan in Luxembourg, Overseas planned to pay only $231,475 or 23.49% of its income tax deficiency. After receiving a copy of the plan, the IRS did not object. When the IRS only received $179,135.76, it levied on payments that third parties in the United States owed to Overseas. This enabled the IRS to collect an additional $919,835.79. Overseas

¹⁵⁷ Id. at 594 (emphasis added).
¹⁵⁸ Id. at 595; contra Glosband & Katucki, *Current Developments*, supra note 76, at 2276.

¹⁶⁰ Id. at 972.
moved for summary judgment claiming that the court should accord comity to the Luxembourg court’s judgment which found that Overseas had fully satisfied its obligations to the IRS.\textsuperscript{161}

The Overseas court ruled in favor of the IRS after closely analyzing the universality and territoriality theories\textsuperscript{162} and deciding that “[i]t need not adopt one approach over the other.”\textsuperscript{163} In a footnote, however, the court revealed that notions of territoriality must take precedence over notions of universality in certain situations:

Overseas also argues that this court should accord comity because doing so would promote efficient resolution of international bankruptcies. While this is a relevant factor in determining whether to recognize a foreign judgment, public policy considerations will receive greater weight when the foreign decree violates domestic public policy.\textsuperscript{164}

This footnote suggests that the court believed that whenever a foreign judicial proceeding might impinge on some notion of domestic public policy, it would retreat to territoriality. In this case, the court found domestic public policy considerations to counsel against according comity to the foreign proceedings. The court made this determination because foreign proceedings would not give priority to the federal taxes and would treat the foreign company’s payment of only a percentage of the taxes it owed as satisfaction of the entire tax obligation.

Another case in which the court refused to defer to a foreign proceeding, \textit{In re Toga Mfg.},\textsuperscript{165} may go down in international insolvency history as the most infamous U.S. decision. This case received more criticism than Overseas and Papeleras primarily because it involved a foreign proceeding in a “sister common law jurisdiction,” Canada.\textsuperscript{166} Traditionally, U.S. courts have held that “[t]hese exceptions [to the rule of comity] are construed especially narrowly when the alien

\textsuperscript{161} Id. at 968-70.
\textsuperscript{162} Id. at 971, 972.
\textsuperscript{163} Id. at 972.
\textsuperscript{164} Id. at 973 n.14.
\textsuperscript{166} Glosband & Katucki, \textit{Current Developments}, supra note 76, at 2278.
jurisdiction is, like Canada, a sister common law jurisdiction with procedures akin to our own."

_Toga_ involved Hesse, a Michigan corporation, which had contracted with Toga, a Canadian corporation, to serve as Toga's exclusive sales representative. Hesse became a judgment creditor of Toga and as a result garnished money that certain creditors owed Toga. A Michigan circuit court clerk held the garnished funds in an account pending resolution of a security interest priority dispute between Hesse and Toga's largest secured creditor, a Canadian bank. Michigan law considered Hesse a lien creditor. Six months later, another creditor of Toga commenced an involuntary proceeding in bankruptcy under Canadian law. Toga's Canadian trustee brought an ancillary proceeding pursuant to Section 304 seeking to enjoin all of Toga's creditors from taking any action against Toga's U.S. assets. The trustee also sought an order directing the Michigan court's clerk to turn the funds over to the Canadian trustee.

The _Toga_ court denied relief to the Canadian trustee because it believed such relief would violate Section 304(c)(4) because the distribution of proceeds would not substantially comport with the Code. The court did not ignore the "close geographic proximity of Canada and the United States." The court did, however, emphasize that U.S. law would recognize Hesse as a lien creditor while Canadian law would consider Hesse an ordinary creditor with no priority in the distribution of proceeds. The court used Section 304(c)(4) as a threshold test. Once the court had determined that the use of Canadian law in this case would fail the Section 304(c)(4) test, it would not accord comity greater weight in its decision.

Commentators have called the court's "use of chauvinistic language" the most shocking aspect of the _Toga_ decision. The first sentence of the discussion stated that, "[h]istorically, the bankruptcy laws of our country have been hostile towards

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167 Clarkson v. Shaheen, 544 F.2d 624, 629-30 (2d Cir. 1976); see supra notes 32-45 and accompanying text.
169 Id.
170 Id.
171 See, e.g., Glosband & Katucki, _Section 304, supra_ note 68.
claims asserted by foreign trustees in bankruptcy against alleged estate property located in the United States." The court quickly pointed out that the definition of comity does not automatically obligate the courts to grant relief to a foreign proceeding and does require the court to have "due regard ... for the rights of its own citizens or of other persons who are under protection of its laws." The court hinted that "[p]rinciples of international comity and respect for the judgments and laws of other nations ... could be promoted by a treaty between the United States and Canada ..." In the absence of such a treaty, the court felt obligated to grant Section 304 relief and argued that other Section 304(c) factors besides comity favor denying such relief.

While some have criticized Toga as an "emasculation" of Section 304, that case did not violate subsection (c). Instead, the court decided to take advantage of the flexibility Congress had offered to it and to give greater weight to subsection (c)(4) than the other factors. One must remember that "[c]omity is only one of the six criteria listed in Section 304(c) to guide the court in determining whether to grant the requested relief; to promote principles of comity above the remaining five criteria would be to ignore the literal terms of the statute." While the Toga court might not have furthered universality in international insolvencies, it did not overstep its Section 304 powers when it decided to protect local creditors rather than to foster international comity principles. As one article which provides a Canadian perspective on Section 304's application noted, "[n]onetheless, the flexibility provided to American courts by section 304, while domestically beneficial, generates too much uncertainty for section 304 to serve as the international model."

The most recent decision to refuse to recognize a foreign

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172 Toga, 28 B.R. at 167.
173 Id. at 169 (quoting Hilton v. Guyot, 159 U.S. 113, 164 (1895)).
174 Id. at 169 (citation omitted).
176 Gitlin & Flaschen, supra note 6, at 321.
177 Id.
178 Leonard, Carfagnini & McLaren, supra note 1, at 32.
bankruptcy proceeding, *Interpool, Ltd. v. Certain Freights of M/V Venture Star*,” has rekindled international concerns about the United States’ willingness to recognize foreign insolvency proceedings. In *Interpool*, a creditor, Wah Kwong, had filed involuntary liquidation proceedings in Australia against the debtor KKL, an Australian liner company which operated liner service between the United States and Australia. Wah Kwong had business dealings with KKL and also sat on its board of directors. KKL also had U.S. creditors and held assets in the United States which included rights to an arbitration proceeding. KKL’s Australian court-appointed liquidator filed a section 304 ancillary proceeding to gain possession of KKL’s U.S. assets. Subsequently, the U.S. creditors filed an involuntary bankruptcy petition under Chapter 7 of the Code for the regular liquidation of the U.S. assets. Thereafter, KKL’s liquidator entered into a settlement where he would distribute to a Wah Kwong subsidiary the first six million dollars that KKL received in any U.S. arbitration award. The liquidator would leave the remaining proceeds to satisfy KKL’s other creditors. Even though the parties did not give prior notice of this agreement between the liquidator and Wah Kwong to any other creditors, the Australian court sanctioned the agreement.

The court refused to dismiss the Chapter 7 case and declined to defer to the liquidator’s section 304 petition. As a result, the court ordered that U.S. law would control the administration of the U.S. assets. The court gave two reasons for denying Section 304 relief. First, because the U.S. creditors had no prior notice of the settlement agreement between KKL and Wah Kwong, they could not participate in

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178 102 B.R. 373 (Bankr. D.N.J. 1988); Glosband & Katucki, *Current Developments*, supra note 76, at 2277; Westbrook, *supra* note 11, at app. III A; see also, Hughes, *supra* note 4 (providing an Australian Perspective on *Interpool*).

180 *Interpool*, 102 B.R. at 374-76 (Australian law does not require notice); see Hughes, *supra* note 4, at 32 (“In this commentator’s experience, it would have been unprecedented for the Supreme Court of New South Wales to not have positively considered the interests of the United States creditors before sanctioning the agreement between the liquidator and the Wah Kwong subsidiary.”).
the agreement. Second, Australian law had no analogue to the substantive remedy of equitable subordination appearing in Section 510(c) of the Code. The court argued that it must consider this difference because of KKL’s and Wah Kwong’s possible insider manipulations: “[o]n its face there appear to be substantial allegations of insider machinations which would require that a court consider equitable subordination.”

The *Interpool* court noted that “[t]here is no requirement that Australian law and United States law be identical.” Nevertheless, the court found that “the procedural protections available to creditors in the United States were not given to the United States creditors in Australia,” and that “the substantive remedy of equitable subordination is available in the United States. It is not, however, available under Australian law.” In forceful language the court argued that “this Court does not intend to sit idly by while United States citizens and creditors are harmed.” This language, replete with territorialism, portends trouble:

*Interpool*, however, may have a more far reaching effect than *Toga Manufacturing* or *Overseas Inns*, because it questions, in general terms, the notice procedures of Australian insolvency law, thereby suggesting that Australian proceedings should rarely be recognized by U.S. bankruptcy courts. Such a view appears contrary to the spirit of section 304 and the principle of comity, and runs counter to many other U.S. decisions recognizing the proceedings of a variety of foreign jurisdictions.

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181 *Interpool*, 102 B.R. at 378, 379. Australia has no law equivalent to Rule 2002(a)(5) of the Rules of Bankruptcy Procedure which requires that “creditors be notified prior to the institutionalization of agreements between the trustee and any of the creditors.” *Id.* at 378; see also Hughes, *supra* note 4, at 32.


183 *Id.* at 380.

184 *Id.* at 378.

185 *Id.* at 379.

186 *Id.*

187 *Id.* at 380.

188 Glosband & Katucki, *Current Developments*, supra note 76, at 2278.
6. CONCLUSION

As Congress has drafted it, Section 304 aspires to become a model for international bankruptcy law. As most courts have applied it, however, it serves as a reminder of the prevailing spirit of U.S. protectionism. Examination of the case law regarding Section 304’s applications reveals that, in most cases, when a foreign representative forces the U.S. court to choose between fostering international comity and protecting local creditors, the court will not compromise local creditors interests even if such a compromise will “best assure an economical and expeditious administration of such estate” for all creditors worldwide. The Culmer, Cunard, and Gee decisions support the United States’ commitment to the principle of international comity. Lineas, Banco, Axona, and Koreag which conditionally defer to foreign insolvency proceedings, and Papeleras, Overseas, Toga, and Interpool, which reject deference to the foreign proceedings even after considering notions of international comity, undermine that support.

Cooperation implies compromise. If the United States truly wishes to encourage other nations to cooperate in international bankruptcy proceedings and sincerely seeks to implement the legislative intent behind Section 304, it must enjoin its courts to consistently adopt a universalistic approach. Such an approach must prevail even if it will compromise U.S. creditors’ interests. Until U.S. courts demonstrate their concerted commitment to universality, the United States will find itself hiding behind a “drapery of illusion” that has become completely transparent to the rest of the world.