Cross-Border Insolvencies: Plenary Cases and Ancillary Proceedings Involving Foreign Debtors in US Bankruptcy Courts*

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There are two types of insolvency proceedings under US bankruptcy law which are available to entities formed outside the United States. First, a foreign entity that is already subject to a 'foreign proceeding' may be made a debtor in an ancillary case commenced by the filing in the United States of a petition by a 'foreign representative' pursuant to § 304 of the US Bankruptcy Code. Secondly, a foreign entity may, subject to limitations discussed below, become a debtor in a full plenary case in the United States.

Bankruptcy Code § 304 is intended to invoke the powers of the bankruptcy courts, in a limited way, in proceedings that are supplemental to a plenary 'foreign proceeding'. One of the central elements of § 304 is a requirement that the bankruptcy court weigh the request for relief in the § 304 petition against a number of factors, including those that stress the interests of the parties in the foreign proceeding and others that stress the interests of US creditors. An examination of the reported decisions under § 304 demonstrates that, with at least one recent exception, courts are generally amenable to:

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* This article is provided as a general informational service and it should not be construed as imparting legal advice on any specific matter.

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(1) granting foreign representatives access to US bankruptcy jurisdiction on the filing of § 304 petitions; and
(2) giving broad definition to the parameters of relief available under § 304.

Though less prevalent, the reported decisions also suggest that US courts are open to entertaining plenary petitions brought under Bankruptcy Code §§ 301 and 303, including involuntary cases commenced by foreign representatives under § 303(b)(4), in order to accommodate the interests of creditors in a simultaneous foreign proceeding. A plenary case differs from an ancillary case in at least two key respects:

(1) the automatic stay applies only in plenary cases; and
(2) US avoidance laws (including preference and fraudulent conveyance laws under the Bankruptcy Code) are available to foreign debtors only in plenary cases.

As will be demonstrated below, however, the jurisdictional and eligibility requirements under Bankruptcy Code § 303 are, in most cases, only slightly more restrictive than those of § 304.

Accordingly, if the Bankruptcy Code and US law automatically apply in a plenary case, there is considerable potential for both forum and 'section' shopping. The absence of more restrictive jurisdictional and eligibility requirements for plenary cases involving foreign debtors requires courts to embrace the kind of choice of law rules adopted by the US Court of Appeals for the Second Circuit in its *Maxwell* decision as a necessary means of preventing forum and 'section' shopping.

This article compares the scope of ancillary and plenary proceedings under the Bankruptcy Code and suggests that the US Congress considers the addition of an express choice of law provision to the Bankruptcy Code that would be applicable in plenary cases.

Jurisdictional bases of proceedings involving foreign entities

Applicable definitions: Bankruptcy Code §§ 101(23) and 101(24)

Cases brought by or against foreign debtors under either § 303(b)(4) or § 304 of the Bankruptcy Code must be commenced by a 'foreign representative'.[1] In addition, the foreign debtor must be subject to a 'foreign proceeding'.[2] A foreign debtor may also file a voluntary petition under § 301. Likewise, a foreign debtor is susceptible to an involuntary petition filed by creditors or other parties in interest (foreign or domestic) under subparagraph (1), (2) or (3) of § 303(b).

1 11 USC §§ 303(b)(4) and 304.
2 *Ibid.*

Sections 101(23) and 101(24) of the Bankruptcy Code set forth the definitions of the terms 'foreign proceeding' and 'foreign representative', respectively. A 'foreign proceeding' is:

> '[a] proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization . . .'[3]

The definition of 'foreign proceeding' thus encompasses any liquidation, adjustment of debts or reorganisation proceeding brought under the laws of a foreign jurisdiction. There is no requirement either that a foreign proceeding be commenced under foreign laws which are specifically related to insolvency or that such a proceeding be administered by a court. Indeed, as will be discussed below, in the context of § 304 ancillary cases, courts have given an expansive interpretation of the definition of 'foreign proceeding'.

A 'foreign representative' means a 'duly selected trustee, administrator, or other representative of an estate in a foreign proceeding'.[4] Like the definition of 'foreign proceeding', that of 'foreign representative' is quite broad. Indeed, the court in *In re Board of Directors of Hopewell Int'l Ins Ltd*[5] rejected an objecting creditor's argument that the debtor's board of directors did not qualify as a 'foreign representative' and said:

> 'It is difficult to swallow the notion pushed by [the creditors] that we could recognize a debtor-in-possession, managed as it is by its board of directors . . . in a full-scale bankruptcy case, but refuse to recognize another country's equivalent of a debtor-in-possession in an ancillary case, especially when, as here, the company and its officers are charged under the scheme with the obligation of carrying out its provisions.'[6]

Thus, all that is required is that the foreign representative be 'duly selected' in the foreign proceeding.

Ancillary cases under Bankruptcy Code § 304

In situations where it is not necessary or desirable to commence a plenary case under Bankruptcy Code § 301 or § 303, a foreign debtor has the option of commencing an ancillary case under Bankruptcy Code § 304.

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3 11 USC § 101(23).
4 11 USC § 101(24).
5 238 BR 25 (Bankr SDNY 1999), *aff'd*, 275 BR 699 (SDNY 2002).
6 *Ibid* at 53-54.

The purpose of § 304, which has no predecessor under the former Bankruptcy Act, is to provide 'a mechanism for the courts in this country to aid foreign courts and accommodate the increasing number of foreign insolvency proceedings having extraterritorial effects within the United States'.[7] An ancillary case under Bankruptcy Code § 304 does not create an estate under Bankruptcy Code § 541 and a debtor in such a proceeding does not have the 'full panoply of rights' available to debtors in plenary cases. 'What it does do is lend a "helping hand" to the foreign court where the main or primary proceeding is pending by enabling the foreign representative to take action in the United States "to prevent piecemeal distribution of assets . . . by means of legal proceedings initiated in domestic courts by local creditors".'[8] In furtherance of the purpose of Bankruptcy Code § 304, courts have broadly construed the term 'foreign proceeding'.[9] So long as a proceeding 'is a foreign judicial or administrative process whose end is to liquidate the foreign estate, adjust its debt or effectuate its reorganization', has some measure of judicial oversight and offers aggrieved creditors some right to be heard, the proceeding will qualify as a 'foreign proceeding'.[10] In addition to the flexibility with which courts have interpreted the term 'foreign proceeding' in the context of § 304, a majority of courts have held that a foreign debtor need not have a place of business or any identifiable assets in the United States in order to commence an ancillary proceeding under § 304 for the purpose of obtaining injunctive relief pursuant to § 304(b)(1)(A)(i) (actions against the debtor) or for 'other appropriate relief' pursuant to § 304(b)(3).[11] It should be noted, however, that while the jurisdiction of the Bankruptcy Court has been liberally

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7 *In re Rubin*, 160 BR 269, 274 (Bankr SDNY 1993).

8 *Hopewell*, 238 BR at 54 (quoting *In re Koreag, Controle et Revision SA*, 961 F 2d 341, 348, 357 (2d Cir 1992)); see also *In re Manning*, 236 BR 14, 21 (BAP 9th Cir 1999); *In re MMG LLC*, 256 BR 544, 549 (Bankr SDNY 2000) ('the foreign court presiding over the original proceeding is in a better position to decide when and where claims should be resolved in a manner calculated to conserve resources and maximize assets').

9 See *In re Netia Holdings SA*, 277 BR 571, 580-81 (Bankr SDNY 2002).

10 *Hopewell*, 238 BR at 49-51; *MMG*, 256 BR at 550 (Cayman proceeding was a 'foreign proceeding' even though it was allegedly commenced for the sole purpose of staying creditors until assets appreciated enough to pay debts); *In re Ward*, 201 BR 357, 360-61 (Bankr SDNY 1996) (even though there were no mandatory court appearances, Zambian voluntary liquidation qualified as a 'foreign proceeding' because there was active court supervision and creditors had a right to participate).

11 See *Haarhuis v Kunnan Enterp, Ltd*, 177 F 3d 1007, 1012 (DC Cir 1999) (there is no requirement under the § 304(b)(1)(A)(i) injunctive provision that the debtor have assets in the United States); *Manning*, 236 BR at 20 (the debtor's ownership of property in the United States is not the 'sine qua non' of subject matter jurisdiction under § 304); *In re Metzeler*, 78 BR 674, 678 (Bankr SDNY 1987) ('no case called to our attention or that we

extended in § 304 cases, this is often due to the type of relief sought in the particular case. Section 304 cases tend to be fact-specific, involving situations where the petitioner requests relief with respect to a particular dispute located in the United States. Thus, it was important to the results in *Haarhuis* and *Manning* that the foreign representatives sought injunctive relief with respect to actions in the United States against the respective debtors, pursuant to Bankruptcy Code § 304(b)(1)(A)(i). Similarly, it was important to the result in *Metzeler* that the principal relief sought was for 'other appropriate relief' – pursuant to § 304(b)(3) – in the form of the prosecution of foreign claims in bankruptcy court.

In contrast, where the foreign debtor seeks relief under § 304(b)(1)(A)(ii) to enjoin actions against 'property' of the debtor, or under § 304(b)(1)(B) for the turnover of 'property' of the debtor, the presence of assets in the United States appears to be required.[12] Moreover, where the debtor seeks relief under those sections, the property sought to be protected must in fact belong to the debtor, which is determined by reference to local law.[13]

As stated by the Second Circuit in *Koreag*:

> 'Property interests have an independent legal source, antecedent to the distributive rules of bankruptcy administration, that determines in the first instance the interests of claimant parties in particular property. It logically follows that before a particular property may be turned over pursuant to § 304(b)(2), a bankruptcy court should apply local law to determine whether the debtor has a valid ownership interest in that property when the issue is properly posed by an adverse claimant.'[14]

The court in *Koreag* remanded to the bankruptcy court for a determination under New York law whether a § 304(b)(2) petition for turnover could properly be maintained against funds in a bank account, where the question of whether the funds constituted property of the estate was contested by the respondent-creditor.

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have been able to find has rejected a § 304 petition by reason of the absence of [a bank account or other] such property [in the United States]'); *In re Gee*, 53 BR 891, 898-99 (Bankr SDNY 1985) (holding that it was not necessary for the foreign debtor to have maintained property or a place of business in the United States, so long as the foreign debtor had a 'strong nexus' with the United States). But see *In re Phoenix Summus Corp*, 226 BR 379, 381 (Bankr ND Tx 1998) (dismissing ancillary proceeding because 'the entire tenor of § 304 is that the Debtor . . . has some property in the United States').

12 See *Haarhuis*, 177 F 3d at 1012.

13 *In re Thornhill Global Deposit Fund, Ltd*, 245 BR 1, 10-11 (Bankr D Mass 2000), *aff'd*, 247 F 3d 328 (1st Cir 2001) (although the issue of whether the property in question is part of the foreign debtor's estate is determined pursuant to the law of the foreign jurisdiction, the initial question of ownership is determined by local law); *In re Lines*, 81 BR 267, 271 (Bankr SDNY 1988) (same).

14 961 F 2d at 349.

In sum, subject to consideration by the bankruptcy court of the factors enumerated in § 304(c), and subject to the specific relief requested, a foreign representative may seek the protection of the US bankruptcy courts for a broad range of purposes intended to protect a foreign debtor's estate, whether or not a foreign debtor has any property in the United States.

Section 109 eligibility requirements in ancillary proceedings

Although there is early case law to the contrary, the majority and more current view is that Bankruptcy Code § 109, which sets forth certain eligibility requirements that prospective debtors must satisfy in order to obtain relief under the Bankruptcy Code, does *not* apply to foreign debtors in § 304 proceedings.[15]

In *Brierley*, Bankruptcy Judge Brozman held that § 109(a) does not apply to § 304 proceedings, stating:

> 'Just as there is little reason to exclude a foreign debtor ineligible for chapter 11 relief from being the subject of an ancillary proceeding, there is equally little reason to exclude an entity ineligible to be a debtor under our laws from being the subject of an ancillary proceeding so long as that foreign debtor is eligible to be the subject of a foreign proceeding under its own laws. The language of section 109(a) itself suggests the propriety of this conclusion, for it declares that its requirements pertain to someone wishing to be a debtor "under this title". But the foreign debtor in an ancillary proceeding is not a debtor in a case under title 11; it is a debtor only under the foreign law. The foreign debtor in a 304 case does not reap the benefits (such as discharge of indebtedness) of a debtor under our laws; it is the foreign representative who is benefited.'[16]

The Bankruptcy Court in *Brierley* allowed the § 304 proceeding to be commenced despite the fact that the foreign debtor, it was asserted, did not meet the requirements of § 109(a) in that it did not reside, was not domiciled and did not have a place of business in the United States.[17]

Similarly, in *Goerg*, the Court of Appeals for the Eleventh Circuit held that a decedent's estate could be a 'debtor', as that term is used in the definition of 'foreign proceeding', even though the estate of a decedent is ineligible to

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15 See, eg, *In re Goerg*, 844 F 2d 1562, 1568 (11th Cir 1988), *cert denied*, 488 US 1034 (1989); *In re Saleh*, 175 BR 422, 425 (Bankr SD Fla 1994); *In re Brierley*, 145 BR 151, 159 (Bankr SDNY 1992); *Lines*, 81 BR at 271; *Gee*, 53 BR at 899-900.

16 145 BR at 159.

17 *Ibid* at 155-56.

be a 'debtor' under § 109 of the Bankruptcy Code.[18] The *Goerg* court focused on the definition of 'foreign proceeding', which provides that it must be a proceeding 'whether or not under the bankruptcy law . . . for the purpose of liquidating an estate'.[19] In order to give effect to the ultimate purpose of § 304, which is 'to help further the efficiency of foreign insolvency proceedings involving worldwide assets', the court chose not to focus on the restrictive definition of 'debtor'.[20] Rather, the court adopted the view that:

> '[T]he term "debtor" as used in the section 304 context incorporates the definition of "debtor" used by the forum in which the foreign proceeding is pending. Under this alternative view, the bankruptcy court has jurisdiction to entertain the section 304 petition provided that the debtor qualifies for relief under applicable foreign law, and provided further that the foreign proceeding to which the debtor is subject is "for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization".'[21]

In *Saleh*,[22] the court followed the rationale of *Goerg* and determined that a governmental entity that would be ineligible to be a debtor under the Bankruptcy Code could nevertheless commence an ancillary case in the United States.

Thus, although the foreign entity must be a 'debtor' as that term is used in the Bankruptcy Code definition of 'foreign proceeding', it need not qualify as a 'debtor' as that term is otherwise used in the Bankruptcy Code, so long as the 'debtor' is eligible to be the subject of a proceeding under non-US law.

Section 109 eligibility requirements in plenary cases

In a plenary case commenced by or against a foreign entity, however, all of the eligibility requirements of Bankruptcy Code § 109 must be met. That is, pursuant to § 109(a), the entity must reside, have a domicile, a place of business or property in the United States and, pursuant to §§ 109(b)(1) and (3), the entity may not be a railway or a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and

18 844 F 2d at 1568.
19 *Ibid* at 1566 (emphasis omitted).
20 *Ibid* at 1568.
21 *Ibid* at 1567 (quoting 11 USC § 101(23)).
22 175 BR at 424-25.

loan association, homestead association, or credit union engaged in such business in the United States.[23]

Scope of relief under Bankruptcy Code § 304

Venue and the three categories of relief

Section 304(b) specifies three categories of relief that may be sought in an ancillary proceeding commenced under that section:
(1) injunctive relief (§ 304(b)(1));
(2) the turnover of assets to the foreign representative (§ 304(b)(2)); and
(3) other appropriate relief (§ 304(b)(3)).
These provisions must be read together with 28 USC § 1410, which provides specific venue rules for § 304 proceedings, pursuant to which:
(1) cases in which the foreign representative seeks to enjoin the commencement or continuation of an action or proceeding in a US state or federal court under § 304 may be brought 'only in the district court for the district where the State or Federal court sits in which is pending the action or proceeding against which the injunction is sought' (28 USC § 1410(a));
(2) cases 'to enjoin the enforcement of a lien against a property, or to require the turnover of property of an estate, may be commenced only in the district court for the district in which such property is found' (28 USC § 1410(b)); and

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23 See, eg, *In re Maxwell Comm Corp plc*, 170 BR 800, 812 (Bankr SDNY 1994) (hereinafter '*Maxwell I*'); *aff'd*, 186 BR 807 (SDNY 1995) (hereinafter '*Maxwell II*'), *aff'd*, 93 F 3d 1036 (2d Cir 1996) (hereinafter '*Maxwell III*'); but see 11 USC § 303(k) (only involuntary Chapter 7 case may be commenced against a foreign bank that is not engaged in such business in the United States and only where a foreign proceeding concerning such bank is pending).When interpreted literally, however, the conditions set forth in § 109 are often very easy to satisfy. For instance, in *In re Axona Int'l Credit & Commerce Ltd*, 88 BR 597 (Bankr SDNY 1988), *aff'd*, 115 BR 442 (SDNY 1990), *appeal dismissed*, 924 F 2d 31 (2d Cir 1991), Bankruptcy Judge Lifland rejected a challenge to the Bankruptcy Court's subject matter jurisdiction over Axona's § 303(b)(4) proceeding based on, among other things, the fact that the foreign debtor had no property in the United States aside from a few bank accounts containing about $500,000 (88 BR at 613-15). Eligibility under § 109 was not the explicit issue in *Axona*. However, in holding that it had subject matter jurisdiction, the *Axona* court's reliance on the fact that the debtor had property in the United States demonstrates that the court considered the related eligibility requirements of § 109 (88 BR at 614-15). *See also In re Aerovias Nacionales De Colombia SA Avianca*, 303 BR 1, 8-9 (Bankr SDNY 2003) (foreign debtor met eligibility requirements under § 109(a) even though it had only 28 employees in the United States and more than 4,000 in Colombia); *In re Global Ocean Carriers Ltd*, 251 BR 31 (Bankr D Del 2000) (holding that a few thousand dollars in US bank accounts and the unearned portions of local counsel's retainer formed a sufficient nexus to satisfy eligibility requirements under § 109).

(3) other cases under § 304 'may be commenced only in the district court for the district in which is located the principal place of business in the United States, or the principal assets in the United States, of the estate that is the subject of such case' (28 USC § 1410(c)).

Courts tend to apply the venue rules of 28 USC § 1410 liberally in order to advance the purpose of § 304 of aiding a foreign debtor in its efforts to preserve assets in the United States and to maintain consistency with venue statutes generally by avoiding unnecessary litigation and excessive costs.[24] In *Evans*, the liquidators appointed in an insolvency proceeding in the United Kingdom commenced a § 304 ancillary proceeding in the Southern District of New York. Venue in that jurisdiction was proper, pursuant to 28 USC § 1410(c), based on the location of the debtor's principal assets in the United States and its place of business.[25] Thereafter, the liquidators sought the turnover of certain escrowed funds held in California.[26] The party in possession of the disputed funds moved to dismiss the turnover proceeding on the ground that, pursuant to § 1410(b), a turnover action may only be commenced in the district where the property in question is located.[27]

In rejecting this argument, the court first noted that one of the goals of § 304 is to enable foreign representatives to administer expeditiously assets located in the United States.[28] This goal would be frustrated if the law required a foreign representative to commence a separate ancillary proceeding every time it sought to enjoin an action or to recover property located outside the judicial district of a properly commenced ancillary proceeding. Accordingly, the *Evans* court held that, once venue of a § 304 ancillary proceeding is proper under 28 U.S.C. § 1410(c), the foreign representative may sue in the 'home' district to recover property located in other districts.[29]

In addition to the injunctive and turnover remedies specifically included under Bankruptcy Code § 304, courts have shown considerable flexibility when ordering 'other appropriate relief' under § 304(b)(3). Thus, § 304 petitions have been granted regularly to permit discovery concerning the

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24 See *Hopewell*, 238 BR at 45; *In re Evans*, 177 BR 193, 196-97 (Bankr SDNY 1995); *In re Officina Conti, SRL*, 118 BR 392, 394 (Bankr DSC 1989).

25 *Evans*, 177 BR at 196.

26 *Ibid* at 195.

27 *Ibid*.

28 *Ibid* at 197.

29 *Ibid*; see also *Hopewell*, 238 BR at 45 ('Where more than one action will or may be commenced, one district should be chosen as the local administrative hub of the foreign proceeding and venue of that district should be determined in accordance with § 1410(c).'); *Saleh*, 175 BR at 425-26.

existence of assets of the debtor (see, eg, *In re Hughes*[30] and *Brierley*[31]), as well as to provide a forum for maintaining litigation under the laws of the jurisdiction in which the foreign proceeding is pending.[32]

Limits of the scope of section 304 relief

In deciding whether to grant relief pursuant to § 304(b), courts are guided by the following factors:

> '(1) the just treatment of all holders of claims against or interests in [the] estate;
> (2) the protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in [the] foreign proceeding;
> (3) the prevention of preferential or fraudulent dispositions of property of [the] estate;
> (4) the distribution of proceeds of [the] estate substantially in accordance with the order prescribed by this title;
> (5) comity; and
> (6) if appropriate, the provision of an opportunity for a fresh start for the individual that [the] foreign proceeding concerns.'[33]

With respect to the application of these factors, one significant point of debate under § 304(c) is the degree to which comity should influence a court's decision. Under what is generally referred to as the 'territorialist approach', the interests of US creditors are generally considered to be of paramount concern. In contrast, the 'universalist approach' emphasises comity in applying the § 304(c) factors.

Although the Bankruptcy Code does not explicitly codify either approach,[34] the legislative history of § 304(c) suggests that comity was an important consideration in its formulation:

> '[The 304(c)] factors are 'guidelines . . . designed to give the court 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

30 281 BR 224, 226-28 (Bankr SDNY 2002).
31 145 BR at 169.
32 See, eg, *In re A Tarricone, Inc*, 80 BR 21, 23-24 (Bankr SDNY 1987) (foreign representative may commence a § 304 proceeding in order to recover property in the United States based on foreign substantive law).
33 11 USC § 304(c).
34 *Manning*, 236 BR at 26.

orders under all of the circumstances of each case, rather than be provided with inflexible rules.'[35]

Moreover, US bankruptcy courts have generally embraced, at least in part, the universalist approach, 'accepting the central premise of universalism . . . that assets should be collected and distributed on a worldwide basis, but reserving to local courts discretion to evaluate the fairness of home country procedures and to protect the interests of local creditors'.[36] Thus, in deciding whether to grant relief pursuant to Bankruptcy Code § 304, courts have placed greater emphasis on comity and systemic interests and comparatively less emphasis on how closely the insolvency laws of the foreign proceeding resemble those of the Bankruptcy Code.[37]

Recently, however, the Second Circuit appeared to signal its approval of a more territorialist approach to transnational bankruptcy. In *In re Treco*,[38] the liquidators of Meridien International Bank Limited (MIBL), a Bahamian company, filed a petition in the Bankruptcy Court for the Southern District of New York pursuant to § 304, requesting the turnover of around $600,000 held in MIBL's account at The Bank of New York (BNY). BNY refused, asserting that it held the funds as security for certain MIBL debts. The Bankruptcy Court and the District Court ordered the turnover of the funds.

In reversing, the Second Circuit focused on § 304(c)(4) and whether the priority rules in the foreign proceeding are '*substantially* in accordance with United States law'.[39] The court stated that the priority rules in the foreign proceeding cannot be compared to US law in the abstract. Rather, the court 'must consider the effect of the difference in the law on the creditor in light

35 *In re Kojima*, 177 BR 696, 701 (Bankr D Colo 1995) (quoting HR Rep No 95-595 at 324-25 (1977), reprinted in 1978 USCCAN 5821); see also Paul L Lee, 'Ancillary Proceedings Under Section 304 and the Proposed Chapter 15 of the Bankruptcy Code, 76 Am Bankr LJ 115, 117, 123-24 (hereinafter 'Lee').

36 *Maxwell I*, 170 BR at 816.

37 See, eg, *Hopewell*, 238 BR at 66 ('Comity . . . is much more than a discrete element or factor to be considered as part of a larger analysis; it is a pervasive principle of international law which reflects that courts of one nation ought to respect the authority of another nation to legislate over, command and adjudicate issues concerning its own citizens'); *MMG*, 256 BR at 553-54 (granting relief based on comity even though the debtor could sell assets and incur post-petition debt without a hearing); *In re Ionica PLC*, 241 BR 829, 836-37 (Bankr SDNY 1999) (granting relief based on comity, even though a UK proceeding would not recognise valid claims for equitable subordination and substantive consolidation because § 304(c)(4) does not require that the 'foreign distribution mirror the United States distribution rules' and will only give rise to a denial of comity if the foreign scheme is repugnant to a fundamental principle of US law).

38 240 F 3d 148 (2d Cir 2001),

39 *Ibid* at 158 (emphasis in original).

of the particular facts presented'.[40] Under US law, a secured creditor's collateral or its value is preserved for the benefit of that creditor and, as a general rule, cannot be used to satisfy administrative expenses.[41] Under Bahamian law, a secured creditor's collateral may be used for the payment of administrative expenses. BNY was thus unlikely to recover more than a fraction of its secured claim if the funds were transferred to the Bahamian proceeding.[42] Thus, the Second Circuit reversed the turnover of the disputed funds because 'the "distribution of proceeds of [MIBL's] estate" in the Bahamian proceedings would . . . *not* be "substantially in accordance with the order prescribed by" United States law'.[43]

To the extent that Treco is read as prohibiting courts from granting § 304 relief if any US creditor, secured or unsecured, will fare materially worse under foreign law, it undermines 'two decades of work aimed at promoting cooperation in international insolvencies'.[44]

Thus far, the few bankruptcy courts to have considered *Treco* have interpreted it narrowly.[45] In *Combustibles*, the Bankruptcy Court interpreted *Treco* as requiring denial of § 304 relief only where the court finds clear evidence of 'maladministration or corruption'.[46] The court further held that § 304(c)(4) does not require that foreign bankruptcy law provide *identical* treatment of a claim to that provided under US law – thereby reaffirming the universalist approach.[47] Indeed, to do so 'would effectively end cooperation among countries because special interest priority schemes vary greatly around the world'.[48]

On appeal, however, although it agreed that § 304(c)(4) did not weigh against extending comity under the specific facts before it, the District Court determined, in an unpublished opinion, that the *Combustibles* Bankruptcy Court had 'improperly circumscribed the applicability of *Treco* to instances of maladministration or corruption'.[49]

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40 *Ibid* at 159.

41 *Ibid* at 155.

42 *Ibid* at 159.

43 *Ibid* (quoting 11 USC § 304(c)(4) (emphasis in original)).

44 Lee, 76 Am Bankr L.J at 172-73 (citing Jay L Westbrook, 'Outside Counsel: International Bankruptcy Approaches Chapter 15', NYLJ at 1 (23 August 2001)).

45 See *In re Board of Directors of Compania General de Combustibles, SA*, 269 BR 104, 110-11 (Bankr SDNY 2001), *aff'd in part and remanded in part*, No 01 Civ 10167 (Wood, DJ) (16 October 2002), appeal dismissed per stipulation, No 02-5074 (2d Cir 11 March 2003).

46 269 BR at 111; see also *In re Board of Directors of Hopewell Int'l Ins Ltd*, 272 BR 396, 411 n 19 (Bankr SDNY 2002).

47 *Combustibles*, 269 BR at 112.

48 *Ibid.*

49 No 01 Civ 10167, slip op at 13.

As the appeal of the District Court's decision was voluntarily dismissed before the Second Circuit had an opportunity to address the merits of the case, the question whether *Treco* represents a true retrenchment in the efforts of US courts to promote a universalist approach to cross-border insolvencies remains open. Nevertheless, *Treco* itself cautioned that § 304 calls for a case-specific analysis and that it was not announcing a rule that relief should be denied whenever § 304(c)(4) is implicated.[50] Thus, as discussed above, a bankruptcy court applying *Treco* 'must consider the effect of the difference in the law on the creditor in light of the particular facts presented'.[51]

Limits on trustee avoidance powers, the automatic stay and other rights

In addition to the limitations inherent in the application of the § 304(c) factors, the current view is that § 304 does not provide a foreign representative with the avoidance powers inherent in plenary proceedings brought under Bankruptcy Code §§ 301 and 303. Thus, while courts have consistently allowed foreign representatives to assert causes of action under foreign law in § 304 cases, the general consensus is that foreign representatives are not permitted to maintain a preference or fraudulent conveyance action based on §§ 544, 547 and 548 of the Bankruptcy Code.[52] Another key distinction is that the automatic stay is not applicable in § 304 proceedings.[53] In addition, the commencement of an ancillary proceeding does not confer authority to appoint a trustee or a creditors' committee, nor does it create a mechanism

50 *Treco*, 240 F 3d at 161.

51 *Ibid* at 158-59; see also *In re Avila*, 296 BR 95, 109-10 (Bankr SDNY 2003) (granting § 304 injunctive relief even though Mexican bankruptcy proceeding did not recognise priority of judgment liens; objectors did not possess judgment liens on *estate* property, thus this abstract difference in law did not militate against granting comity. The US Congress is considering adding a new chapter (Chapter 15) to the Bankruptcy Code, which would replace § 304 with a new set of provisions to govern ancillary cases and other cross-border insolvency matters. The new Chapter 15 would render moot some of the issues raised by the *Treco* decision. See, eg, Paul L Lee, 'Global Finance and Transnational Failure: Comity and the Bankruptcy Code' (2001) 118 Banking LJ 623, 631-33. Chapter 15 would elevate comity to the introductory language of § 1507 (which corresponds to the current § 304(c)), making it the central concept to be addressed when determining whether to provide 'additional assistance' to foreign debtors. See Michael E Foreman and Maryse S Selit, 'Bankruptcy and Corporate Reorganization', NYLJ, 26 August 2002, 13 (citing HR Rep No 107-3, at 80 (2001)). The provisions of proposed Chapter 15 are based on a Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law. See United Nations Commission on International Trade Law, Model Law on Cross-Border Insolvency with Guide to Enactment, 30th Sess, UN Doc A/CN 9/442 (1997).

52 See *Tarricone*, 80 BR at 23; *Metzeler*, 78 BR at 677.

53 See *Haarhuis v Kunnan Enterp, Ltd*, 223 BR 252, 254 n 3 (DDC 1998), *aff'd*, 177 F 3d 1007 (DC Cir 1999) ('A § 304 proceeding .. does not enjoy the benefit of the 11 USC § 362 automatic stay.').

for the filing and adjudication of claims against the bankruptcy estate.[54] These limitations on the scope of relief available in § 304 cases constitute the principal distinctions between such proceedings and plenary cases.[55]

Choice of law and jurisdictional issues with respect to plenary cases involving foreign debtors

Axona

Since *Maxwell*, a bankruptcy court in the Southern District of New York faced with a foreign debtor in a plenary proceeding under the Bankruptcy Code is arguably obliged to engage in a choice of law analysis with respect to the application of US or foreign law to avoidance actions. Prior to *Maxwell*, as noted in n 23 above, in *Axona*, the Bankruptcy Court held that, as with a US debtor, the fact that the foreign debtor maintained bank accounts in the United States, without any other property or place of business in the United States, was sufficient to satisfy the jurisdictional requirements of a § 303(b)(4) proceeding and to permit the debtor to commence avoidance actions under US law for distribution in the foreign proceeding.[56]

In *Axona*, a creditor argued that neither the former Bankruptcy Act nor the Bankruptcy Code specifies the amount or type of property in the United States which would be sufficient to allow a plenary case to be commenced in the United States by a foreign debtor.[57] The creditor asserted that due process considerations mandated the establishment of guidelines for determining

54 See *In re Bullmore*, 300 BR 719, 725-26 (Bankr D Neb 2003).

55 The choice of bankruptcy proceedings – ancillary proceedings commenced under § 304 versus plenary cases commenced pursuant to § 301 or 303 – is illustrated by the worldwide insolvency proceedings of Parmalat Finanziaria SpA ('Parmalat') and certain of its affiliates. Parmalat initially commenced a plenary bankruptcy proceeding in its home country, Italy. Thereafter, the foreign representatives of certain Cayman Island affiliates commenced a § 304 proceeding in the United States (*In re Petition of Gordon I Macrae and James Cleaver as Joint Provisional Liquidators of Parmalat Capital Finance Limited, et al*, Case No 04-10362 (RDD) (Bankr SDNY 2004)), which is ancillary to a plenary case pending in the Cayman Islands. These Cayman Island entities have (at least at the time of writing) little property in the United States and, thus, their foreign representatives have only sought injunctive relief and the turnover of US property (should there be any). In contrast, certain of Parmalat's US affiliates have more recently commenced a plenary case pursuant to § 301 (*In re Parmalat USA Corp, et al*, 04-11139 (RDD) (Bankr SDNY 2004)), which – unlike a § 304 proceeding – confers on these US affiliates all of the rights ordinarily available to debtors under the Bankruptcy Code. In the coming months, it will be interesting to watch the interaction of these proceedings with one another, as well as with the other insolvency proceedings involving Parmalat entities that are pending around the world, including those in Europe and South America.

56 *Axona*, 88 BR 597, 613-15 (Bankr SDNY 1988).

57 *Ibid* at 603.

when a § 303(b)(4) case may be properly commenced and suggested that foreign representatives only be allowed to initiate plenary cases when:

> '(i) the foreign debtor [has] a business presence in the United States and . . . US creditors have conducted business with the foreign debtor in the US; or (ii) there are creditors who have dealt with the foreign debtor in its domicile who have flouted a foreign judgment or order; or (iii) a foreign representative will only utilize the law of the debtor's domicile to recover a transfer.'[58]

Interpreting the jurisdictional requirements of Bankruptcy Code § 303(b)(4) literally, the Bankruptcy Court in *Axona* rejected the creditor's arguments and held that since:

(1) the case was commenced by a foreign representative,
(2) Axona was the subject of a foreign proceeding and
(3) the bank accounts constituted property in the United States

the case was 'properly commenced . . . pursuant to § 303(b)(4) of the Code' and there existed 'a sufficient predicate for subject matter jurisdiction over the § 303(b)(4) case'.[59] In addition, the court did not engage in a choice of law analysis with respect to the applicability of US avoidance law because '[i]n a case under § 303 a trustee . . . has the unquestionable power to utilize the provisions of the Code to avoid preferential or fraudulent dispositions of property'.[60]

Thus, in one of the few reported cases in which a court was faced with the jurisdictional issues involved in a § 303(b)(4) proceeding, the Bankruptcy Court concluded that bank accounts in the United States constituted a sufficient presence in the United States to warrant the commencement of a separate plenary case in the United States and the application of US avoidance laws. In the absence of a choice of law analysis, this enabled the foreign representatives to choose the law that would be most advantageous to their position and to use US avoidance laws ultimately to recover assets from US creditors. As a result of the Hong Kong liquidators' successful motion to dismiss the US case and to turn over the recovered assets to Hong Kong for distribution to Axona's worldwide creditors, all of Axona's assets, including those recovered from US creditors under US law, were distributed in the Hong Kong proceeding.[61] Thus, the *Axona* decision created considerable

58 *Ibid.*

59 *Ibid* at 614-15.

60 *Ibid* at 606.

61 The creditor's challenge to the District Court of the Hong Kong liquidators' motion for an order dismissing the US plenary case and for the turn over of all assets to the Hong Kong proceeding was also rejected; and its appeal to the Second Circuit was dismissed based on the Judicial Improvements Act 1990, pursuant to which Bankruptcy Code § 305(c) was amended to preclude more than one layer of appellate review of a dismissal motion.

potential for forum and 'section' shopping because it allowed a foreign debtor that had little connection with the United States to commence a plenary bankruptcy case in the United States and to apply US avoidance law to a decidedly non-US dispute because it failed to engage in a choice of law analysis.

Maxwell Communication Corp

Many of the broader forum and 'section' shopping implications of *Axona* were implicitly rejected in the post-confirmation bankruptcy proceedings of Maxwell Communication Corporation ('Maxwell Communication').

Maxwell Communication was an English holding company that was controlled by Robert Maxwell until his death in November 1991.[62] Maxwell Communication administered the majority of its financial affairs in the United Kingdom while its operating subsidiaries, which constituted its principal assets, were located in the United States.[63] When the Maxwell Communication financial empire began to fall apart shortly after Robert Maxwell's death, Maxwell Communication commenced dual plenary bankruptcy proceedings in the United States under the Bankruptcy Code (the 'Chapter 11 Proceeding') in the Bankruptcy Court for the Southern District of New York (the 'Bankruptcy Court') and in the English High Court of Justice (the 'High Court') under the Insolvency Act 1986 (the 'UK Insolvency Proceeding').[64]

To minimise the potential inconsistencies and conflicts that simultaneous plenary bankruptcy proceedings would be likely to present, Bankruptcy Judge Brozman appointed an examiner (the 'Examiner'), pursuant to 11 USC § 1104(a) in the Chapter 11 Proceeding to 'harmonize the two proceedings so as to permit a reorganization under US law which would maximize the return to creditors'.[65] In a showing of unprecedented cooperation, with the approval of both the High Court and the Bankruptcy Court, the Examiner and the joint administrators appointed in the UK Insolvency Proceeding (the 'Administrators') entered into a protocol (the 'Protocol'), which set forth the respective rights and duties of the Administrators and the Examiner.[66] Moreover, each court recognised the standing of both the Administrators and the Examiner to appear in either court.[67]

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62 *Maxwell I,* 170 BR at 801.

63 *Ibid* at 801-02; Jay Lawrence Westbrook, 'The Lessons of Maxwell Communication' (1996) 64 Fordham L Rev 2531, 2534.

64 See *Maxwell I,* 170 BR at 802.

65 *Ibid* at 802.

66 *Ibid.*

67 *Ibid.*

Around one year after the approval of the Protocol, the Administrators and the Examiner filed a plan of reorganisation (the 'Plan') in the Bankruptcy Court and a scheme of arrangement (the 'Scheme') in the High Court.[68] Although technically separate documents, the Plan and the Scheme were 'mutually dependent and, in their effect, constitute[d] a single mechanism, consistent with the laws of both countries, for reorganizing [Maxwell Communication] . . . through the sale of assets as going concerns and for distributing assets to creditors'.[69] Creditors were permitted to submit claims in either the Chapter 11 Proceeding or the UK Insolvency Proceeding and the Plan and the Scheme established a single pool of assets for the distribution to all creditors irrespective of where their claims had been filed.[70]

However, neither the Plan nor the Scheme addressed the treatment of preferences or the choice of avoidance law.[71]

Following approval of the Scheme and the Plan, the Administrators commenced an adversary proceeding in the Bankruptcy Court pursuant to US law, ie § 547 of the Bankruptcy Code, in order to avoid certain allegedly preferential payments made to three foreign banks.[72] Each of the challenged transfers occurred in England and involved English or French banks.[73] All payments were made on account of antecedent debts that were incurred in the United Kingdom.[74] In fact, the only tangible connection that the challenged transfers had to the United States was that Maxwell Communication obtained the transferred funds through the sale of its US subsidiaries.[75]

The Administrators chose not to pursue their claims in the UK Insolvency Proceeding because English law would have required the Administrators to prove that Maxwell Communication intended to place the transferee in a better position.[76] In contrast, § 547 contains no subjective state of mind requirement.[77] The subjective intent requirement of English law would most likely have been an 'insurmountable obstacle' for the Administrators had they sought to challenge the allegedly preferential transfers in the UK Insolvency Proceeding.[78]

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68 *Ibid.*
69 *Ibid.*
70 *Ibid.*
71 *Maxwell III,* 93 F 3d at 1042.
72 *Maxwell II,* 186 BR at 814.
73 *Ibid* at 817.
74 *Ibid.*
75 *Ibid.*
76 *Maxwell I,* 170 BR at 808.
77 *Ibid.*
78 *Maxwell III,* 93 F 3d at 1043.

Relying primarily on the presumption against extraterritoriality, Bankruptcy Judge Brozman dismissed the adversary proceeding.[79] Alternatively, Judge Brozman held that the doctrine of international comity also precluded application of § 547 to the challenged transfers.[80] The District Court and the Second Circuit affirmed the dismissal of the adversary proceeding.[81] However, in concluding that the Bankruptcy Court properly dismissed the adversary proceeding, the Second Circuit relied exclusively on the doctrine of international comity.[82]

In assessing whether § 547 should be interpreted to cover the challenged transfers, the Second Circuit looked to the principles set forth in the *Restatement (Third) of International Relations*, which provides that nations normally refrain from prescribing laws governing 'activities connected with another state "when such exercise is unreasonable"'.[83] Ultimately, the Second Circuit determined that § 547 should not be construed to extend to the challenged transfers. In so holding, the court first concluded that England had a much stronger connection to the disputes than the United States.[84] As a result, England's relative interest in the application of its own laws was

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79 *Maxwell I*, 170 BR at 814. The presumption against extraterritoriality is a canon of statutory construction that prohibits the extraterritorial application of US law in the absence of clear evidence of Congressional intent to the contrary (*Maxwell I*, 170 BR at 808-10). The presumption has two distinct elements. First, it must be shown that the application of the statute in question to the particular facts would be extraterritorial (*ibid* at 809). If that is the case, the next question is whether Congress intended to permit such extraterritorial application (*ibid*). Bankruptcy Judge Brozman concluded that the alleged transaction was extraterritorial because the dispute had no tangible connection to the United States (*ibid*). Next, after looking at both Bankruptcy Code § 547 and the fabric of the Bankruptcy Code as a whole, Bankruptcy Judge Brozman concluded there was no indication Congress intended to permit the extraterritorial application of §547 (*ibid* at 810-14).

80 *Ibid* at 814-18. The doctrine of international comity is a traditional component of choice of law theory (see *Maxwell II*, 186 BR at 822 (citing *Hartford Fire Ins Co v California*, 509 US 764 (1993)), applicable where there is a true conflict between the laws of the United States and those of a foreign jurisdiction (*Maxwell III*, 93 F 3d at 1049). It is, in effect, a canon of statutory construction that provides that an 'act of Congress ought never to be construed to violate the law of nations if any other possible construction remains' (*Maxwell II*, 186 BR at 822 (quoting *Hartford*, 509 US at 764)). The doctrine does not impose a limitation on the sovereign power of the United States 'to enact laws applicable to conduct occurring abroad' (*Maxwell III*, 93 F 3d at 1047). Rather, it 'guides' the 'interpretation of statutes that might otherwise be read to apply to such conduct'. In short, 'Congress, in prescribing laws, is presumed not to exceed customary international law limits on its jurisdiction' (*Maxwell I*, 170 BR at 814).

81 *Maxwell II*, 186 BR at 812; *Maxwell III*, 93 F 3d at 1040.

82 *Ibid* at 1040.

83 *Maxwell III*, 93 F 3d at 1047-48 (quoting *Restatement (Third) of Foreign Relations* § 403(1)(1986)).

84 *Ibid* at 1051.

much stronger than that of the United States.[85] Moreover, the policies underlying the United States' preference laws – equal distribution to creditors and the prevention of the pre-petition dismemberment of a debtor's assets – would be effectuated even if the challenged transfers were governed by English law.[86] That is, English avoidance laws serve similar purposes – even if results in individual cases might differ.[87]

Finally, in addition to the relative strengths of the interests of England and the United States, the court also recognised that there were compelling systemic interests that weighed against application of § 547 to the challenged transfers.[88] In other words, Maxwell Communication's dual plenary insolvency proceedings were characterised by a significant amount of cooperation between the Bankruptcy Court and the High Court. In the light of the accomplishments attributable to this cooperation and the importance of similar cooperation in reaching workable solutions in the context of international insolvencies, the Court of Appeals was wary of the consequences of a 'selfish application' of US law.[89]

As this element of the Second Circuit's analysis would suggest, it is possible that it was the unique nature of the *Maxwell* case (ie the extensive cooperation) that guided the court's willingness to engage in a choice of law analysis.[90] At the least, courts may be less willing to extend comity to a parallel foreign proceeding if the cooperation that characterised *Maxwell* is absent.[91]

Post-Maxwell

The *Maxwell* case was groundbreaking in that it established a framework for a workable and fair approach to the treatment of avoidance actions in dual

85 *Ibid* at 1052.

86 *Ibid.*

87 The Second Circuit stated that it might have decided differently if there had not been a parallel proceeding pending, and hence no alternative mechanism for avoiding preferences. See *Maxwell III*, 93 F 3d at 1052.

88 *Ibid* at 1053.

89 *Ibid.*

90 See, eg, Jay Lawrence Westbrook, 'A Global Solution to Multinational Default' (2000) 98 Mich L Rev 2276, 2322 ('It [the Second Circuit] affirmed the lower courts primarily to vindicate international cooperation in a case they found to be mainly British'); see also *In re Regus Bus Centre Corp*, 301 BR 122, 127 (Bankr SDNY 2003) (determining '"whether to abstain from a case on the basis of international comity is a matter within the discretion"' of the bankruptcy court) (quoting *United Feature Syndicate, Inc v Miller Features Syndicate, Inc*, 216 F Supp 2d 198, 212 (SDNY 2002)).

91 The proposed Chapter 15 to the Bankruptcy Code does not, for the most part, address issues relating to dual plenary cases.

plenary cases. The *Maxwell* Protocol has been used in several more recent cases involving dual plenary proceedings, including *In re Loewen Group International, Inc, et al*[92]; *In re Livent (US) Inc, et al*[93]; *In re Olympia & York Maiden Lane Co, LLC, et al*[94] and *In re Federal Mogul Global, Inc, et al.*[95] Proceeding on this basis is, however, only possible where there is a high degree of cooperation between the two courts and between the administrators appointed in each proceeding.[96]

In addition, as was seen in Maxwell itself, even with a high degree of cooperation between the two courts and the administrators, the Protocol does not provide a methodology for dealing with every issue that may arise in a case involving dual plenary proceedings. For example, there is nothing in *Maxwell* that would preclude a foreign entity from commencing dual plenary proceedings for the purpose of commencing avoidance actions in the United States (provided that *Maxwell*'s choice of law analysis was complied with) and then seeking dismissal of the US case and distribution of the assets through the foreign proceeding (as was done in *Axona*).

Conclusion

A foreign entity may commence two types of cases under US bankruptcy law – an ancillary case pursuant to Bankruptcy Code § 304 or a full plenary case pursuant to § 301 or 303. As § 304 is designed to function in aid of a foreign proceeding, it invokes the jurisdiction and powers of US Bankruptcy Courts only in limited ways. Accordingly, there is no automatic stay in § 304 ancillary cases. Section 304 proceedings also do not confer authority to appoint trustees or creditors' committees, nor do they provide a mechanism for the filing and adjudication of claims. Perhaps most importantly, a foreign representative may not utilise US avoidance law to challenge allegedly preferential and/or fraudulent transfers.

In contrast, although a case commenced under § 301 or 303 is a plenary bankruptcy case, the jurisdictional and eligibility requirements with respect to §§ 301 and 303 do not differ greatly from those of a § 304 ancillary proceeding. Thus, in the absence of the application of choice of law

92 Case No 99-1244 (PJW) (Bankr D Del).

93 Case No 98-B-48312 (AJG) (Bankr SDNY).

94 Debtors, Case No 98-B-40167 (JLG) (Bankr SDNY).

95 Debtors, Case No 01-10578 (Bankr D Del).

96 *Cf In re Cenargo Int'l, PLC*, 294 BR 571 (Bankr SDNY 2003) (jurisdictional conflicts and uncertainty were created as a result of (1) a creditor's commencement of a provisional liquidation in England in violation of the automatic stay in a pending Chapter 11 proceeding and (2) the issuance of an injunction in the English proceeding preventing the debtor's management from continuing to act in the Chapter 11 proceeding).

principles, Congress's statutory scheme and lenient jurisdictional and eligibility requirements afford a unilateral option to foreign representatives for the selection of applicable law – particularly with respect to avoidance law. For example, in *Axona*, the foreign representative, at his whim, had the choice of invoking either US law (by commencing a plenary proceeding) or Hong Kong law (by commencing an ancillary proceeding) – obviously, whichever one proved to be more advantageous.

The *Maxwell* court's use of the doctrine of international comity for choice of law purposes appears to have limited the potential for forum and 'section' shopping that follows from a literal interpretation of the Bankruptcy Code's jurisdictional and eligibility requirements. To the extent, however, that the *Maxwell III* court was principally driven by enhancing the degree of cooperation in the dual plenary proceedings, the Bankruptcy Code's procedure for dealing with international insolvencies may still be an invitation for forum and 'section' shopping, enabling a non-judicial officer to select the law which will govern a bankruptcy case, without regard for traditional choice of law principles. Therefore, consideration should be given by Congress – in order to alleviate any possible uncertainty – to the enactment of an explicit requirement that courts engage in a choice of law analysis where appropriate in § 301 or 303 proceedings.