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The University of Texas School of Law

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1. E. Ernest Goldstein, *Thank You Fidel! Or How the International Law Society and the* Texas International Law Journal *Were Born*, 30 TEX. INT'L L.J. 223 (1995).

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Introduction

JAY LAWRENCE WESTBROOK*

The globalization of markets acts like a superhighway through the middle of town. In exchange for promises of efficiency and greater wealth, it obliterates local landmarks, including structures that represented a thousand local struggles and a thousand local compromises, the collective judgments of the community over many years. A community that insists on preservation all of these structures risks being bypassed. It is faced with difficult and important choices

Among the commercial structures in every country are the rules of priority that apply when the financial distress of a company means all of its creditors and other stakeholders will receive less value than they legitimately expected that company to distribute. If that company is one of the many whose operations and markets stretch across national borders, each country concerned will instinctively seek to maintain its established priority structures in the face of the common financial disaster. Yet each will discover that the logic of global commerce inexorably presses for common solutions and transitional accommodation.

The instinct to preserve local distributional priorities in the face of a company's global financial crisis is a central problem in the contemporary effort to create efficient and fair international rules and institutions to govern cross-border insolvencies. The decision of the House of Lords in *McGrath v. Riddell (In re HIH)*[1] represents a milestone in the resolution of that problem. The decision also prompted the convening of this symposium in Austin on May 11, 2010, to discuss the role of national priority systems in cross-border insolvencies. The organizers were able to entice Lord Leonard Hoffmann, the author of one of the judgments in *HIH*, to join a distinguished group of academics and judges for this discussion. The judgments in *HIH* together with Lord Hoffmann's opening remarks at the symposium served as the platform from which to launch our conversation.

Although some of the papers describe the facts in the *HIH* case, it seems sensible to include here a brief summary. HIH, an Australian insurance company, entered insolvency proceedings in Australia. It had substantial assets in the United Kingdom, primarily in the form of reinsurance claims. The Australian rules gave a priority to claimants under insurance policies over other creditors; the English rules did not. Choice of the rule to apply would make a considerable difference in the result of the distribution of the English assets.

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1. McGrath v. Riddell (*In re* HIH Cas.& Gen. Ins., Ltd.), [2008] UKHL 21, [36], 1 W.L.R. 852 (H.L.) 863 (Lord Hoffmann) (appeal taken from Eng.).

All of the five members of the panel in the House of Lords agreed to turn over the assets to the Australian liquidators. Three of them were content to decide that the restraining effect of the English priority system was overcome by the application of an unusual feature of English law, section 426 of the Insolvency Act, which reflects a special reciprocity in insolvency matters among a small group of jurisdictions. The judgment of Lord Hoffmann, with Lord Walker's concurrence, took a very different approach. In their view, the "golden thread" of universalism in English common law requires that the English court turn over assets in cooperation with a foreign court as a general rule unless there is some principle of justice or UK public policy that prevents the turnover. Two of the remaining three members of the panel squarely disagreed with Lord Hoffmann, while Lord Phillips declined to reach the issue. It is of particular interest to an American audience to note that the United States is not a member of the special "club" formed by section 426. As a result the decision of two of the judges would preclude turnover to a United States trustee in bankruptcy while the approach of Lords Hoffmann and Walker would often permit this sort of cooperation with a United States court. Thus this case presents a nearly ideal vehicle for a discussion of cross-border priorities.

The participants in the symposium represent a broad spectrum of experience in the cross-border field. In addition to the judgment in *HIH*, Lord Hoffmann's remarkable legal career included authoring another ground-breaking cross-border insolvency judgment, *Cambridge Navigation* in the Privy Council.[2] He is of course renowned for many other important decisions across the whole expanse of the law. Two much-admired American bankruptcy jurists, Judges Clark and Gropper, have both had extensive experience in cross-border cases and have also made substantial scholarly contributions to the field in the legal literature.[3] Professor Fletcher's book, *Insolvency in Private International Law*,[4] is the leading treatise in the field and serves as the core of a large body of scholarly work about cross-border issues. The Honorable Jose Garrido is not only the Senior Counsel for Insolvency and Creditor Rights Initiative at the World Bank, but has written importantly about the history of insolvency.[5] Professor Janger has made a number of significant and creative contributions to commercial law in general and insolvency law in particular, including a recent article to which I had the privilege of responding.[6] Professor Pottow is the leading voice in the rising generation of scholars in the field and has already established a body of well-recognized work.[7]

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2. Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26, [2007] 1 A.C. 508, [16] (appeal taken from the Isle of Man) (U.K.).

3. *See, e.g.*, *In re* Inverworld, 267 B.R. 732, 740 n.10 (Bankr. W.D. Tex. 2001) (Clark, J); a case and an article each. *See, e.g.*, *In re* Inverworld, 267 B.R. 732, 740 n.10 (Bankr. W.D. Tex. 2001) (Clark, J.); LIEF M. CLARK, ANCILLARY AND OTHER CROSS-BORDER INSOLVENCY CASES UNDER CHAPTER 15 OF THE BANKRUPTCY CODE: A COLLIER MONOGRAPH §5 (Daniel M. Glosband ed., 2008). *In re* Bd. of Dirs. of Multicanal S.A., 314 B.R. 486 (Bankr. S.D.N.Y. 2004) (Gropper, J.); Allan L. Gropper, *Current Developments in International Insolvency Law: A United States Perspective*, 938 PLI/COMM 1023 (2011).

4. IAN FLETCHER, INSOLVENCY IN PRIVATE INTERNATIONAL LAW: NATIONAL AND INTERNATIONAL APPROACHES (2nd ed. 2005).

5. *See, e.g.*, JOSE MARIA GARRIDO, TRATADO DE LAS PREFERENCIAS DEL CRÉDITO (2000)

6. Edward J. Janger, *Virtual Territoriality*, 48 COLUM. J. TRANSNAT'L L. 401 (2010); Jay Lawrence Westbrook, *A Comment on Universal Proceduralism*, 48 COLUM. J. TRANSNAT'L L. 503 (2010).

7. *See, e.g.*, John A.E. Pottow, *The Myth (and Realities) of Forum Shopping in Transnational Insolvency*, 32 Brook. J. Int'l L. 785 (2007).

All of the authors in the symposium agree that some deference must be paid to local priorities or the concerns those priorities reflect, but there is a considerable range of difference as to the deference required. Judge Gropper's paper firmly anchors the case to be made for applying local priorities in full. Although he is very familiar with the demands of cross-border cases and committed to their success, he argues strongly that claims that are given priority by the various local insolvency regimes must be paid if cross-border cooperation is to be achieved. Professor Janger's paper reflects the evolution of his views about methods of accommodating central administration of cross-border cases with the policies underlying local priority hierarchies in a system he calls "Reciprocal Comity," an approach that turns on choice of law rules that identify the appropriate local priority a main proceeding should apply to each situation.

Professor Fletcher gives us a wonderfully clear and precise understanding of the workings of the European Regulation on Insolvency,[8] which governs insolvency cases within the EU, and offers possible reforms to prevent abuse of cross-border rules. In the process he discusses a major variable in the cross-border calculations, the impact of local secondary proceedings. Professor Pottow also addresses local bankruptcies, suggesting "synthetic" secondary proceedings and a possible system of registration of priorities that have received international endorsement. Judge Clark takes on the most challenging priority of them all, security interests. He joins Professor Fletcher in discussing possible approaches to this challenge, but goes farther in analyzing the underlying core of security rights, arguing that some of the less fundamental aspects of security might be modified in a cross-border case while preserving the fundamental function of security interests in commercial transactions.

I find myself in the challenging position of following all this fine scholarship. My paper argues that the legal and political concerns supporting localism are greatly overblown and that sensitive choice of law rules as to certain priorities will suffice to accommodate those concerns. I propose a rule of centralization of priority rules in the "main" proceeding with exceptions where claims have a special relationship to local assets and important local policies.

All of us at the Law School are deeply grateful to the participants in this symposium, especially Lord Hoffmann. I personally want to add my appreciation for the students of the Texas International Law Journal for their interest in the subject and their hard work in bringing this project to fruition.

8. Council Regulation 1346/2000, 2000 O.J. (L 160) 1 (EC).

Reciprocal Comity

EDWARD J. JANGER*

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INTRODUCTION

Let me begin by saying what an honor it is to be here. I am a relative newcomer to the field of cross-border bankruptcy. The thought that I might have something useful to say to this group comes to me as a bit of a surprise. Lord Hoffmann and Professor Westbrook have been thinking about international bankruptcy since before I became a bankruptcy lawyer.[1] Even John Pottow, who is a few minutes younger than I am, has been thinking deep thoughts about international bankruptcy law longer than me.[2] Hopefully, I can offer a fresh perspective without appearing naïve.

First, a bit of context: for several years now, I have been trying to flesh out a mode of thinking about cross-border insolvency that I call "universal proceduralism."[3] Universal proceduralism has, at its core, a choice-of-law principle that I call "virtual territoriality."[4] I will explain these terms in greater detail shortly, but the goal is to facilitate a bankruptcy case administered at the debtor's center of main interest that is procedurally global, but substantively territorial. To my mind, the principal focus of any cross-border bankruptcy architecture is to capture the benefits of coordinated decision-making. I am less concerned than some with equality of distribution across borders, and am therefore prepared to allow nations to determine their own approach to priority. I seek an administratively centralized cross-border regime that maximizes the extent to which decisionmaking can be coordinated, but which minimizes the extent to which local entitlements are disturbed.

Professor Westbrook disagrees with me about the importance of respecting local priorities.[5] He seeks to approximate a regime of "one case under one law," while I advocate a regime of "one case under many laws."[6] In Jay's view, the principle of universalism, articulated by Lord Hoffmann in *McGrath v. Riddell* ("*HIH*"), crystallizes our disagreement.[7] In a recent colloquy about the extent to which local priority schemes should control distributions in cross-border bankruptcy cases, Jay closes with the following lines:

> [I]n the realm of distribution rules *HIH* posed squarely the question that divides Professor Janger and me: Should local law control assets? . . .

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1. Lord Hoffmann handled the first major cross border bankruptcy case, *In re* Maxwell Commc'n Corp. plc. [1992] B.C.C. 372. In 1991, Jay Westbrook was practicing as a cross-border bankruptcy attorney and had served as an expert in the United States. I became a practicing attorney in 1990.

2. *See* John A.E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 VA. J. INT'L L. 935 (2005) (contending that international bankruptcy reform mechanisms succeed due to a combination of attributes such as modesty of scope and procedural focus).

3. *See* Edward J. Janger, *Virtual Territoriality*, 48 COLUM. J. TRANSNAT'L L. 401 (2010) [hereinafter Janger, *Virtual Territoriality*] (developing a set of choice-of-law principles that would facilitate both the administration of global bankruptcy cases and the acceptance of rescue-based insolvency regimes); Edward J. Janger, *Universal Proceduralism*, 32 BROOK. J. INT'L L. 819 (2007) [hereinafter Janger, *Universal Proceduralism*] (advocating the adoption of a "universal proceduralism" regime). *But see* Jay Lawrence Westbrook, *A Comment on Universal Proceduralism*, 48 COLUM. J. TRANSNAT'L L. 503 (2010) [hereinafter Westbrook, *A Comment*] (criticizing the universal proceduralism proposal).

4. Janger, *Virtual Territoriality*, *supra* note 3, at 108.

5. Westbrook, *A Comment*, *supra* note 3, at 517.

6. *Id.* at 516–17.

7. *Id.*; McGrath v. Riddell (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21, [36] 1 W.L.R. 852 (H.L.) 863 (Lord Hoffmann) (appeal taken from Eng.).

> [F]or all the reasons discussed above I think that Lord Hoffmann's opinion expresses the correct and future answer to that question. I look forward to a continuing dialogue over the best method to take proper account of localized interest and concerns in the resolution of a global insolvency proceeding.[8]

So here I am, and the dialogue continues. I am not just honored to be here; I am also intimidated. It is one thing to be the loyal opposition. It is another to take on Jay Westbrook and Lord Hoffmann—two of my heroes—at the same time. If I can, I will try to lay out my areas of agreement and disagreement with Lord Hoffmann, and to sort out whether those agreements are the same as my areas of agreement and disagreement with Jay. I think that they are similar, but not identical.

This article will proceed in three steps.

First, I will briefly describe universal proceduralism in contradistinction to the modified universalism advocated by Professor Westbrook, and explain why I advocate it as a normative approach to cross-border bankruptcy.

Second, I will separately parse my differences with Jay and Lord Hoffmann. I will argue that Westbrook is slightly mischaracterizing universal proceduralism—possibly because he is confusing me with Lynn LoPucki; and, that he may also be slightly mischaracterizing Lord Hoffmann, or at least the holding in *HIH*.[9] As a result, the extent of my disagreement with Lord Hoffmann is much narrower than my disagreement with Jay, and may not be a disagreement at all. I will suggest that the appearance of disagreement between me and Lord Hoffmann arises from the fact that in *HIH* he was focusing on comity norms for courts to apply in "ancillary" or "secondary" bankruptcy proceedings, while the focus in my most recent work has been on the comity and choice of law principles that should be followed in the "main" case pending at the debtor's center of the main interest ("COMI").[10]

Third, I will argue that the principle goal of a cross-border insolvency regime should be oriented toward coordinated governance rather than equality of distribution. In particular, I will argue that Westbrook's view that priority should be determined by the rules of the main jurisdiction is likely to make such coordinated governance more, rather than less, difficult.

In conclusion, I will argue that when one looks at Lord Hoffmann's stance in *HIH*, as well as the manner in which he handled the avoidance actions in *Maxwell*, he manifests (as a practical matter) the sort of bilateral comity that I applaud, and that Professor Westbrook appears to find problematic.

I. *HIH*, MODIFIED UNIVERSALISM, AND UNIVERSAL PROCEDURALISM

This is a symposium in celebration of the *HIH* case, so it makes sense to begin with a description of that case. In *HIH*, the House of Lords was faced with an appeal from the High Court refusing to remit U.K. assets of an Australian insurance

8. Westbrook, *A Comment*, *supra* note 3, at 13.

9. *McGrath*, [2008] UKHL 21, [36] 1 W.L.R. at 863.

10. Janger, *Virtual Territoriality*, *supra* note 3, at 406.

company to Australia for administration in Australia.[11] The question arose because, under U.K. law, insurance claimants share *pari passu* with other unsecured claimants against the estate, while in Australia, insurance claims take priority over the claims of other unsecured creditors.[12] Both lower courts concluded that U.K. courts did not have jurisdiction to deviate from the U.K.'s *pari passu* distributional scheme.[13] They therefore could not remit assets to Australia where the non-insurance claims would be subordinated.[14]

The House of Lords unanimously disagreed, but the Lords differed on rationale.[15] On the one hand, this would appear to be an easy case. Under U.K. law, there is a statutory basis for cooperating with Commonwealth countries, and the Lords found this to be the proper basis for overruling the lower court.[16] All of the Lords agreed that, where Commonwealth countries are involved, a U.K. court has discretion to remit assets even where the foreign priority scheme is not identical to that of the U.K.[17] Lord Justice Hoffmann, however, articulated an alternative basis grounded in the court's inherent power to cooperate with a foreign insolvency proceeding under the principle of modified universalism in bankruptcy cases.[18] By finding this inherent power to cooperate, Lord Hoffmann gives the U.K. courts the power to harmonize their approach to ancillary practice in cases where the main case is pending in a country that is not a member of either the E.U. or the British Commonwealth. It should be noted that the particular need for inherent power in such cases was substantially limited when Great Britain enacted the UNCITRAL Model Law on Cross-Border Insolvency.[19]

In *HIH*, Lord Hoffmann notes a longstanding tradition in British courts of universalism in bankruptcy cases.[20] He describes universalism as the willingness of an ancillary court to cooperate with a case pending at the debtor's center of main interest, and states that universalism may require the ancillary court to accept that the court in the main case might apply a different law of priority than the court in the ancillary jurisdiction.[21]

Hoffmann makes, however, an important distinction between administration and choice of law. He points out that allowing assets to be centrally administered

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11. *McGrath*, [2008] UKHL 21, [1] 1 W.L.R. at 855. *See also* McMahon v. McGrath (*In re* HIH Cas. & Gen. Ins. Ltd.), [2005] EWHC (Ch) 2125, [155] (Eng.) (describing the High Court's holding regarding the impropriety of remitting HIH's assets to Australian liquidators).

12. *McGrath*, [2008] UKHL 21, [2] 1 W.L.R. at 855.

13. *Id.* at [11].

14. *McMahon*, [2005] EWHC (Ch) 2125, [155].

15. *McGrath*, [2008] UKHL 21, [36], [43], [62–63], [80] 1 W.L.R. at [863–864], [872], [876].

16. *Id.* at [171]; *see* Insolvency Act, 1986, c. 45, Part XVII, § 426 (U.K.) (addressing the framework for jurisdiction and choice of law issues between the U.K. and "relevant" countries in insolvency proceedings)

17. *McGrath,* [2008] UKHL 21, [21], [24] 1 W.L.R. at [859]. [860].

18. *Id.* at [6–7].

19. *See* Insolvency Act (addressing the framework for jurisdiction and choice of law issues between the U.K. and "relevant" countries in insolvency proceedings); Council Regulation 1346/2000, 2000 O.J. (L 160) 1 (EC) [hereinafter EC Regulation] (detailing the procedures for coordinating insolvency proceedings within the European Union); UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT (1997), *available at* http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf [hereinafter UNCITRAL Model Law] (model law setting forth procedures for coordinating cross-border insolvency proceedings).

20. *McGrath*, [2008] UKHL 21, [6] 1 W.L.R. at.[856].

21. *Id.* at [8], [21], [24].

does not necessarily mean that the main jurisdiction will apply its own law to the dispute.[22] It only means that the main jurisdiction will apply its own choice of law principles to the question.[23] As I read *HIH*, this is as far as Lord Hoffmann goes, and as such, he is agnostic as to what those choice of law principles should be. This last point—the scope of *lex fori concursus*—is where Professor Westbrook and I differ. To what extent does bankruptcy law place a thumb on the choice of law scales in the main jurisdiction?[24] I think the main jurisdiction should respect local priorities. Jay thinks the priorities of the forum court (the "main") should govern.

Jay's "modified universalism" thus contemplates a centralizing choice of law rule. In his view, a debtor's choice of bankruptcy forum should determine the four major choice-of-law questions in a bankruptcy case: control, priority, avoidance and reorganization policy.[25] To be sure, this scheme has much to recommend it. To the extent that enlightened judges, like Lord Hoffmann, are prepared to remit assets to the main case, notwithstanding the possibility of outcome differences, it is possible to administer a unified bankruptcy case and to make (hopefully) coherent decisions about how to administer a debtor's assets.

I have, however, two concerns about this centralizing approach to choice of law that are relevant to today's discussion. They are forum shopping (which I have discussed in my previous work) and asymmetric comity, a concept that I will develop here.[26] Both concerns arise because the modified universalist places the entire burden of cooperation on the ancillary court.

A. Forum Shopping

Concerns about forum shopping and jurisdictional competition arise whenever one adopts a centralizing choice of law rule because it allows one jurisdiction to impose its legal policy choices on people and property located elsewhere. This gives parties the ability to use forum choice strategically. Two classic examples of such centralizing choice of law rules can be found in U.S. law. The first is the choice of

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22. *Id.* at [20–21].

23. *Id.*

24. I must note that with regard to positive law in the U.K., Lord Hoffmann assumes at paragraph 20 that a U.K. liquidator would not have the power to deviate from the U.K. distribution scheme: "The principal liquidator would have no power to distribute them according to English law any more than the English liquidator, if he were doing the distribution, would have power to distribute them according to the foreign law." *Id.* He does not assume that this is the inevitable result, however, and assumes that other legal systems might take a different view: "The power to remit assets to the principal liquidation is exercised when the English court decides that there is a foreign jurisdiction more appropriate than England for the purpose of dealing with all outstanding questions in the winding up. It is not a decision on the choice of the law to be applied to those questions. That will be a matter for the court of the principal jurisdiction to decide. Ordinarily one would expect it to apply its own insolvency laws but in some cases its rules of the conflict of laws may point in a different direction." *Id.* at [28]. As I will discuss later, Lord Hoffmann's conduct in the *Maxwell* case suggests that he might be in sympathy with this latter view.

25. Jay Lawrence Westbrook, *Locating the Eye of the Financial Storm*, 32 BROOK. J. INT'L L. 1019, 1021 (2007) [hereinafter Westbrook, *Financial Storm*].

26. *See generally* Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and Race to the Bottom*, 83 IOWA L. REV. 569 (1998) (arguing that the uniform law process is not well suited to addressing distributive questions); Janger, *Virtual Territoriality*, *supra* note 3 (discussing the choice-of-law principles that should govern an universal proceduralism regime); Janger, *Universal Proceduralism*, *supra* note 3 (explaining universal proceduralism).

law rule articulated in the *Marquette National Bank* case.[27] In that case, the Supreme Court held that consumer credit transactions are governed by the law of the jurisdiction where the lender is incorporated.[28] The second is the generally accepted rule that corporations are governed by the corporate law of their jurisdiction of incorporation, regardless of the location of operations, assets, or shareholders.[29] In both instances, one can observe that this centralizing rule has caused certain jurisdictions to compete for incorporations. The literature on the role of Delaware in corporate law is too familiar to need discussion.[30] By the same token, the repeal of usury laws in both Delaware and South Dakota have made them the jurisdiction of choice for credit card banks and their payment processing centers.[31]

These concerns about jurisdictional competition do not arise because the location of the debtor is uncertain, or because it is difficult to determine which jurisdiction's law governs. Quite the contrary: jurisdictional competition arises because the governing law is both easily determined malleable. It takes only the filing of a few documents, the hiring of a registered agent, and the payment of franchise tax to become a Delaware or South Dakota (or Ireland) corporation. Centralizing choice of law rules give states and countries added incentive to attract venue shoppers with either efficient rules, or rules that benefit those with control over a corporation's choice of jurisdiction.

The effects of jurisdictional competition play out in various ways, sometimes leading to more efficient rules, but sometimes, and in predictable ways, leading countries to adopt inefficient rules. Debt and tax haven jurisdictions in the Caribbean are extreme examples, but the phenomenon is pervasive.

B. Asymmetric Comity

My second concern about modified universalism is a bit less obvious. My contention is that for modified universalism to succeed there must be a strong global norm of bankruptcy comity. This is the norm that both Westbrook and Lord Hoffmann call universalism.[32] As Westbrook describes universalism, it is a one-way street. The courts in an ancillary jurisdiction must, in the interest of orderly

27. Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299 (1978).

28. *Id.* at 310–13.

29. 28 U.S.C.A. § 1332(c)(1) (2005).

30. *See generally* William L. Carey, *Federalism in Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663 (1974); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913 (1982); Lucian Arye Bebchuk, *Federalism and Corporate Law: The Race to Protect Managers and Takeovers*, 99 COLUM. L. REV. 1168 (1999).

31. Citibank's credit card bank is located in South Dakota. MBNA and many others have incorporated their credit card banks in Delaware. *See* Janger, *Virtual Territoriality*, *supra* note 3, at 426 (discussing the choice-of-law principles that should govern under universal proceduralism). The Citibank website in the fine print on the bottom states that the credit cards are issued by CITIBANK N.A. *available at*: http://www.citigroup.com/us/home.htm (last visited Feb. 9, 2011). MBNA merged with Bank of America in 2005, but its credit card services are still based out of Delaware. http://money.cnn.com/2005/06/30/news/fortune500/boa/ (last visited April. 8, 2011).

32. *McGrath*, [2008] UKHL 21, [7] 1 W.L.R. at [856]. *See also* Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2277 (2000) [hereinafter Westbrook, *Global Solution*] (describing universalism as the administration of multinational insolvencies by a leading court applying a single bankruptcy law).

bankruptcy administration, defer to the home court, even if the creditors would receive substantially different treatment.[33] By contrast, the court in the main jurisdiction need only apply its own law. The effect is that ancillary courts must tolerate outcome differences, but main courts need do nothing to minimize them.

1. Catch-22

Modified universalism thus creates a choice of law vicious circle. Its centralizing choice of law rule encourages jurisdictions that wish to attract international bankruptcy case filings to skew their bankruptcy law in favor of those LoPucki would call the "case placers."[34] It then imposes a norm of cooperation that enhances the effect of this legal differentiation by requiring ancillary courts to cooperate. Modified universalism thus increases the benefits of jurisdictional competition and its stakes. This incentive to compete through differentiation, in turn, places increasing strains on the cross-border bankruptcy architecture, and requires an even greater strengthening of the "universal" norm of cooperation.

This is the "Catch-22"[35] of modified universalism. As Westbrook, and others, have noted, modified universalism works best if bankruptcy regimes are harmonized.[36] However, they do not appear to recognize that modified universalism itself creates an incentive for jurisdictional differentiation and the seeds of its own undoing.

2. Encouraging Harmonization Through Decentralization

This is where universal proceduralism seeks to move in a different direction. Instead of seeking unilateral cooperation by courts in of ancillary jurisdictions with the case pending at the debtor's COMI, universal proceduralism envisions a regime of bilateral comity. Instead of using the debtor's choice of bankruptcy court to determine which jurisdiction's priority regime should govern, virtual territoriality would call upon the court in the main case to apply ordinary choice of law principles to determine which jurisdiction's priority scheme should govern the debt contract. In other words, just as ancillaries are expected to defer to the main, the main would be expected to, at least, match the distribution that the creditor would have received had the assets been distributed in the ancillary jurisdiction. My claim, developed further below, is that universal proceduralism and the reciprocal comity that it entails are more likely to facilitate cross-border coordination and the propagation of the

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33. Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27, 28–31 (1998).

34. LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS 17 (2005).

35. JOSEPH HELLER, CATCH-22 (1961).

36. *See generally* Jay Lawrence Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT'L L. 499, 517 (1991) (arguing that choice of avoidance law is dependent on the system of international cooperation that a country has chosen); Gabriel Moss, *Group Insolvency—Choice of Forum and Law: The European Experience Under the Influence of English Pragmatism*, 32 BROOK. J. INT'L L. 1005, 1018 (2007) (discussing how English administrators respected foreign priorities to prevent creditors from opening bankruptcy cases in their home countries in *Re* Collins & Aikman SA, [2006] EWHC (Ch) 1342, [2006] B.C.C. 861).

global norm of cooperation than the centralizing approach envisioned by the modified universalist.

II. PARSING THE DIFFERENCES

Universalism has two centralizing strands: administrative and substantive.[37] For Westbrook, modified universalism requires centralization of both.[38] The distinction between modified universalism and universal proceduralism is that under modified universalism, a debtor's assets and claims are administered centrally under the bankruptcy law of the debtor's center of main interest. The role of the court in an ancillary case in this scheme is simply to cooperate in that global administration by assisting in the gathering of assets. In universal proceduralism, by contrast, the centralization is administrative, but *not* substantive.[39] Under universal proceduralism, a debtor's assets and claims are administered centrally, but ordinary, non-bankruptcy law principles are used to locate the claims and assets of a debtor and distributional floors are set according to hypothetical local distribution. This is the difference between Westbrook and me. Lord Hoffmann's position is somewhat more difficult to discern. He invokes univeralism in his *HIH* opinion, but in fact, Lord Hoffmann may be more agnostic on substantive centralization than Westbrook suggests. As Hoffmann takes pains to point out, all he is deciding is to remit the assets.[40] His decision does not determine or even turn on whether the "main" court would apply its own law, or local law to distribution of the assets.[41] In this section, I will respond to Westbrook's critique of universal proceduralism and virtual territoriality, and also show that it is possible for both of us to praise Lord Hoffmann's decision in *HIH*.

A. *Westbrook's Critique of Universal Proceduralism*

Jay criticizes universal proceduralism for determining distributions based on the location of assets. As he puts it: "Universal proceduralism connects local interest to local assets rather than to policies that are inherently local."[42] Universal

37. Janger, *Virtual Territoriality*, *supra* note 3, at 431–32.

38. *See* Westbrook, *Financial Storm*, *supra* note 25, at 1021 ("The close integration among bankruptcy rules and policies in each jurisdiction applies to the big four of bankruptcy policy: control, priority, avoidance, and reorganization policy. Under modified universalism, such centralization should be the goal, although not always the result.").

39. Westbrook has argued that the line between substance and procedure is difficult to draw, and Bill Eskridge has pointed out (in comments on an earlier draft) that the *Erie* jurisprudence is replete with frustrating attempts to draw a distinction between substance and procedure. Procedures can effectively expand and contract the scope and value of substantive rights, and this point is particularly important when one talks about insolvency law, which is, at bottom, about the scope and ranking of remedies. There are a number of responses to this point. First, to say that a line is difficult to draw does not mean that it doesn't exist or that the distinction is not a helpful one. But more importantly, the difficulty in drawing the line actually counsels a narrower scope for *lex fori* rather than a broader one. To the extent that procedures are distributive they can lead to forum shopping, and should be subjected to non-bankruptcy specific interest analysis.

40. *McGrath*, [2008] UKHL 21, [28] 1 W.L.R. at [861].

41. *Id.*

42. Westbrook, *A Comment*, *supra* note 3, at 509.

proceduralism, he believes, places the location of assets as a trump over local interests.[43]

1. Universal Proceduralism Misconstrued

Westbrook's criticism oversimplifies and subtly mischaracterizes my approach. My choice of law focus is broader than just assets. Jay is right that choice of law rules are the manner in which courts determine which jurisdiction has the greatest interest in regulating a transaction. To that end, there are choice of law rules to determine which jurisdiction's property law governs a particular piece of property, and there are choice of law rules for situating contract claims based on which jurisdiction has the greatest interest in regulating the transaction. Jay takes the view that the filing of a bankruptcy proceeding in a particular venue increases that jurisdiction's interest in the transaction. I disagree. I envision a narrow role for *lex forum concursus*, and a much broader role for *lex situs*. My focus is not limited to assets. Claims must also be "located," based either on which jurisdiction's interests predominate or other applicable choice of law principles. Only once both claims and assets have been situated can one calculate a baseline bankruptcy distribution under universal proceduralism. Once assets and claims have been situated, however, it is not difficult to calculate hypothetical local distributions and to recognize that those distributions serve as distributional floors.

Indeed, universal proceduralism may be even more "territorial" than Jay suggests. I would use interest analysis to determine the location of assets *and* the location of claims. Asset location does not trump local interests—interest analysis should be used to determine asset location. To the extent that choice of law rules locate assets, they should seek to vindicate a number of policies, such as notice, predictability, and local interest in regulation. The same can be said for the choice of law principles determining the location of a claim based in contract or tort. My argument is simply that interest analysis should be relatively unaffected by the fact that the debtor's main bankruptcy case is pending in one jurisdiction or another. Just as location of assets should not be a trump, the debtor's choice of bankruptcy venue should not trump either.

2. Locating Assets

Notwithstanding Westbrook's oversimplification of universal proceduralism and virtual territoriality, he is correct that calculating a hypothetical territorial distribution will require the court to determine what assets would be available for distribution in a particular country.[44] It is an attribute of virtual territoriality, and hence universal proceduralism, that assets must be "located" for the purpose of calculating distributions. As such, I must respond to Jay's critique. I do not, however, believe that locating assets is as insurmountable a problem as Westbrook suggests.[45]

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43. *Id.* at 510.

44. Westbrook, *Global Solution*, *supra* note 32, at 2309.

45. *See id.* (comparing the location of assets to a game of musical chairs); Westbrook, *A Comment*, *supra* note 3, at 511.

3. Litigation Over Assets

In Westbrook's view, universal proceduralism is not an advance over modified universalism because litigation over COMI will simply be replaced by litigation over the location of assets.[46] Here, I disagree. Many, if not most, assets locate themselves. Tangible assets have a physical location and, in virtually every jurisdiction, asset location governs substantive rules of priority and distribution. Intangible assets and mobile assets are somewhat more problematic, but they are not nearly as difficult to situate as Westbrook suggests. In the U.S., locating intangible assets has not been a problem. Since the adoption of the U.C.C., the location for intangible assets and mobile goods has been the location of the debtor.[47] Westbrook points to the problem of securities held in the indirect holding system and cash in a company's cash management system[48], but again, there are well established and increasingly uniform choice of law rules that locate these assets for the purposes of distribution.[49] Often, these assets will be deemed located at the debtor's COMI, or at the bank that holds the account. My point here is only that location of assets is not an insurmountable problem, and to the extent that there are difficulties they can be solved by harmonizing choice of law rules.

Here, universal proceduralism presents a significant opportunity for quicker payoff than modified universalism. One place where international and multijurisdictional harmonization efforts have been moving forward fairly quickly is in the area of secured credit. While not all of these instruments are in force, they do reflect a push to articulate uniform choice of law rules for secured transactions. UNCITRAL has promulgated a convention seeking to harmonize the law of accounts receivable financing.[50] UNIDROIT has prepared conventions on mobile goods and securities in the indirect holding system.[51] While the convention on securities in the indirect holding system leaves the question of applicable law to private international law, the Hague Securities Convention locates the securities in the jurisdiction of the securities intermediary who dealt with the customer (the "relevant intermediary").[52] The Convention on Mobile Goods uses a central registry

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46. Westbrook, *A Comment*, *supra* note 3, at 511.

47. U.C.C. § 9-301(1)(2005); *see also* Neil B. Cohen & Edwin E. Smith, *International Secured Transactions and Revised UCC Article 9*, 74 CHI.-KENT L. REV. 1191, 1195 (1999) (explaining that U.C.C. § 9-103, which has since been amended and moved to U.C.C. § 9-301, located intangible assets at the location of the debtor).

48. Westbrook, *Global Solution*, *supra* note 32, at 2312–14.

49. *See, e.g.*, Lynn LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216, 2233–34 (2000) (explaining that intangible assets have well-established locations under international law); Janger, *Virtual Territoriality*, *supra* note 3, at 419 n. 68 (stating that under U.S. law intangible goods are located where the debtor is located).

50. U.N. Convention on the Assignment of Receivables in International Trade, G.A. Res. 56/81, U.N. Doc. A/RES/56/81 (Jan. 31, 2002) [hereinafter UNCITRAL Convention] (U.N. General Assembly calling on member states to consider becoming party to the draft Convention prepared by UNCITRAL).

51. International Institute for the Unification of Private Law [UNIDROIT], *Convention on International Interests in Mobile Equipment* (Nov. 16, 2001), http://www.unidroit.org/english/conventions/mobile-equipment/mobile-equipment.pdf [hereinafter UNIDROIT Mobile Equipment]; UNIDROIT, *Convention on Substantive Rules for Intermediated Securities* (Oct. 9, 2009), http://www.unidroit.org/english/conventions/2009intermediated securities/convention.pdf [hereinafter UNIDROIT Intermediated Securities].

52. Hague Conference on Private International Law, Convention on the Law Applicable to Certain Rights in Respect of Securities Held within an Intermediary (July 5, 2006), http://www.hcch.net/index_en.php?act=conventions.text&cid=72.

to locate mobile goods,[53] while under the Receivables Convention the location of the assignor/debtor is deemed to be the location of the asset.[54] This last is the same rule that is followed in the United States for intangible property and mobile goods. While that rule for receivables is a "centralizing" choice of law rules, it is somewhat difficult to imagine an alternative. Also, in most cases, it is likely to be similar to a COMI rule, and therefore no *more* centralizing than modified universalism.

By contrast, there does not appear to have been any great effort to harmonize the location rule for ordinary tangible assets. One can only speculate as to why, but it may be, as I mentioned before, that tangible assets tend to locate themselves for choice of law purposes. They tend to be governed by the law of the jurisdiction where they are physically located. Indeed, there is one notable exception to this rule, and it may be this exception that goes farthest toward proving the rule.

Under section 9-301 of the Uniform Commercial Code, the law of the jurisdiction where the debtor is located (not the location of the collateral) determines where and how to perfect a security interest.[55] However, here the U.C.C. makes an important distinction.[56] While the law of the jurisdiction where the debtor is located governs which filing system should be searched, the law of the jurisdiction where the collateral is located governs the effect of perfection.[57] In the U.S., the drafters were able to distinguish the interests that dominate with regard to filing (predictability and notice) from the interests relating to priority and other incidents of the secured credit relationship (local control of local assets).

In sum, choice of law rules for locating property seem to be converging in fairly predictable ways. By contrast, the rules for locating a debtor's COMI under bankruptcy law seem to be diverging rather markedly. In the E.U., the *Eurofoods* case and the cases following it articulate a fairly strong presumption in favor of jurisdiction of registration as the debtor's COMI.[58] By contrast, in cases like *Bear Stearns*, in the U.S., the courts seem to be looking more closely at where a debtor's operations and assets are located.[59] Thus, focusing on the location of assets may actually reduce the amount of litigation, rather than increase it by focusing on an area where principles are converging, rather than diverging.

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53. UNIDROIT Mobile Equipment, *supra* note 51, art. 16.

54. UNCITRAL Convention, *supra* note 50, art. 30 (priority governed by the "law of the state where the assignor is located"); UNIDROIT Mobile Equipment, *supra* note 51; UNIDROIT Intermediated Securities, *supra* note 51.

55. U.C.C. § 9-301(1) (2005).

56. *Id.* Under the former, pre-2000, Article 9, § 9-103(1) applied only to documents, instruments, and ordinary goods. Under former Article 9, the effect of perfection was determined by the jurisdiction where the last event occurred that was the basis for the assertion that the security interest was either perfected or non-perfected. Under current § 9-301(1), while a debtor is located in a jurisdiction, the effect of perfection is based on the local laws of that jurisdiction. Under § 9-301(2) perfection of collateral is determined by the law of the jurisdiction where the collateral is located. Under §9-301(3), negotiable documents, goods, instruments, money, or tangible chattel paper, perfection is based on where they are located.

57. *Id.* § 9-301(2).

58. *In re* Eurofood IFSC, Ltd., [2005] B.C.C. 999, [1] (S.C.) (Ir.); *see also In re* Stanford Int'l Bank Ltd., [2009] EWHC (Ch) 1441, [4] (Eng.) (upholding the *Eurofood* test).

59. *In re* Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122, 129–30 (S.D.N.Y. 2007); *In re* SPhinX, 351 B.R. 103, 119–20 (S.D.N.Y. 2006), *aff'd*, 371 B.R. 10 (S.D.N.Y. 2007); *In re* Tri-Continental Exchange Ltd., 349 B.R. 627, 639 (E.D. Cal. 2006).

B. *Different Effects of Contractual Provisions*

A second concern raised by Jay is drawn from the *Lehman/Perpetual* case.[60] There, a derivatives transaction contained, in effect, a "default on bankruptcy" clause that would have flipped the priority between a swap counterparty and a noteholder upon Lehman's bankruptcy.[61] This would, if enforced, have excluded a significant amount of money from the estate.[62] Under U.S. law, such a clause would likely be unenforceable (assuming that the derivative safe harbor provisions do not apply), while a court in England determined that their cognate, "anti-deprivation" rule would not prevent termination of the derivative contract.[63] Jay argues that the resolution of this dispute has nothing to do with the location of the assets (which, by all accounts, were located in the U.K.).[64]

Here, Jay sees a disagreement where there is none. The location of the assets is not relevant to determining the effect of the contractual provision. For me, the relevant question is the "situs" of the contract. If, under non-bankruptcy choice of law rules, the transaction would be located in the U.K., then the effect of the provision should be determined under U.K. law. If it would be located in the U.S., then U.S. law would govern. The location of the debtor may be relevant to this determination, but only because the debtor is one of the contracting parties, not because the debtor is in bankruptcy. I believe that Jay would agree with me on this.

Where Jay and I differ, I believe, is on the next step: determining which country's bankruptcy law will be used to determine the effect of bankruptcy on the transaction (and/or the assets). I would use the bankruptcy law of the jurisdiction where the transaction is located. Jay would use the bankruptcy law of the jurisdiction where the debtor is located.

C. *Asset Stashing*

Finally, Westbrook argues that under universal proceduralism, forum shopping will be replaced with asset stashing.[65] Creditors and debtors will conspire to choose a favorable bankruptcy regime by locating assets in those jurisdictions. Again, this is a problem, but it is not particularly a problem of universal proceduralism. Asset havens exist and, by virtue of their non-cooperation with international bankruptcy regimes, they are a problem that will not be solved by modified universalism. Indeed, to the extent that asset havens also adopt favorable bankruptcy rules, modified universalism enhances rather than reduces the power of haven jurisdictions.

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60. *In re* Lehman Bros. Holdings Inc., 422 B.R. 407 (Bankr. S.D.N.Y. 2010); Perpetual Tr. Co. Ltd. v. BNY Corporate Tr. Services Ltd., [2009] EWCA (Civ) 1160 (Court of Appeal).

61. *Perpetual*, [2009] EWCA (Civ) 1160, [18–19].

62. *Lehman Bros.*, 422 B.R. at 421.

63. *See* Westbrook, *A Comment*, *supra* note 3, at 512 ("The English courts upheld the 'flip' in priority, but the United States bankruptcy court held that it violated the American rule against making bankruptcy a default condition.").

64. *Id.* at 512–13.

65. *Id.* at 513.

III. WESTBROOK'S *HIH* AND HOFFMANN'S *HIH*

Westbrook sees *HIH* as supporting his view of local priorities. I believe, however, that Westbrook is reading more into the *HIH* case than is actually there. Westbrook reads *HIH* as a broad statement in support of modified universalism, and, while Lord Hoffmann certainly states his sympathy for the project, it is not clear that *HIH* deserves the weight placed on it by Jay.

In Jay's view, modified universalism empowers the court at the debtor's center of main interest to impose a norm of unilateral cooperation on courts in ancillary jurisdictions.[66] For Jay, modified universalism is also a choice of law rule for the court at the debtor's COMI that empowers that court to utilize its own insolvency law to resolve issues in the case.[67]

HIH does not go this far. The facts of *HIH* required the Court to address the question of ancillary cooperation, and here Lord Hoffmann spoke out strongly and correctly in favor of the need for ancillary courts to cooperate with the court at the debtor's COMI, even if that court might treat creditors differently than the ancillary court.[68] Westbrook reads this to mean that under Hoffmann's modified universalism the priority scheme of the debtor's COMI controls.[69] This, however, is not what Hoffmann says. Indeed, he expressly holds open the question of what law will be applied by the court at the debtor's COMI. Instead, he invokes the principle of renvoi.[70] The question of applicable priority scheme is to be determined by the choice of law rule at the COMI:

> The power to remit assets to the principal liquidation is exercised when the English court decides that there is a foreign jurisdiction more appropriate than England for the purpose of dealing with all outstanding questions in the winding up. It is not a decision on the choice of the law to be applied to those questions. That will be a matter for the court of the principal jurisdiction to decide. Ordinarily one would expect it to apply its own insolvency laws but in some cases its rules of the conflict of laws may point in a different direction.[71]

In short, while Westbrook and Hoffmann clearly agree on the principle of cooperation by ancillary courts, this is only half the picture. The *HIH* opinion says nothing about what choice of law principles ought to be applied by the court at the debtor's COMI.

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66. Westbrook, *A Comment*, *supra* note 3, at 516.
67. Westbrook, *Global Solution*, *supra* note 32, at 2301–02.
68. *McGrath*, [2008] UKHL 21, [20–21] 1 W.L.R. at [859–60].
69. Westbrook, *A Comment*, *supra* note 3, at 517.
70. *McGrath*, [2008] UKHL 21, [28] 1 W.L.R. at [861].
71. *Id.*

IV. *HIH* AND THE PUZZLE OF *MAXWELL*: LORD HOFFMANN AND VIRTUAL TERRITORIALITY

In evaluating Lord Hoffmann's legacy, I think Jay and I must both come to grips with the fact that Hoffmann is a more Delphic oracle than either of us might like to admit. In *HIH*, Westbrook sees a strong advocate of cooperation by an ancillary jurisdiction with the court at the debtor's COMI. I do too, and I join Jay in my admiration. But to what extent should the court at the debtor's COMI take into account the interests of the creditors who dealt with the debtor in the ancillary jurisdiction? This question is not presented in *HIH*, and Hoffmann makes clear that it is a question to be determined by the choice of law rules of the principal jurisdiction. As to the content of that choice of law rule, Hoffmann leaves somewhat conflicting hints.

The first hint in Lord Hoffmann's jurisprudence is *Maxwell*.[72] There, Lord Hoffmann was presented with precisely the question held open in *HIH*. The story is well known. In *Maxwell*, the debtor's COMI was the U.K., but it had substantial assets and operations in the United States.[73] Plenary cases were opened in both the U.S. and the U.K.[74] On the eve of bankruptcy, a number of U.K. bank creditors of the U.K. entities received payments that would have been viewed as preferential under U.S. law, but not U.K. law.[75] The U.K. administrators went to the U.S. and sought to bring avoidance actions under U.S. law.[76] The preference defendants took advantage of Lord Hoffmann's vacation, and sought an injunction against the U.S. lawsuits.[77] When Lord Hoffmann returned from vacation, he vacated the injunction, saying that it was up to the U.S. bankruptcy court to determine whether U.S. law would reach the challenged transactions.[78]

As it happened, Judge Brozman, applying U.S. choice of law principles, concluded that the payments by an English company to an English creditor in England were not governed by U.S. preference law.[79] Westbrook, while happy with the outcome, was not happy with Judge Brozman's reasoning. He believed that the question of which country's avoidance law governed was determined by the fact that the U.K. was the debtor's center of main interests.[80] Judge Brozman, by contrast, examined the transactions themselves and determined that their center of gravity was in England.[81] Westbrook would have applied *lex forum concursus*. Brozman, while she reached the same result, applied *lex situs*. Lord Hoffmann was silent.

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72. *In re* Maxwell Commc'n Corp., 170 B.R. 800 (Bankr. S.D.N.Y. 1994), *aff'd* 186 B.R. 807, 822 (S.D.N.Y. 1995), *aff'd*, 93 F.3d 1036, 1051 (2d Cir. 1996).

73. *Id.* at 801–02; *see also* Westbrook, *Global Solution*, *supra* note 32, at 2321 (explaining that the parent's headquarters and most of its financing were in London, but most of its assets were in the United States).

74. *Maxwell*, 170 B.R. at 801.

75. *Id.*

76. *Id.*

77. *In re* Maxwell Commc'n Corp., 186 B.R. 807, 815 n.3 (S.D.N.Y. 1995).

78. *Id.* at 805.

79. *Id.* at 818.

80. Jay Lawrence Westbrook, *The Lessons of* Maxwell Communication, 64 FORDHAM L. REV. 2531, 2540–41 (1996).

81. *Maxwell*, 170 B.R. at 818.

Maxwell gives us a partial answer to the question posed by *HIH*. It shows Lord Hoffmann exercising, what I will call in the next section, bilateral comity. Even as the judge in the principal case he was willing to defer to the U.S. court and allow it to make its own decision about choice of law. We never learn, however, whether, if he had been the judge in the Southern District of New York, he would have applied Westbrook's or Brozman's approach to the question. Moreover, we do not know whether he would follow the same approach with regard to priorities as he did with regard to avoidance.

Lord Hoffmann has not, however, been entirely silent on the subject of the law to be applied in the principal case. A hint to the answer to this question comes from dicta in another case:

> There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated.[82]

A facile reading of this dictum would suggest that Hoffmann has thrown in his lot with the substantive strand of modified universalism. The obvious way to accomplish this is to adopt Westbrook's approach and to apply the bankruptcy scheme of the COMI without deviation.

But, where unsecured creditors are concerned, modified universalism is not the only route to *pari passu* distribution. Even in a territorial regime, the fact that a claim is situated in a particular jurisdiction for choice of law purposes does not mean that claims may only be asserted against the debtor in that jurisdiction. Judgments of one country can be enforced in other jurisdictions, and foreign creditors may generally assert claims against a debtor in the debtor's home country. Therefore, the "equality of distribution" that Hoffmann seeks can even be achieved in a territorial regime.[83] It can therefore be accomplished using a virtual territorial approach as well. A "virtually territorial" regime that assumes cross-filing will achieve the same result—eliminating the relevance of asset location to relative distribution—while at the same time giving effect to local priorities. While this is not necessarily the approach I would use, I have not ruled it out either.[84]

Once one recognizes that modified universalism and universal proceduralism do not differ where distributions to unsecured creditors are concerned, it becomes clear where the differences lie. They appear with regard to (1) property rules, and (2)

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82. Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings Plc [2007] 1 A.C. 508, [16].

83. *See McGrath*, [2008] UKHL 21, [30], [31] 1 W.L.R. [861], [862] (recommending that English courts should remit assets to Australia, the country of principal liquidation, to ensure that all the company's assets are distributed to its creditors under a single system of distribution).

84. The approach that Jay advocates is one he refers to as "universal priority." Under his approach, all countries should make their priorities available to both nationals and non-nationals. Westbrook, *Universal Priorities*, *supra* note 33, at 43. For example, a French employee of a US corporation, living and working in France, would be able to take advantage of both the French priority for employees and the US priority. I, by contrast, favor a rule of "virtual priority," where the French worker would likely be able to claim the French priority against assets located in France, but would not qualify for the US priority. This is the same distribution as would result from the opening of a territorial case in France. Both approaches, however, satisfy the constraint articulated by Lord Hoffmann in *Cambridge Gas*, [2007] 1 A.C. 508, [16].

unsecured priority creditors. I would use non-bankruptcy choice of law rules to situate those rights. Westbrook would situate both at the debtor's COMI. Again, neither *HIH, Cambridge Gas,* nor *Maxwell* indicate Lord Hoffmann's view on this.

V. RECIPROCAL COMITY

One thing that makes the discussion at today's conference so rewarding is that everybody here is seeking to formulate a cross-border bankruptcy regime that accomplishes two goals to the extent possible. Those goals are coordinated, efficient decisionmaking about how to maximize the value of a debtor's assets, and fairness in distributing that value. Jay takes the view that coordinated decisionmaking can best be accomplished by administering a universal bankruptcy case from the debtor's COMI, and that fairness can best be achieved through equality of distribution, utilizing the single priority scheme used in the debtor's COMI.[85]

While I agree that administrative centralization is necessary, I take a different approach to "fairness." Instead of viewing fairness as equality of distribution, one can view fairness as consistency with creditor expectations. These creditor expectations may very well include reliance on a particular national approach to the rights of secured creditors, or on a particular national approach to the rights of employees or tort claimants.

The modified universalist would respond with the argument that creditor expectations are not defeated when they know that they are lending to a debtor who is located in a particular jurisdiction. This will often be the case, but not always. Westbrook accuses me of making asset location control the choice of law interest analysis.[86] I have rejected that characterization of virtual territoriality. However, it seems to me that Westbrook *is* taking a similarly monolithic approach to choice of law by declaring that once a debtor files for bankruptcy, the location of the debtor is the choice of law trump.

My concern with this "location of the debtor" trump is that it puts tremendous pressure on the courts in the ancillary jurisdiction to retain assets and therefore makes it more difficult for the ancillary court to cooperate with the principal case.[87] The more national distribution schemes differ, the greater the incentive creditors have to fight over whether assets will be administered locally or centrally. The more creditors have an incentive to play jurisdictional distribution games, the harder it will

85. Westbrook, *Global Solution, supra* note 32, at 2309.

86. Westbrook, *A Comment, supra* note 3, at 503.

87. Westbrook has long acknowledged this point, saying, "[t]hus, applying Mexican priority law to the Mexican assets has the very considerable benefit of replicating the results that would have followed from the usual situation, the opening of a Mexican proceeding. The result is to make modified territorialism substantially more predictable and, perhaps more important, to lower the incentives for multiple local proceedings. If Mexican creditors, especially priority creditors, know that their claims will be given Mexican-law treatment in the U.S. courts to the extent of the Mexican assets, they have much less motive to institute Mexican proceedings. In that case, there is the prospect of much lower costs and greater speed than where each relevant jurisdiction opens a proceeding." Westbrook, *Universal Priorities, supra* note 33, at 41–42. These advantages are, in his view, outweighed by the pernicious effects of *situs* rules. It should be noted, however, that here he is describing a slightly different system from the one I advocate. He is describing what he calls universal cross filing with cross-priority. I am advocating something that would be described in Westbrook's terminology as universal cross filing with territorial priority. In Westbrook's view, priority claims should be given national treatment in all countries. In my view, priority claims ought only be given priority if the situs of the transaction would extend local law to cover the claim.

be for the principal court to make coordinated decisions about how to maximize asset value. By contrast, a regime that encourages the court at the debtor's COMI to disapply its own national priority scheme in favor of the scheme that would have applied if assets and claims had been administered territorially will encourage coordination without undercutting "fairness" in any a priori way.

The case that divides Jay and me, and which may divide Lord Hoffmann and me, is the case of *Collins & Aikman*.[88] In that case, the U.K. administrators of the European subsidiaries of a U.S. auto parts supplier recognized that German and Spanish creditors would receive a greater distribution if they opened a territorial secondary case in their own country.[89] The administrators also recognized that the opening of secondary cases early in the case would likely frustrate a going concern sale of the company's European assets.[90] To preserve the value that could be captured in a going concern sale, the administrators promised the German and Spanish creditors that they would receive the same distribution they would have had local secondaries been opened.[91] The problem arose when it came time to deliver on that promise. Under Article 4 of the E.U. Regulation on Insolvency, the bankruptcy law of the jurisdiction of opening would apply in the main case.[92] As such, the U.K. was to apply its own bankruptcy law to the case. The Court in *Collins & Aikman* managed, through a fair amount of common law maneuvering, to reach the conclusion that it was possible to allow a deviation from the U.K. priority scheme in this particular case.[93] In other words, the court in the principal case deferred to the priority scheme that would have been applied in a secondary case, had one been opened. In my view, this is the normatively superior approach. For Westbrook, this violates his all or nothing view that COMI choice determines bankruptcy priority.

HIH would allow and encourage courts in ancillary jurisdictions to defer to the distribution scheme in the main case. *Collins & Aikman* and virtual territoriality suggest that such deference should be reciprocal and symmetric, rather than unilateral. Such reciprocal deference has much to recommend it. First, it will ease the recognition of the orders of the principal court. Or, to put it differently, it will reduce the pushback that occurs when an ancillary court has to swallow hard before remitting assets because local creditors will not be treated as well in the central administration. Second, it will streamline proceedings to the extent that the need for involved proceedings in secondary jurisdictions is alleviated. The ancillary courts will be more likely to remit assets if they can be assured that the principal court will seek to mirror their distributional scheme. Third, it will reduce opportunities and incentives for the parties themselves to forum shop, or game the territorial distributions.

Virtual territoriality might be seen as adopting a distinctly British approach to choice of law. A unique aspect of British choice of law jurisprudence has long been the principle of "double renvoi." England, alone in the world, takes the view that

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88. *In re* Collins & Aikman Europe SA, [2006] EWHC (Ch) 1343, [8–10], [20], [41] (Eng.); *see also* Moss, *supra* note 36, at 1006–08 (noting the two different approaches used in Europe).

89. Id. at [8].

90. *Id.*

91. *Id.*

92. Council Regulation 1346/2000, Insolvency Proceedings, art. 4, 2000 O.J. (L 160) (EC), available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32000R1346:EN:HTML

93. *Collins & Aikman,* [2006] EWHC 1343, [36].

where U.K. choice of law rules point abroad, they point to both the substantive law and choice of law rules of the foreign jurisdiction.[94] Where those foreign choice of law rules point back to the U.K., the U.K. choice of law rules would again point abroad.[95] If both jurisdictions have a "double renvoi" rule, the result may be an infinite loop.[96] Luckily for the world, however, the U.K. is the only jurisdiction to use "double renvoi."[97] Most other jurisdictions use only "single renvoi."[98] Therefore, if the foreign court points back to the forum court, the remission is accepted. The result of the U.K. using double renvoi and the rest of the world using single renvoi is to minimize the extent to which one can forum shop one's way into U.K. substantive law. One way of thinking about virtual territoriality might be to think of it as a rule using double renvoi in the main, and single renvoi in the ancillary. This approach will minimize the extent to which central administration of assets will disturb territorial approaches to property and/or priority.

All of these aspects of virtual territoriality suggest that such a regime will help divorce the debate over how to maximize the value of the assets from fights about how those assets should be distributed, and will reduce the stakes of any fight over where decisionmaking power should be located. Since COMI choice will have little or no effect on the distributional scheme, there will be considerably less incentive to fight over it.

VI. CONCLUSION

In sum, while Jay and I have much to discuss about whether the location of claims and assets or the location of the debtor should determine the applicable priority scheme, and Lord Hoffmann may choose to weigh in on one side or the other, I can applaud and appreciate Lord Hoffmann's decisions in both *HIH* and *Maxwell* because each, in their own way, embody the sort of reciprocal comity that lies at the heart of the universal proceduralist vision. Indeed, these two cases taken together demonstrate that cooperation in cross-border bankruptcy cases cannot be a one way street. The ancillaries must cooperate with the main, but the main must take into account the interests and concerns of the ancillary jurisdictions in crafting a distribution. This is just one of the many lessons taught by Lord Hoffmann.

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94. Ernest Otto Schreiber, *The Doctrine of Renvoi in Anglo-American Law*, 31 HARV. L. REV. 523, 525–26 (1917); Larry Kramer, *Return of the Renvoi*, 66 N.Y.U. L. REV. 979, 979–80 (1991); Elizabeth B. Crawford, *The Uses of Putativity and Negativity in the Conflict of Laws*, 54 INT'L & COMP. L. Q. 829, 842 (2005).

95. Crawford, *supra* note 94, at 842.

96. *Id.*

97. *See* Crawford, *supra* note 94, at 842 (describing the English approach to renvoi, and the resulting loop.)

98. RUSSELL J. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS, 89–90 (2006).

No Two Snowflakes the Same: The Distributional Question in International Bankruptcies

JOSÉ M. GARRIDO*

Abstract

This article provides a short comment to the House of Lords' decision in McGrath v. Riddell, *and takes that decision as an example for a summary analysis of the diverse situations that differences in priorities may create in international bankruptcies. It is well known that differences in priority regimes correspond to diverse distributional decisions taken by states, and represent one of the most important roadblocks in the way of international cooperation in insolvency.[1] The theoretical and legal models of international bankruptcy have not tackled all of the issues connected with the treatment of priorities, so court decisions have to devise pragmatic approaches in order to deal with the problems that differences in priorities present. A typology of the differences in priorities could be a starting point to understand the balance of interests that needs to be achieved for effective international bankruptcy cooperation.*

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* This article presents the personal views and opinions of the author, and does not purport to represent the World Bank's position on these issues. Professor of Commercial and Corporate Law, Universidad de Castilla-La Mancha (Spain), and Senior Counsel, Insolvency and Creditor Rights Initiative, The World Bank. The views expressed in this article are exclusively those of the author, and do not necessarily reflect the views of the World Bank, its Executive Directors, or the Governments they represent. I wish to thank Jay Westbrook and all the distinguished participants in the University of Texas Law School 2010 International Insolvency Symposium for their views.

1. In this article, "bankruptcy" and "insolvency" are used as synonyms throughout the text.

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I. INTRODUCTION

In the case of *McGrath v. Riddell*, an Australian insurance company (HIH) was declared insolvent in Australia, but had substantial assets in the United Kingdom.[2] The U.K. Courts debated on whether to apply the Australian distributional scheme or to apply the U.K. distributional scheme to the assets located in the United Kingdom.[3] In the final judgment, the House of Lords agreed to transfer the assets to the Australian insolvency proceedings, in spite of the differences in distribution schemes, and the corresponding differences in outcomes for creditors.[4] This result conforms to a universalist view of international insolvency: given the fact that the Australian courts had jurisdiction over the insolvency of the insurance company, it was appropriate that the Australian ranking of claims was applied to all assets of the company, universally. It is widely recognized that one of the salient features of the universalist approach to international bankruptcy is that a single ranking of claims should be applied to all creditors and proceeds, wherever they may be located. However, there are several specific circumstances that explain the ability of the British courts to defer to the Australian hierarchy of creditors.

After a consideration in Section II of the most important facts in the case, Section III deals with the basic propositions of the different theories of international bankruptcy law, especially territorialism, universalism, and modified universalism. It is suggested that practical experience has shown the advantages of modified universalism. The different implications of the theories are explored in connection with the existence of different preferential creditors in their respective insolvency law systems. It is submitted that, frequently, the discussion of the different positions is highly theoretical and, to a certain extent, even "byzantine." Theories have to be tested against real and specific situations in order to assess the different outcomes that they can provide to the problems of international insolvency. The weak spot of the modified universalist approach is found on the different interpretations that may be given to the concept of the "center of main interests" (COMI) of the debtor, and to the important concept of "establishment."

Section IV covers the problems that differences in priorities cause in international bankruptcies. It is submitted that there are no two priority systems that are identical, and that harmonization or unification of the law in this area is extremely unlikely to happen. In fact, priority systems are but the expression of the hierarchy of values that permeate a given legal system. This means that graduation of creditors is primarily political, and that the influence of powerful groups of

2. McGrath v. Riddell, (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21, [1], 1 W.L.R. 852 (H.L.) 855 (Lord Hoffmann) (appeal taken from Eng.)

3. *Id.*

4. *Id.* at [2], [43].

creditors, the inertia of legal tradition, or the conscious and deliberate choice to promote certain values, are the factors that explain the fundamental differences encountered in various jurisdictions around the world. However, once that diversity is accepted as a fact in international bankruptcies, it is helpful to formulate a "taxonomy" of the various situations that may arise where there are differences in priorities between the legal systems connected to an international bankruptcy. This classification of situations illustrates the potential for different outcomes in the treatment of priorities. Section V concludes.

II. *MCGRATH V. RIDDELL*: AN EXAMPLE OF THE TREATMENT OF PRIORITIES IN INTERNATIONAL BANKRUPTCY

The facts that gave rise to the different judgments in *McGrath v. Riddell* are relatively straightforward and easy to summarize: companies belonging to an Australian insurance group of companies (HIH Casualty & General Insurance) were declared insolvent in Australia, but had substantial assets in the United Kingdom.[5] The assets situated in the United Kingdom were mainly reinsurance claims corresponding to reinsurance policies taken out in the London market.[6] A request was sent to England, asking that the provisional liquidators be directed, after payment of their expenses, to remit the assets to the Australian liquidators for distribution.[7]

The existence of a priority in Australian legislation in favor of insurance creditors, and the lack of a similar provision in English law at the time, meant that the differences in outcome for unsecured creditors would be substantial, depending on the decision to recognize or to disregard the Australian priority:

> It is agreed that if the English assets are sent to Australia, the outcome for creditors will be different from what it would have been if they had been distributed under the 1986 Act. Some creditors will do better and others worse. Approximate figures are given in para 17 of the judgment of the Chancellor in the Court of Appeal. Generally speaking, insurance creditors will be winners and other creditors will be losers.[8]

Therefore, the English courts debated whether to apply the Australian distributional scheme or to apply the English distributional scheme to the assets located in England. In the first instance, the English court considered that English creditors would have been disadvantaged if the assets of HIH were remitted to Australia for distribution in accordance with Australian law.[9] Some Australian statutory provisions (specifically, § 562A of the Corporations Act 2001)[10] create a priority for insurance creditors,[11] and this would result in a prejudice to English

5. *Id.* at [1].
6. *Id.* at [35].
7. *Id.* at [1].
8. *McGrath*, [2008] UKHL 21, [2], 1 W.L.R. at 855 (Lord Scott). The differences resulting from applying the English and the Australian distributional schemes are stated in a table. *Id.* at [53].
9. *Id.* at [59].
10. *Corporations Act 2001* (Cth) s 562A (Austl.).
11. *McGrath*, [2008] UKHL 21, [51], 1 W.L.R. at 866–67 (Lord Hoffmann).

unsecured creditors. Richards J. rejected the Australian request, on the basis that the court had no power to order a transfer if the *pari passu* rule of the principal jurisdiction were not substantially the same as that under English law.[12]

In the Court of Appeal, the same result was reached, but Sir Andrew Morritt CVO decided that there was jurisdiction.[13] The test for the exercise of the court's discretion was balancing the advantages and disadvantages to the creditors in the ancillary jurisdiction resulting from a transfer to the principal place of bankruptcy.[14] The advantage for some insurance and reinsurance creditors resulting from the transfer did not outweigh the prejudice suffered by the other creditors.[15] So, no countervailing advantage could justify the interference with the statutory scheme of distribution imposed under the Insolvency Act 1986.

After differing judgments in previous instances, the House of Lords agreed to transfer the assets to the Australian insolvency proceedings, in spite of the differences in distribution schemes.[16] This result corresponds, prima facie, with a universalist view of international insolvency: given the fact that the Australian courts had jurisdiction over the insolvency of the insurance company, it was appropriate that the Australian ranking of claims was applied to all assets of the company, universally.[17] That included the assets located in England, despite the fact that the English distributional scheme did not include any priority for the claims of insurance creditors.[18] Universalism has been historically connected to the predictability of the insolvency regime and the protection of creditors' expectations. Some of the reasoning by Lord Hoffmann appears influenced by that orientation:

> Furthermore, it seems to me that the application of Australian law to the distribution of all the assets is more likely to give effect to the expectations of creditors as a whole than the distribution of some of the assets according to English law. Policy holders and other creditors dealing with an Australian insurance company are likely, so far as they think about the matter at all to expect that in the event of insolvency their rights will be determined by Australian law. Indeed, the preference given to insurance creditors may have been seen as an advantage of a policy with an Australian company.[19]

In fact, Lord Hoffmann's concluding remarks stress that in this case the principle of universalism must be given "full rein."[20] However, it would be more correct to state that in the particular set of circumstances of the case, the court agreed to a solution consistent with the basic tenets of universalism. Moreover, it would be too far-reaching to declare that the court decided to embrace universalism

12. McMahon v. McGrath (*In re* HIH Cas. & Gen. Ins. Ltd.), [2005] EWHC (Ch) 2125, [50] (Eng.).
13. *McGrath*, [2008] UKHL [11] 1 W.L.R. at 857.
14. *Id.* at [33]–[35].
15. *Id.* at [11].
16. *Id.* at [36].
17. *Id.* at [6] ("There should be a unitary bankruptcy proceeding in the court of the bankrupt's domicile which receives world-wide recognition and it should apply universally to all the bankrupt's assets.").
18. *Id.* at [21], [24], [41].
19. *McGrath*, [2008] UKHL 21, [33], 1 W.L.R. at 862.
20. *Id.* at [36].

as the approach to be taken in all issues pertaining to international insolvency problems.

There are numerous specific factors that explain the ability of the English courts to defer to the Australian hierarchy of creditors. Perhaps the single most important factor is that Australia is one of the jurisdictions listed by the Secretary of State as being qualified to receive special assistance under the Insolvency Act (§ 426 of the English Insolvency Act 1986).[21] The fact that a country is included in the list attached to § 426 means that the possibilities for assistance by English courts are greatly increased.[22] Actually, in the judgment in *McGrath v. Riddell*, several of his Lordships remarked that they did not consider that the case would have been resolved in the same way if the jurisdiction that sought assistance was not included in the list.[23] It is the existence of this selected list of jurisdictions[24] that grants a special character to English international insolvency law, as this provision allows English courts to cooperate closely with courts from those jurisdictions, and apply foreign law in situations like the one that is the subject of this commentary.[25] By including a country in the list of relevant jurisdictions, the Secretary of State is satisfied that the law and the courts of that jurisdiction are reasonably similar and compatible with those of England.[26] Under present English law, the possibilities of cooperation in international bankruptcies have been increased: thus, not only § 426 may assist in international cooperation, but also the E.U. Insolvency Regulation[27] and the provisions that have incorporated the UNCITRAL Model Law in England (Cross-Border Insolvency Regulations 2006).[28] However, the fact that the case involved an Australian company and that English courts are prepared to defer to Australian law in ways that would be inapplicable to other countries, is not the only explanation for the outcome in this particular case.

Another important factor that helps explain the deference to a different priority scheme lies with the very *elimination* of those differences: English law was set to

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21. *Id.* at [4].

22. *See* Kate Dawson, *Assistance under Section 426 of the Insolvency Act 1986*, 8 INT'L INSOLVENCY REV. 109, 117 (explaining that a court requesting assistance must be on the list of countries or territories designated by the Secretary of State).

23. *See McGrath*, [2008] UKHL 21 [4], [55], [76], [77], 1 W.L.R. at 856, 868, 875–76. (including three Lordships reference that a country be on a list of relevant countries designated by the Secretary of State, in order to receive assistance under § 426(4) of the 1986 Insolvency Act).

24. For some time, lawyers have referred informally to this list as the "cricket-playing" countries. Sandy Shandro, *International Judicial Co-operation: Can the Common Law Make a Comeback?*, 7 INT'L INSOLVENCY REV. 63, 84 (2008). According to Lord Hoffmann, England traditionally has recognized closer cooperation with countries sharing a similar legal tradition, specifically countries that were or are British colonies. Leonard Hoffmann, *Cross-Border Insolvency: A British Perspective*, 64 FORDHAM L. REV. 2507, 2511 (1996).

25. Gabriel Moss, *Common Law Judicial Assistance Comes of Age*, 19 INSOLVENCY INTELLIGENCE 123, 125 (2006).

26. *See* Blanca Mamutse, McGrath v. Riddell: *A Flexible Approach to the Insolvency Distribution Rules?*, 19 INT'L INSOLVENCY REV. 23, 35 (2010) (explaining how the Secretary of State's designation implies that the listed jurisdiction is accepting of English legal standards).

27. Council Regulation 1346/2000, 2000 O.J. (L 160) 1 (EC). As it is well known, regulations are directly applicable in all E.U. Member States, and do not require implementation by national legislation or regulations.

28. *See* Paul Omar, *Cross-Border Insolvency Law in the UK: An Embarrassment of Riches*, 22 INSOLVENCY LAW & PRAC. 132 (2006) (describing how UNCITRAL's increase in popularity has led some states to adopt the Model Law).

recognize the priority granted to insurance creditors over reinsurance claims, due to the necessary implementation of European rules on the matter.[29] If the case were to be heard today, there would not be any difference in the ranking of claims and, consequently, no differences in outcome for the creditors involved.

A supplementary specific circumstance that needs to be remembered in the context of the analysis of this case is that, as Lord Hoffmann recognizes, the deference to the Australian priority for insurance creditors actually benefits the position of London as an important reinsurance market:

> The fact that there are assets in England is principally the result of the companies having placed their reinsurance business in the London market. For the purposes of deciding how the assets should be distributed, that seems to me an entirely adventitious circumstance. Indeed, it may not be to the advantage of London as a reinsurance market if the distribution of the assets of insolvent foreign reinsurance companies is affected by whether they have placed their reinsurance business in London rather than somewhere else.[30]

Notwithstanding all the circumstances and specific factors listed above, I would argue that there is a major feature of this case that is crucial for the better understanding of its implications. The issue in *McGrath v. Riddell* is mainly a conflict between a foreign priority and the local principle of equality of creditors (*pari passu* rule or *par condicio creditorum*). According to the taxonomy of conflicts between priorities in international settings that is developed later in this article,[31] this type of conflict is not as intense as others and allows for some flexibility in its resolution, precisely because in it there is no confrontation with a major interest protected by local law, but, rather, with the diffuse interest of unsecured creditors as a class. This logical underpinning is implied in the reasoning of Lord Neuberger:

> It is not as if the Australian regime would distribute assets between groups of unsecured creditors (whether preferential or not) other than on a *pari passu* basis, or has significantly different set-off rules from those which apply in this jurisdiction.[32]

It is clear, therefore, that a host of different factors contributed to a solution in which the courts defer to the Australian hierarchy of distribution among creditors, but it is submitted that the one of the decisive factors—and the most interesting one, from a comparative law perspective—is the nature of the conflict between unsecured creditors and a foreign priority.

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29. *See* Council Directive 2001/17/EC, 2001 O.J. (L 110) 3 (EC) (stating that Member States shall protect insurance creditors); *see also* Mamutse, *supra* note 26, at 36 ("In *McGrath v. Riddell*, the difference between the English and the Australian distribution schemes was tempered by the awareness that English law had in the intervening period become subject to a regime whereby insurance creditors would receive more favourable treatment in the distribution of an insolvent insurer's assets than their peers in the ordinary unsecured class.").

30. *McGrath*, [2008] UKHL 21, [35], 1 W.L.R. at 863.

31. *See infra* part 4 (explaining the various approaches to differences in priorities in cooperative systems of international bankruptcy).

32. *McGrath*, [2008] UKHL 21, [81], 1 W.L.R. at 876–77.

There were, of course, some arguments in favor of a solution based on territoriality. Basically, it could be argued that the English courts should protect the ranking of claims according to English law, whereas cooperation with the Australian courts amounted to disregarding the scheme of distribution of English law, and it worsened the position of unsecured creditors under English law. In fact, the Court considered a common law test, whether "distribution in the country of the principal liquidation produced advantages for the non-preferred creditors which counteracted the prejudice they suffered."[33] However, this test was not satisfied as the unsecured creditors in England would not derive any particular benefit from the remission of the assets to Australia, where the operation of a different ranking of claims would result in a net prejudice to the unsecured creditors in England.[34]

It is possible to conclude that the judgment "*provides an illustration of the pragmatism which is brought to bear on matters relating to distribution in international insolvency.*"[35] In fact the word "pragmatism" captures the approach taken by English courts on numerous occasions,[36] and it aptly describes a solution that some specialists may find at odds with the theoretical analysis of international insolvencies. The different theoretical approaches to international cooperation have been analyzed in an enormous body of legal literature. A quick review of the main orientations will serve as the basis for a more fruitful discussion of the different problems caused by diverging priorities in international insolvencies.

III. A SUMMARY CONSIDERATION OF THEORIES OF INTERNATIONAL BANKRUPTCY

The question of the treatment of priorities in international bankruptcy cases cannot be complete without a summary analysis of the different theoretical approaches that have been followed in international bankruptcies, a favorite subject for international private lawyers since the 19th century. The analysis of the theories that have been developed would cover far more space than is available for this discussion. The aim of this section, therefore, is solely to summarize some of the tenets of the different orientations, as a theoretical background, in order to proceed to the analysis of the specific problem of the conflict between diverse priority schemes in international bankruptcy.

The discussion on international bankruptcy models is often abstract and highly theoretical. In order to keep the discussion focused, it would be helpful to remember that bankruptcy regulation should promote certain goals, especially the need for

33. *Id.* at [11] (Lord Hoffmann).

34. *Id.* at [31], [34] (Lord Hoffmann).

35. Mamutse, *supra* note 26, at 15 (emphasis added).

36. Specific cases of English and U.S. courts have taught us many lessons in international bankruptcy. *See* Richard A. Gitlin & Ronald J. Silverman, *International Insolvency and the Maxwell Communication Corporation Case*, in INTERNATIONAL BANKRUPTCIES: DEVELOPING PRACTICAL STRATEGIES 7, 21 (Practising Law Institute, 1992) (discussing the process the courts used to facilitate cooperation); Jay L. Westbrook, *The Lessons of Maxwell Communication*, 64 FORDHAM L. REV. 2531, 2534 (1996) (describing "unprecedented cooperation" between American and English bankruptcy courts); Hoffmann, *supra* note 24, at 2507 (outlining the history of Anglo-American relations in the bankruptcy context); *see generally* John K. Londot, *Handling Priority Conflict Rules in International Bankruptcy: Assessing the International Bar Association's Concordat*, 13 BANKR. DEV. J. 163 (1996).

predictability in asset distribution,[37] and, above all, the need for efficiency.[38] It is in the interests of the creditors that liquidation occurs in "an equitable, orderly, and systemic manner, rather than in a haphazard, erratic or piecemeal fashion."[39] International cooperation is needed to achieve these goals;[40] therefore, the discussion should revolve around the appropriate ways to advance the interests of all parties involved in the debtor's bankruptcy.

The theoretical discussion on international bankruptcy is polarized in two opposing positions: territorialism and universalism, with a number of intermediate theories in the middle of the spectrum.

Territorialism simply postulates that the courts in a jurisdiction will have the competence to open insolvency proceedings in their own territory, and that insolvency proceeding will be limited to the assets and creditors located in the jurisdiction.[41] Foreign creditors are left unprotected, unless there are assets in their own jurisdiction, in which case they will be able to open a local bankruptcy proceeding.

Territorialism is directly linked to the definitions of competence and forum non conveniens in insolvency proceedings. In some legal systems, it suffices that assets exist in the jurisdiction in order to assert the existence of bankruptcy competence. Courts may even open insolvency proceedings where there are no assets in the jurisdiction, as normally the presence of assets in the jurisdiction is not a requirement for the opening of insolvency proceedings, and even though an insolvency process with no assets is generally useless. In other cases, a sufficient connection with the jurisdiction is required, and the reasonable possibility that, if a winding-up order is made, there is benefit to those applying for the winding-up order and the court is able to exercise jurisdiction over one or more persons in the distribution of assets.[42]

In fact, territorialism is the most ancient approach to insolvency: in the first systematic work on insolvency law, Salgado de Somoza's *Labyrinthus Creditorum*, there is already a sense that those creditors who have relationships with a debtor that

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37. Ulrik Rammeskow Bang-Pedersen, *Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests*, 73 AM. BANKR. L.J. 385, 386–87 (1999); Jay L. Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 466 (1991); F. J. Brewerton & Jane LeMaster, *Toward Universalism in International Bankruptcy Law: Foundations for Strategy Formulation in Selected Countries*, 1 J. BUS. & ECON. RES. 97, 99 (2003).

38. *See* Thomas M. Gaa, *Harmonization of International Bankruptcy Law and Practice: Is it Necessary? Is it Possible?*, 27 INT'L LAW. 881, 885 (1993) (describing the mutual desire of creditors and debtors for predictability of results, efficient administration of the estate, its equitable distribution, and finality of result).

39. Cunard Steamship Co. v. Salen Reefer Serv., 773 F.2d 452, 458 (2d Cir. 1985); *see* Westbrook, *supra* note 36, at 2531 (explaining the systematic approach of liquidation used in order to protect creditors).

40. *See* Jay L. Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT'L L. 499, 516 (1991) ("There is almost unanimous agreement that more international cooperation ... is required."); *see also* Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT'L L. 1, 4 (1997) (describing how most academic writing in the area of transnational insolvencies has demanded greater international cooperation).

41. In fact, the usefulness of an insolvency proceeding is very limited if there are no assets of the debtor in the jurisdiction. However, in most cases, there is no requirement that creditors prove that there are assets belonging to the debtor in the jurisdiction. Of course, rational behavior dictates that creditors will only pursue insolvency proceedings where there are possibilities of obtaining a return.

42. *See, e.g.*, *Re* Real Estate Development Co., [1991] B.C.L.C. 210 (Ch) at 217 (Eng.) (reflecting this principle under the English law).

has a establishment (*negotiatio*) in the territory, should satisfy their claims with the proceeds of the liquidation of that establishment.[43] Salgado makes this claim irrespective of the fact that the establishment as such has no legal personality. In the time Salgado's work was published, the questions connected with legal personality had not developed as we understand them today. In any case, it is interesting to note that, in the first stages of development of modern bankruptcy law, the theorists defended two ideas. First, that the liability of the merchant was connected to the assets and organization displayed in a territory.[44] Second, that creditors should enforce their claims over the assets of the debtor that are located in the territory, as the natural reach of the creditors' powers is limited by the territorial organization of the debtor.[45] It is also implicitly understood that merchants extend credit to debtors based on the assets that those debtors have, and which are immediately accessible to creditors.

Territorialism, in its original form, suggests a total lack of coordination between courts in different jurisdictions. The courts of each country would be free to initiate insolvency proceedings against a debtor, even if other insolvency procedures have been opened in other countries. The territorialist approach is easy to implement in practice, as it requires no coordination efforts, but its operation denies the attainment of the objectives of insolvency law: in a pure territorialist approach, it is virtually impossible to attain the proper objectives of an insolvency regime, like the maximization of the value of the assets of the estate, the minimization of the creditors' losses, and the reorganization of the debtor's business. Moreover, the outcome of insolvency is fundamentally unpredictable, as it is extremely difficult to determine where the debtor's assets are located, and the location of assets determines the applicability of the insolvency law, including priorities and rules for distribution.[46] Territoriality is shown to generate a distortion in investment patterns that might lead to an inefficient allocation of capital across countries.[47] The fact that creditors are able to "grab" the assets of the debtor wherever those are located means that local creditors and multinationals tend to be benefited by territorialism.[48]

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43. FRANCISCO SALGADO DE SOMOZA, LABYRINTHUS CREDITORUM CONCURRENTIUM AD LITEM PER DEBITOREM COMMUNEM INTER ILLOS CAUSATAM, (ed. 1757), Vol. I, Part II, Chapter XII, n.73–75; Angel Espiniella Menendez, *The Ancillary Insolvency Proceeding*, 19 INT'L INSOLVENCY REV. 99, 100 n.2 (2010) ("Salgado de Somoza already seemed to plead for territorialism when he referred to a plurality of businesses in different places.").

44. *See, e.g.*, FRIEDRICH KARL VON SAVIGNY, PRIVATE INTERNATIONAL LAW AND THE RETROSPECTIVE OPERATION OF STATUTES 257, 258 (William Guthrie trans., Rothman Reprints 1972) (1880).

45. *See, e.g.*, *id.* at 260.

46. In today's world, the location of assets for a given debtor is a real spinning wheel. For some important assets, location is purely conventional (like intellectual property). The location of creditors is a different matter, but it is not entirely exempt from complications. Frederick Tung, *Skepticism About Universalism: International Bankruptcy and International Relations* 57 (Berkeley Law & Econ., Working Paper No. 2001-7, 2002), *available at* http://www.escholarship.org/uc/item/0kn6d3dw.

47. Lucian A. Bebchuk & Andrew T. Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 J. L. & ECON. 775, 778 (1999) ("More specifically, territoriality leads to a distortion of the capital allocation decision while universality avoids the distortion and leads to a more efficient allocation of capital."). However, it is recognized that some countries may benefit from territoriality, at the expense of foreign firms. *Id.* at 780.

48. Westbrook, *supra* note 36, at 2532 ("[G]rab rule proceedings yield inequitable results. Creditors appearing before the courts that have grabbed the most assets fare better than creditors generally"); Todd Kraft & Allison Aranson, *Transnational Bankruptcies: Section 304 and Beyond*, 1993 COLUM. BUS. L.

Notwithstanding these disadvantages, there are countries that have been traditionally inclined towards territorialism.[49] Territorialism is also strong in some specialized sectors, such as international bank insolvency,[50] and has also received some academic support.[51]

Universalism occupies the opposite end of the spectrum. In universalism, "one court administers the insolvency of a debtor on a worldwide basis with the help of the courts in each affected country."[52]

Thus, universalism defends the existence of a single bankruptcy proceeding for any given debtor, irrespective of the fact that a debtor may have assets located in different jurisdictions, or that creditors have their domicile in other countries. In universalism, ideally, there should be one forum and one law,[53] applicable to the single bankruptcy procedure. The obvious appeal of universalism lies in its simplicity and its coherence with the basic features of insolvency. From a general point of view, bankruptcy arises, as a procedural and substantive institution, as a response to the problem of plurality of creditors and insufficiency of the debtor's assets to meet those claims. In order to fulfill its objectives, bankruptcy law requires that all of the debtor's assets and creditors are brought together in a single proceeding, in order to minimize the damage to creditors and achieve the most efficient economic solution to the indebtedness problem.

The English courts have defended universalism vigorously:

> The English common law has traditionally taken the view that fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets of fewer or the creditors are situated.[54]

In addition, universalism brings several important advantages: the fact that the debtor is subject to a single insolvency procedure and to a single insolvency law

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REV. 329, 337 (1993).

49. *See, e.g.*, Shoichi Tagashira, *Intraterritorial Effects of Foreign Insolvency Proceedings: An Analysis of "Ancillary" Proceedings in the United States and Japan*, 29 TEX. INT'L. L.J. 1, 6–9 (1994) (discussing the historically territorial nature of Japanese bankruptcy law).

50. *See* Thomas C. Baxter, Joyce M. Hansen, & Joseph H. Sommer, *Two Cheers on Territoriality: An Essay on International Bank Insolvency Law*, 78 AM. BANKR. L.J. 57, 80–81 (2004) (discussing the possible superiority of territoriality for banks, even if universality is superior for general business firms). The international financial crisis has prompted efforts for coordination in crises of multinational financial institutions. However, those efforts have not yet crystallised into specific international instruments.

51. *See* Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-universalist Approach*, 84 CORNELL L. REV. 696 (1999) (arguing that territoriality would provide the best foundation for international cooperation); *see generally* Lynn M. LoPucki, *Universalism Unravels*, 79 AM. BANKR. L.J. 143 (2005) (discussing the failures of universalism in contrast to territorialism).

52. Jay L. Westbrook, *Multinational Enterprises in General Default: Chapter 15, the ALI Principles and the EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1, 5–6 (2002).

53. *See* Donald T. Trautman et al., *Four Models for International Bankruptcy*, 41 AM. J. COMP. L. 573, 575–76 (1993) (describing the basics of universalism).

54. Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26, [16] (appeal taken from Isle of Man). The judgment goes on to affirm that universality of bankruptcy has long been an *aspiration* of United Kingdom law, even if it has not always been fully achieved. *Id.* at [17].

means that the creditors can predict more accurately the impact of insolvency, and that fact, in turn, influences the pricing and availability of credit for debtors. Increased predictability, as derived from universalism, is one of the clear benefits of the doctrine. And predictability would, in turn, have positive economic effects.[55]

The fact that there is a single competent forum and a single applicable law for the insolvency of any debtor means that, depending on the criteria selected for the determination of the insolvency regime, a different law would be applicable to the insolvency of one debtor. This means that, under universalism, authorities and creditors must be prepared to accept differences in outcome.[56] Under universalism, local creditors can receive a worse treatment than they would receive under territorialism. But it can also happen that, in other cases, those local creditors benefit from universalism, as they would be able to recover from assets located in other jurisdictions. Hopefully, the cases in which local creditors would be prejudiced and the cases in which they would be benefited would compensate each other ("*rough wash*" is the expression coined by Jay Westbrook[57]), so that a universalist rule will roughly even out the benefits and the losses to local creditors. Therefore, it is possible to hypothesize the existence of a net gain for all creditors, materialized in increased predictability, and reductions in costs for all parties.[58] Therefore, the treatment of local creditors as the main objection against universalism would be unfounded.[59]

Universalism is the theory that has received the most academic attention: it is by no means the oldest theory for international insolvency—as we have seen, territorialism was developed before—but it is certainly the most influential theory among bankruptcy scholars.[60] Indeed, it can be said that universalism is the preferred

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55. "[T]he increased predictability of the results of default would significantly reduce the costs of borrowing." Westbrook, *supra* note 37, at 466. However, there is some criticism as to the validity of these positive effects of universalism. Sefa Franken, *Three Principles of Transnational Corporate Bankruptcy Law: A Review,* 11 EUR. L.J. 232, 233 (2005) ("Universalism claims its superiority over territorialism in that it would offer investors an enhanced ex ante predictability of the outcomes of their debtors' bankruptcies as well as foster ex post value maximisation of transnational businesses. Yet, despite the claimed advantages of universalism, territorialism still is the dominant approach to cross-border insolvency, not in the least because states resist universalist régimes by pointing to the differences in local redistributive policies."). Franken continues arguing that the predictability argument has been not proved by universalists: "although universalism may have advantages with respect to the ex post value maximisation of cross-border businesses, proponents of universalism have not been able to argue convincingly that universalism would offer a higher degree of ex ante predictability to investors. Proponents of territorialism, on the other hand, have not been able to demonstrate that local creditors and local policies would be systematically harmed if a universalist approach were adopted." *Id.* at 233.

56. *See* Westbrook, *supra* note 37, at 458 (noting universalism reform must have certain characteristics, including an acceptance of outcome differences).

57. *See id.* at 464 (noting that a principle argument in favor of universalism is that it creates an even wash for local creditors).

58. *See* Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177, 2208 (1999–2000) (arguing that universalism offers more certainty regarding which rules are applicable); *see also* Rasmussen, *supra* note 40, at 27 (noting that universalism is known for decreasing lending and administration costs).

59. *See* Bebchuk & Guzman, *supra* note 47, at 780 (noting that favoritism among creditors in the United States is unlikely).

60. *See id.* at 778 ("The alternative rule, universalism, favors the settlement of bankruptcy within a single 'main' jurisdiction. Other jurisdictions turn the assets of the bankrupt corporation over to this 'primary' jurisdiction and the case is dealt with under the latter's laws.").

paradigm[61] among bankruptcy theorists, but its validity is more theoretical than practical, because it is generally challenged by the insurmountable obstacles faced in practice.

Universalism is simpler conceptually, but the practical problems of applying a universalist rule are considerable. Pure universalism would require that all countries would share the same private international law rules.[62] If the rules for assigning competence over matters, or the rules to determine the applicable law to all substantive and procedural aspects of the insolvency, are different, it would be impossible to establish, for a specific debtor, one competent court and one applicable law. Therefore, universalism would require, in order to operate seamlessly, that private international law rules relating to bankruptcy be unified, possibly by means of an international treaty.[63] It would also require that all countries would adhere to this universalist view: if a number of significant countries deviate from universalism, most of its benefits are simply lost. Transformations of world economy make the application of pure universalism more unlikely, because universalism hides a power struggle between jurisdictions. For these reasons, pure universalism remains largely a utopia, an unrealistic proposition in today's world.[64] It is hardly surprising that the judgment in *McGrath v. Liddell* states emphatically that universality is an aspiration, rather than a reality.[65]

One of the most important obstacles to universalism is the existence of different priority regimes. Universalism "creates incentives for 'priority inflation'":[66] if the priorities created by a legal system are recognized to have a worldwide effect, the chances of priorities being effective actually increase, and the legislator may feel prone to expand the categories of protected creditors as much as possible.

As it was stated before, universalism and territorialism should be regarded as the opposite and extreme ends of a spectrum. Pure universalism is practically unworkable, and extreme territorialism has serious detrimental effects for the interests of international business. Ultimately, the distinctions between the different theoretical solutions to the problems of international bankruptcy are blurred. It is submitted that the discussion of the different positions is highly theoretical and, to a

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61. *See* Liza Perkins, *A Defense of Pure Universalism in Cross-Border Corporate Insolvencies*, 32 INT'L L. & POL. 787, 790 (2000) (explaining that territorialism is seen in a much "less favorable light"); Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT'L L. 31, 33 (2001) (arguing that although universalism is conceptually appealing, it is politically impossible to adopt); *see also* Frederick Tung, *Passports, Private Choice, and Private Interests: Regulatory Competition and Cooperation in Corporate, Securities, and Bankruptcy Law,* 3 CHI. J. INT'L L. 369, 378–79 (2002) (noting that universalism is preferred more among scholars than lawmakers).

62. *See* Jay L. Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2277 (2000) (discussing that modified universalism is more pragmatic because it fits well with an array of laws); Jay L. Westbrook, *Universalism and Choice of Law*, 23 PENN ST. INT'L L. REV. 625, 625–26 (2004–2005) (noting that universalism would allow a single court to make distributions to creditors around the world); Westbrook, *supra* note 37, at 480 (noting that differing insolvency laws lead to nonuniform outcomes).

63. According to Lord Hoffmann, "Full universalism can be attained only by international treaty." *McGrath*, [2008] UKHL 21, [7], 1 W.L.R. at 856 (Lord Hoffmann). Another possibility for attaining real universalism would be through a model law, but experiences with model laws suggest that the degrees of separation from the model would cause different systems to operate, thereby destroying the benefits of a unified approach.

64. *See* Tung, *supra* note 46, at 11 (arguing that regularized universalist cooperation is improbable).

65. *McGrath,* [2008] UKHL 21, [7], 1 W.L.R. at 856 (Lord Hoffmann) (referring to Lord Hoffmann's previous assertion in *Cambridge Gas* that universality is an aspiration).

66. Baxter, Hansen & Sommer, *supra* note 50, at 87.

certain extent even "byzantine," as Professor Giuliano, one of the pioneer scholars in the field of international bankruptcy law, wrote.[67]

The common point of all modern solutions to the problem of international bankruptcy is the focus on cooperation. International cooperation is essential to achieve the ends of bankruptcy,[68] in spite of the numerous obstacles.[69]

Most of the solutions with practical relevance in international bankruptcy law lie within the space situated between pure territorialism and pure universalism. In this intermediate space, the solutions that appear more successful are cooperative territorialism and, especially, modified universalism.

In cooperative territorialism, courts are free to open insolvency proceedings where there are assets located in the jurisdiction, and there are no restrictions for the opening of insolvency procedures in other jurisdictions, but the courts of different countries coordinate in order to attain efficiencies in the treatment of the debtor's insolvency, and foreign creditors are allowed to participate in national proceedings. Cooperative territorialism may be defended as a realistic solution to the problems of international insolvency.[70]

"Modified universalism" is an accepted term in legal terminology that refers to a universalist approach in which some concessions are made to territorial interests for the sake of ensuring the effective functioning of the international bankruptcy system.[71] Modified universalism accepts the central premise of universalism, that is, "that assets should be collected and distributed on a worldwide basis, but reserving to local courts discretion to evaluate the fairness of the home-country procedures and to protect the interests of local creditors."[72] In modified universalism,[73] it is possible to open non-main insolvency proceedings where there is an establishment of the debtor situated in the relevant jurisdiction.[74] However, the plurality of

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67. MARIO GIULIANO, IL FALLIMENTO NEL DIRITTO PROCESSUALE CIVILE INTERNAZIONALE 80 n.48 (1943) [Bankruptcy in International Civil Procedural Law] [Italy].

68. *See generally* Harold S. Burman, *Harmonization of International Bankruptcy Law: A United States Perspective*, 64 FORDHAM L. REV. 2543 (1995–1996) (discussing the importance of cross-border cooperation in insolvency proceedings and the progress toward harmonization since the late 1970s).

69. *Cf.* Douglass G. Boshkoff, *Some Gloomy Thoughts Concerning Cross-Border Insolvencies*, 72 WASH. U. L.Q. 931 (1994) (arguing that the lack of interest in the reciprocity requirement and the lack of trust in foreign legal regimes are barriers to international cooperation).

70. *See* Frederick Tung, *Is International Bankruptcy Possible?*, *supra* note 61, at 101–02 (arguing that international bankruptcy should focus on territorially-based cooperation); *see also* Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216, 2240 (1999–2000) ("The level of error and deception would be higher in a universalist system than in the current territorial one.").

71. *See* Jay L. Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2277 (1999–2000) (introducing "'[m]odified universalism,' as proposed by the American Law Institute Transnational Insolvency Project" as "an interim solution pending movement to true universalism").

72. Maxwell Comm'n Corp. PLC v. Barclays Bank *(In re* Maxwell Comm'n Corp. PLC, et al.*)*, 170 B.R. 800, 816 (Bankr. S.D.N.Y. 1994).

73. Modified universalism has been aptly described by Westbrook, *supra* note 36, at 517–18 (explaining that countries accept that assets should be collected and distributed by a single forum on a worldwide basis, while reserving to their local courts discretion to evaluate the fairness of the home-country procedures and to protect the interests of local creditors).

74. Model Law on Cross-Border Insolvency, G.A. Res. 52/158, U.N. Doc. A/RES/52/158, art. 17 (Jan. 30, 1998) (hereinafter Model Law), *available at* http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf. The Model Law defines "establishment" in article 2(f).

proceedings does not imply lack of coordination between them: in fact, modified universalism assumes that there will be coordination between main and non-main proceedings, and that courts of other jurisdictions where assets are located will also cooperate with bankruptcy proceedings.

It is submitted that practical experience shows that modified universalism is the preferred position, both in theoretical and practical terms. Certainly, modified universalism has been criticized on the grounds that, the advantages of universalism are lost,[75] but modified universalism offers a pragmatic compromise between the theoretical foundations of universalism and the realities of international practice.

"Modified universalism" is the theoretical foundation of international bankruptcy systems such as those of the European Insolvency Regulation and the UNCITRAL model law for cross-border insolvency.[76] According to both systems, there is one jurisdiction in which the debtor should file for bankruptcy, and that bankruptcy should have a universal effect. In both instances, there is a uniform conflict-of-laws rule according to which the State in which it is possible to open bankruptcy proceedings with universal reach is the country where the center of main interests (COMI) of the debtor is located.[77] The concept of COMI, therefore, assumes a pivotal role in the determination of the competent court for the opening of insolvency proceedings. Naturally, the problem is the lack of definition of some of the elements of COMI and the divergent interpretations of that concept in different countries and different courts.[78] It is extremely difficult to find a completely predictable rule, uniformly interpreted, that would provide a totally certain solution to the problem of determining the forum for the opening of bankruptcy proceedings in the case of debtors with multiple international connections. The complexity of the connecting factors that are taken into account for the determination of the center of main interests, and the high likelihood that there are international elements in the connecting factors, increase the difficulties in the determination of the appropriate insolvency regime. Certainly, the weak spot of the modified universalist approach is found on the different interpretations that may be given to the concept of "centre of main interests" of the debtor.[79] Although some of the international legal materials cited before express a preference for a concept which would be easier to determine, such as the legal seat of the corporate debtor, this is used only as a rebuttable presumption for establishing the center of main interests of the debtor.

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75. *See* Lynn LoPucki, *Cooperation in International Bankruptcy, supra* note 51, at 728–32 (describing the problems of modified universalism including that its departures from pure universalism undercut its benefits).

76. *See* Edward S. Adams, & Jason K. Fincke, *Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism*, 15 COLUM. EUR. L. 43 (2008–2009) (describing that UNCITRAL and Model Law have a modified universalism foundation); *see also* Christoph G. Paulus, *Global Insolvency Law and the Role of Multinational Institutions*, 32 BROOK. J. INT'L L. 755 (2007) (discussing the momentum toward a common theoretical framework for international insolvency). Naturally, there are many technical differences between the European and the UNCITRAL approaches to the regulation of international insolvency, but it can be said that both texts share numerous features.

77. *See* Model Law, *supra* note 74, art. 2(b) (defining "foreign main proceeding" as a "foreign proceeding taking place in the State where the debtor has the centre of its main interests").

78. For this reason, UNCITRAL has decided to start a project on refining the definition and interpretations of the elements of COMI. See the proposal by the U.S. delegation at http://daccess-dds-ny.un.org/doc/UNDOC/LTD/V10/511/16/PDF/V1051116.pdf.

79. *See Stanford International Bank: UK Court of Appeals Clarifies Appropriate Test for COMI*, 29 AM. BANKR. INST. J., no. 4, May 1, 2010, at 38 (surveying approaches to defining COMI).

It is important to note that in modified universalism, the approach taken is not entirely universal: certainly, it is assumed that the bankruptcy will be opened before the courts of the debtor's COMI, and that proceeding will initially have universal reach. However, the adjective "modified" suggests that there are limits to this universalist proposition. Modified universalism allows for the opening of simultaneous insolvency proceedings, thus denying one of the nuclear principles of pure universalism. However, proceedings that are not opened at the forum of the debtor's COMI are subordinated to the principal bankruptcy (these proceedings are defined by terms such as "secondary" or "ancillary") and their reach tends to be territorial.[80] Secondary proceedings cannot be opened in all cases—otherwise, there would be no distinction between modified universalism and territorialism—but only if certain conditions are met. Only where there is a special connection between the debtor and the jurisdiction is it possible to open a secondary insolvency proceeding. In the model of the Council Regulation and UNCITRAL Model Law,[81] the special connection is defined by the concept of "establishment."[82] An "establishment" identifies a permanent place of operations, but this concept is just as elusive as the concept of center of main interests, in spite of a long tradition in its usage by courts and legislators in numerous countries.

In both the European and the UNCITRAL models, a pragmatic compromise is at work.[83] However, in both models a criticism can be made because the lack of specific duties by courts does not allow attaining the much needed predictability in international bankruptcies.[84] Among the countries that have incorporated the UNCITRAL Model Law, there are significant differences. In the United States, Chapter 15 of the Bankruptcy Code has incorporated the UNCITRAL Model Law, and some specialists suggest that the United States is still undecided between universalism and territorialism.[85] It is submitted that this is only a reflection of the hybrid nature of modified universalism.

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80. *See* Council Regulation 1346/2000, art. 3 (discussing that secondary proceedings cover only assets which are situated in the state in which the proceedings are opened are allowed alongside the main proceedings).

81. Jenny Clift, *The UNCITRAL Model Law on Cross-Border Insolvency—A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency*, 12 TUL. J. INT'L. & COMP. L. 325–26 (2004).

82. *See* MIGUEL VIRGOS & FRANCISCO GARCIMARTIN, THE EUROPEAN INSOLVENCY REGULATION: LAW AND PRACTICE 15–17 (2004) (defining "establishment" as any place of operations where the debtor carries on a non-transitory economic activity with human means and goods).

83. *See* Hans Hanisch, *"Universality" versus Secondary Bankruptcy: A European Debate*, 2 INT'L INSOLVENCY REV. 151, 163–64 (1993) (describing attempts to incorporate "unity" of insolvency proceedings in drafting the new EC Insolvency Convention). Some commentators argue that in fact the E.U. model is universalist, but that is a debatable proposition. *See, e.g.*, Look Chan Ho, *Perfecting the Union, Perfecting Universalism*, 2 CORP. RESCUE & INSOLVENCY 71, 72 (2009) (referring to the E.U. Insolvency Regulations as "based on the model of modified universalism").

84. *See* Paul Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT'L L. 743, 785 (1999) (stating that the UNCITRAL Model Law on Cross-Border Insolvency expands the range of action of bankruptcy courts without imposing substantial obligations that those bodies must honor, which is likely to result in a régime that would decrease the predictability of outcomes in international bankruptcies without achieving any clear improvements in the legal rules).

85. *See* John J. Chung, *The Retrogressive Flaw of Chapter 15 of the Bankruptcy Code: A Lesson from Maritime Law*, 17 DUKE J. COMP. & INT'L L. 253, 269 (2007) ("Thus, there are two messages concerning Chapter 15, and the content of each message depended on the audience. For Congress, the message: Chapter 15 is about cooperation; there is no universalism in the legislation. For internationalists, on the

Finally, it must be noted that there are new theoretical orientations in international bankruptcy. A theoretical trend defends a contractual solution to the problems of international bankruptcy,[86] even though the practical problems of such an arrangement are likely to be insurmountable. The most interesting new theoretical orientation is possibly virtual universalism. Virtual universalism defends the existence of an ancillary proceeding with no substantive effects, no distribution of proceeds or ranking of claims.[87] This model would be closer to the ideal of universalism. These theoretical models have not gained widespread support among policymakers and rulemaking bodies with responsibilities in international bankruptcy.

IV. APPROACHES TO DIFFERENCES IN PRIORITIES IN COOPERATIVE SYSTEMS OF INTERNATIONAL BANKRUPTCY (WITH A TAXONOMY)

An important point to address is that of the different implications of the theories are explored, in connection with the existence of different preferential creditors in their respective insolvency law systems. In fact, theories of international bankruptcy meet their test in the treatment of creditors,[88] where advantages and disadvantages of each theory become apparent.

Under pure universalism, only the priorities of the *lex fori concursus* are enforced.[89] This means that the priorities of the applicable law would gain universal recognition, while the priorities of jurisdictions in which there are assets and/or creditors would be entirely disregarded.

By contrast, under a purely territorial system, the priorities of local creditors are enforced over the assets located in the jurisdiction. Thus, every set of priorities would find satisfaction limited to the proceeds of the assets that are situated in a particular country.

Both the pure universalist and territorialist positions are thoroughly unsatisfactory from the point of view of the treatment of priorities. The universalist system is unrealistic, as it requests that local courts cooperate with a universal proceeding disregarding entirely the protection of interests explicitly adopted by their national laws. As priorities are the expression of a hierarchy of interests in a legal system,[90] it is unreasonable that this hierarchy of interests, which in many cases is a reflection of local political interests,[91] is imposed universally.

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other hand, the message was: Chapter 15 is a significant step toward eventual and inevitable universalism.").

86. *See* Robert K. Rasmussen, *Resolving Transnational Insolvencies Through Private Ordering*, 98 MICH. L. REV. 2252, 2254 (2000) (proposing "contractualism" as an option that allows firms to elect a universalist, territorial, or hybrid approach in the event of insolvency).

87. *See* Menendez, *supra* note 43, at 112–13 (proposing a new model for approaching insolvency proceedings that focuses on procedural aspects).

88. *See* Franken, *supra* note 55, at 236 (pointing out that *ex ante* predictability is one of the major emphases of universalism proponents). Franken criticizes universalism proponents' arguments about universalism's efficiency as "based on the assumptions that in a territorialist regime local and foreign creditors are paid on a pro-rata basis," because these assumptions do not correspond to the way in which bankruptcy regimes deal with foreign creditors in practice. *Id.* n.16.

89. *See* Dr. Wolfgang Leuke, *The New European Law on International Insolvencies: A German Perspective*, 17 EMORY BANKR. DEV. J. 369, 373 (2001) (discussing that universality is favored and the law applicable is *lex fori concursus*).

90. *See, e.g.*, *In re* Bank of Credit and Commerce Int'l, [1997] EWHC (Ch.) 213 (Eng.) [1997] 2

Moreover, the universalist position has the effect of increasing the efficacy of the priorities contained in the applicable law, and eliminating the protection for creditors whose priorities are based on other laws.[92] This has been one of the biggest obstacles for the expansion of universalism. In a territorialist model, the satisfaction of priority creditors depends on the presence of sufficient assets in the jurisdiction, and the synergies of a going concern liquidation or reorganization, which would benefit all creditors, are lost.

Thus, the problem of priorities re-emerges in the creation of cooperative international bankruptcy regimes, in which different bankruptcy procedures coexist and cooperation demands a solution to the problem of the treatment of creditor priorities. In this way, complexities appear in all models in which there is a degree of international cooperation, and most notably, in modified universalism.

The first question to be addressed is the participation of foreign creditors in bankruptcy proceedings. It is assumed that in a system of cooperative international bankruptcy, creditors should be allowed to participate in all the different proceedings.[93] In models of cooperation, therefore, foreign creditors are allowed to file their claims in all bankruptcy proceedings opened vis-à-vis the same debtor, irrespective of the jurisdiction (universal cross-filing, or UCF).[94] Indeed, "universal cross-filing" is one of the basic manifestations of cooperation, and implies the ability of foreign creditors to prove their claims in a bankruptcy in the same manner as local creditors.[95] In this way, cross-filing allows a universality of claims, as opposed to the universality of bankruptcy assets.[96] This principle tends to be universally accepted,[97]

W.L.R. 172 (discussing the example of how set-off is treated differently in England and Luxembourg and is considered a matter of public policy, at least in the latter).

91. *See* John Pottow, *Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to "Local Interests,"* 104 MICH. L. REV. 1899, 1913 (2006) (explaining the role that "powerful domestic lobbying interests" may have in setting local laws).

92. *Id.* at 1934. Ideally, universalism would work best in systems where there are no priorities (*klassenlose Konkurs*, as in Austria or Germany), but there is a characterization problem. There are priorities in those systems, but those priorities receive a different name (like legal pledges, *gesetzliche Pfandrecht* for instance).

93. This is the case in the European Regulation: each liquidator is required to lodge claims in a secondary proceeding, when he is appointed in other proceedings, provided that the interests of creditors in the former proceedings are served thereby. Thus, a global list of creditors and claims is created. *See* Council Regulation 1346/2000 art. 32(1)–(2) (stating that "any creditor may lodge his claim in the main proceedings and in any secondary proceedings" and that "liquidators in the main and any secondary proceedings shall lodge in other proceedings claims which have already been lodged in the proceedings for which they were appointed, provided that the interests of creditors in the latter proceedings are served thereby, subject to the right of creditors to oppose that or to withdraw the lodgement of their claims where the law applicable so provides").

94. Jay L. Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27, 29–30 (1998). According to Westbrook, the universal cross-filing consists of the liquidator in country A filing claims in country B for all creditors in country A.

95. *See id.* at 30–31 (describing how a universal cross-filing system may lead to equal distributions and how the addition of cross-priority would "lessen national discrimination").

96. *See* 11 U.S.C. § 1513 (2006) ("foreign creditors have the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors. But afterwards this provision states that this does not change or codify present law as to the priority of claims under sections 507 or 726, except that the claim of a foreign creditor under those sections shall not be given a lower priority than that of general unsecured claims without priority solely because the holder of such claim is a foreign creditor.").

97. *See* Westbrook, *supra* note 94, at 31 (arguing that the prevalence of national treatment standard in international trade law, when viewed together with the principle of nondiscrimination, results in

overcoming a long history of discrimination against foreign creditors.[98] The only important exception to this principle affects the claims of tax and other public authorities. In fact, tax claims and other public law claims can be understood to be unenforceable outside their national jurisdiction. This means that the claim, and not only the priority, is disregarded in international insolvencies.[99] Therefore, tax and public law claims remain subject to express discrimination in numerous jurisdictions,[100] including the United States.[101] In the European Union system, however, tax and public law claims of Member States are recognized in the insolvency proceedings of other Member States, although it seems that only unsecured creditor status is given to those claims.[102]

In short, the models of cooperation in international bankruptcy assume that creditors are allowed to file their claims in all bankruptcy proceedings.[103] However, there is insufficient theoretical analysis as to the treatment of priorities in those models. In fact, the only reference to the position of foreign creditors indicates that those creditors cannot be subordinated to the status of local unsecured creditors, but it leaves open the question of whether priority status can be accorded to foreign creditors.[104]

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equivalent treatment of national and foreign creditors, similar to UCF).

98. *See* Kurt H. Nadelmann, *Discrimination in Foreign Bankruptcy Law Against Non-domestic Claims*, 47 AM. BANKR. L.J. 147 (1973) (profiling different bilateral, regional, and international approaches to preferences for individual creditors). It has been recognized, long ago, that equality of creditors plays a very important role for cooperation, although equality can be understood as lack of discrimination more than equality in distribution. *See* Kurt H. Nadelmann, *Creditor Equality in Inter-State Bankruptcies: A Requisite of Uniformity in the Regulation of Bankruptcy*, 98 U. PA. L. REV. 41, 51–53 (1949–1950) (demonstrating discrimination against foreign creditors in different countries' statutes); Kurt H. Nadelmann, *Concurrent Bankruptcies and Creditor Equality in the Americas*, 96 U. PA. L. REV. 171, 172 (1947) (explaining the principle of equalization as expressed in the Hotchpot Rule move case cite to after the second sentence).

99. According to U.S. court doctrine, foreign tax and other public law claims are unenforceable outside the state of origin. *See* Moore v. Mitchell, 30 F.2d 600 (2d Cir. 1929) (holding that state tax law cannot be given extra territorial effect to make collections through agency courts of another state). This is also the traditional position in England. *See* Planche v. Fletcher, (1779) 99 Eng. Rep. 164, 165 (U.K.) ("One nation does not take notice of the revenue laws of another."); *see also* Brenda Mallinak, *The Revenue Rule: A Common Law Doctrine for the Twenty-First Century*, 16 DUKE J. COMP. & INT'L. L. 79, 88–89, 97–98 (2006) (discussing U.S. and British adherence to the revenue rule, which declines to enforce foreign tax laws in domestic proceedings).

100. *See also* Pottow, *supra* note 91, at 1912 ("While many well developed legal systems now accord national treatment, it remains the case that at least certain matters, such as tax claims, remain subject to express discrimination, by being either disallowed wholesale or precluded from enjoying the special priority distribution that may attend domestic tax claims.").

101. *See* Westbrook, *supra* note 94, at 37 ("denial of revenue claims is not limited to insolvency cases"); *see also* 11 U.S.C. § 1513(b)(2) (2006) (stating that the previous sections of the code do not "change or codify present law as to the allowability of foreign revenue claims or other foreign public law claims in a proceeding under this title"). This is a general policy question that transcends insolvency law.

102. *See* Council Regulation 1346/2000, art. 39 ("Any creditor who has his habitual residence, domicile or registered office in a Member State other than the State of the opening proceedings, including the tax authorities and social security authorities of Member States, shall have the right to lodge claims in the insolvency proceedings in writing.").

103. *Id.* art. 32(1). For instance, The European Regulation contains the explicit rule that creditors are allowed to claim in the main proceedings and in any secondary proceedings. *Id.*

104. *See* Model Law, *supra* note 74, para. 104 (referring to the possibility of granting a special ranking to claims of foreign creditors). This rule is interpreted in the sense that a claim of a foreign creditor cannot be subordinated below the claims of general unsecured creditors simply because the holder of such a claim is a foreign creditor. *See* 11 U.S.C. § 1513 (2006) (describing the access of foreign creditors to a

The position more consistent with the cooperative methodological approaches should posit not only universal cross-filing, but also universal priorities: creditors with priorities under a national legal system should be allowed to exercise their priorities in foreign insolvency proceedings, at least in some cases. However, this theoretical approach faces numerous obstacles, in practice there is a trend to not recognize foreign priorities.[105] The traditional assumption is that each forum will distribute assets according to its own priority rules.[106] Thus, there would be an asymmetry: foreign creditors are allowed to participate in all bankruptcy proceedings, but the priorities would be subject to a territorial rule.[107] The alternative would be to recognize the priorities awarded to foreign creditors: a general recognition of all priorities would be unfeasible, as it would directly and dramatically impact the prospects of recovery for local creditors. A more limited recognition could be accepted where the foreign creditors meet the same requirements for a priority that local creditors enjoy.[108] In the words of Jay Westbrook:

> Most national legal systems I have explored seem not to have developed a rule about the availability of local priorities to foreign creditors whose claims would qualify for priority treatment if they were local creditors.

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case).

105. *See* Franken, *supra* note 55, at 239

> Equating foreign security interests to similar, albeit somewhat different, security rights of the home country therefore attenuates to some extent the costs imposed on trade creditors by a foreign bankruptcy regime . . . With respect to foreign statutory priority rights the situation is somewhat different. Because in a universalist system the home country's forum applies its own priority scheme, it disregards foreign priority rights, thereby relegating creditors with such rights to the status of generally unsecured creditors. In this way, universalism interferes with local distributive policies, which are typically translated into statutory priority rights. However, under the real-world forms of territorialism or modified universalism, bankruptcy courts generally do not recognise foreign statutory priority rights either. On the one hand, in a territorial system, local bankruptcy courts only recognise local statutory priority rights. The extent to which local creditors could benefit from their statutory priority rights then depends on the amount of assets available in the local estate. On the other hand, a universalist system replaces all local statutory priority rights by those of the home country. Foreign local rights are then negated insofar as the home country's laws do not grant the same statutory priority status to the creditors involved. The issue of statutory priority rights is perceived as highly sensitive, as it affects differing national policies and political beliefs on desired forms of redistribution.

106. *See* Westbrook, *supra* note 94, at 40 (discussing the traditional application of foreign and domestic priority rules).

107. *Id.* at 32 ("Without cross-priority, a universalist system will greatly serve home-country priorities and general creditors, while all creditors with priority rights outside the home country will suffer.").

108. *See, e.g.*, 11 U.S.C. § 507(a)(6)(B) (2006) (regulating unsecured claims of persons engaged as United States fishermen). It should be possible to apply priorities to foreign claimants that conform to the requisites for the recognition of priority treatment. If the U.S. Bankruptcy Code contains a provision that refers specifically to U.S. fishermen, maybe it is legitimate to suppose that the references to workers, or consumers, are made irrespective of the nationality of the creditor. Of course, the question is more complicated than determining the nationality of the creditor, because the territoriality element is not normally attached to nationality (i.e., a priority for workers' claims covers all labor contracts subject to the law of the jurisdiction).

> The granting of such non-discriminatory treatment can be called "cross-priority."[109] This is one of the most important questions that is omitted in the models of regulation of international bankruptcy. In spite of all the work on modified universalism, the treatment of priorities has not been sufficiently developed. It is unclear if foreign priorities can be recognized in a main proceeding, or to what extent national courts can apply foreign law in granting relief to petitioners.[110] It is unclear if the priorities in the main proceeding have to be recognized in the secondary proceeding. The failure to address the issue of the treatment of priorities in international bankruptcy brings back the question of diversity in priority regimes as an obstacle to cooperation.

It is not an exaggeration to assert that the difference in priority regimes constitutes one of the most important barriers to the treatment of international insolvencies.[111] In fact, one commentator has argued that priority conflicts represent an intractable problem.[112]

In international cooperative regimes, the bankruptcy organs in the main proceeding will seek assistance from jurisdictions where assets are located and cooperation with jurisdictions where secondary or ancillary proceedings are opened.[113] This is the essence of modified universalism. However, the necessary cooperation of foreign courts may be subject to considerations of the differences in priorities, which remain formidable obstacles to cooperation.

Under the influential UNCITRAL Model Law, the courts whose assistance is requested are allowed to subject relief to the conditions that they deem appropriate,[114] but the courts must pay special attention to the adequate protection of national creditors.[115] Public order considerations could also interfere with the assistance to foreign insolvency proceedings.

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109. Westbrook, *supra* note 94, at 30–31; *see also* Pippa Rogerson, *International Insolvency—Law Applied to Distribution*, 67 CAMBRIDGE L.J. 476, 476–79 (2008) (discussing the challenges in private international law caused by international insolvency proceedings where both creditors and assets have overlapping connections with multiple countries).

110. It is debated to which extent it is possible to apply foreign law. *See generally* Look Chan Ho, *Applying Foreign Law Under the UNCITRAL Model Law on Cross-Border Insolvency*, 24 BUTTERWORTHS J. INT'L BANKING & FIN. L. 655 (2009) (noting objections to the application of foreign law and giving reasons why the application of foreign law is appropriate).

111. *See* Jay L. Westbrook, *Priority Conflicts as a Barrier to Cooperation in Multinational Insolvencies*, 27 PENN ST. INT'L L. REV. 869, 869–70 (2008–2009) ("In recent years we have seen the general acceptance of 'modified universalism'—a pragmatic, accommodating form of the universalist approach to insolvency that seeks to promote cooperation between courts and to produce results as near as possible to the ideal of a single, global proceeding. This approach also permits a meaningful chance for a global reorganization of a business, thus avoiding the serious loss of value almost always associated with piecemeal liquidation. Yet the clash of priority systems presents a serious obstacle to the universalist project.").

112. John K. Londot, *Handling Priority Rules Conflicts in International Bankruptcy: Assessing the International Bar Association's Concordat*, 13 BANKR. DEV. J. 163, 163 (1996).

113. *Id.* at 173.

114. UNCITRAL Model Law, *supra* note 74, art. 22(2).

115. *See id.* art. 21(2) (positing the protection of local creditors as a precondition for cooperation: "Upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court, provided that the court is satisfied that the interests of creditors in this State are adequately protected."). *See also* Cross-Border Insolvency

The UNCITRAL Model Law does not condition cooperation upon the relevant insolvency systems containing same priorities. As a matter of fact, it is extremely unlikely that two priority systems would be completely identical. In some systems, the courts have discussed the requirement of a "rough similarity" between priority systems in order to cooperate with foreign bankruptcy proceedings, but that requirement did not find widespread acceptance in the international community.[116] Instead, the Model Law makes an explicit point of the protection of local creditors, and that point is directly connected with the question of priorities.[117]

The issue of the adequate protection of local creditors[118] is directly related to the question of the differences in priorities.[119] In order to cooperate, the courts will make sure that local creditors are not disadvantaged by that cooperation. Because the prevailing doctrine is that priorities have a territorial effect, the courts tend to make sure that local priority creditors are satisfied with the proceeds of local assets before remitting the rest of the assets to the foreign court.[120] This is an implicit solution in the modified universalist system implemented by the European Union.[121] In modified universalist regimes, if creditors receive a partial payment in a foreign proceeding, independent of their status as preferential or unsecured creditors, they will not be able to receive a payment under the national proceedings until creditors in the same class receive a proportionate equivalent payment (hotchpot rule).[122] This

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Regulations, 2006, S.I. 2006/1030, Reg. 2 (U.K.) (incorporating the UNCITRAL Model Law, requiring that "the interests of creditors in Great Britain are adequately protected"); 11 U.S.C. § 1521(b) (2010) (requiring that interests are sufficiently protected). The model of the European Union does not contain a similar provision, as it implies a restriction in cooperation.

116. *See* Westbrook, *supra* note 94, at 28 (discussing how "modified territorialism" dominates thinking in most of the other countries in the world).

117. Model Law, *supra* note 74, part 2, para. 20(d).

118. *See* Franken, *supra* note 55, at 235 (discussing how protection of local creditors denies universalism).

119. *See* Pottow, *supra* note 91 (discussing the effect of different types of local bankruptcy laws that focus on different priorities and how these provisions affect local creditors).

120. *McGrath*, [2008] UKHL 21, [62], 1 W.L.R. at 872 (Lord Scott) ("I agree, as I think is common ground, that the English liquidators should first discharge the debts of those creditors who, under the English insolvency scheme, are entitled to preferential payment."). *See also id.* [21] (quoting Lord Hoffmann discussing the usual English practice, when remittal to a foreign liquidator is ordered, to make provision for the retention of funds to pay English preferential creditors). This is also the position of the Istanbul Convention of the Council of Europe, which only envisaged the transfer of assets to the home country net of secured and preferential claims that are distributed in the recognizing country according to the *lex situs*. *See* European Convention on Certain International Aspects of Insolvency (Istanbul Convention) arts. 21, 22, 28, June 5, 1990, E.T.S. No. 136. Similar principles exist in numerous jurisdictions, like Singapore. Tohru Motobayashi v. Official Receiver [2000] 4 SLR 529 (CA); *see also* Hans Tjio & Wee Meng Seng, *Cross-Border Insolvency and Transfers of Liquidation Estates from Ancillary Proceedings to the Principal Place of Bankruptcy*, 20 SINGAPORE ACAD. L.J. 35, 40 (2008) (discussing *Thoru Motobayashi v. Official Receiver* as an example of Singapore's cross-border bankruptcy policies).

121. *See* Council Regulation 1346/2000, art. 35 (showing claims accepted in secondary proceedings, particularly those entitled to preferential treatment, can be satisfied before anything is remitted to the main proceedings); *see also id.*, art. 20 (according to the "hotchpot" rule, creditors who receive full or partial satisfaction of their debts in proceedings in one state are entitled to keep them, except that a partially paid creditor would not receive anything from proceedings in another state where it has made claims until creditors in those proceedings have received the same percentage of payment as it has).

122. 11 U.S.C.A. § 1532 (2005) (stating hotchpot rule: "a creditor who has received payment with respect to its claim in a foreign proceeding pursuant to a law relating to insolvency may not receive a payment for the same claim in a case under any other chapter of this title regarding the debtor, so long as

rule is aimed at preserving the equality among creditors, but its specific application to priority creditors is particularly unclear.[123]

However, the question of the adequate protection of local creditors can be more complex: local creditors can be not only priority creditors, but also general unsecured creditors, and those creditors would be impaired by the remission of the assets, to a foreign court, which applies a law in which other priorities exist. Although local creditors are not discriminated against and can take part in the foreign insolvency proceedings, the existence of a different set of priorities may imply that, as unsecured creditors, they will not receive any significant payment, whereas the situation would have been different under a territorial system. Thus, the problem intensifies where the foreign proceeding may treat creditors in a different way, denying[124] or granting priorities to creditors that do not exist under the law of the ancillary proceeding.[125]

In any case, adequate protection cannot mean that the priorities are exactly the same. In the Privy Council case of *Cambridge Gas*, one of the tests used for determining the possibilities of cooperation with a U.S. court was whether there was any prejudice to a creditor in the Isle of Man by cooperating with the Chapter 11 proceedings.[126] The assets should not be transferred to the United States if the prejudice suffered by creditors was not overcome by countervailing advantages. It is submitted that pragmatic approaches to the issue of adequate protection should substitute a mere comparison of the priority regimes between jurisdictions.

The definition of "local" or "national" creditors is extremely difficult, as there are no elements to suggest that the criteria should be based on nationality, residence, or place of business.[127] In the case of financial creditors, the distinction between local and foreign creditors does not seem logical.

Naturally, the underlying problem is that the key concepts of "adequate protection" and "local creditors" are not sufficiently defined in the international texts. Therefore, there is a high degree of court discretion involved in international bankruptcy cooperation.[128] If these concepts are interpreted in an extensive way, the possibilities for international cooperation are restricted.

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the payment to other creditors of the same class is proportionately less than the payment the creditor has already received").

123. In fact, the hotchpot rule refers to creditors of the same ranking, but it is not clear which ranking to apply. *See id.* (for instance, if a foreign creditor had a priority abroad, it is understood that that creditor will not be able to share as an unsecured creditor until the general unsecured creditors in the U.S. bankruptcy have received the same amount for their claims). Therefore, the notion of "equality" introduced by the rule is questionable.

124. *See In re* Bank of Credit and Commerce Int'l, [1997] Ch. at 246 (concerning the winding up of a major international bank in the U.K.).

125. *See generally* McMahon v. McGrath, [2006] EWCA (Civ) 732, [2007] 1 All E.R. 177 (CA) (applying U.K. bankruptcy rules to U.K. creditors in insolvency of an Australian company).

126. Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26, [32] (appeal taken from Isle of Man); *see generally* A. Walters, *Judicial Assistance in Cross-Border Insolvency at Common Law* 28 COMPANY LAW. 73 (2007) (analyzing *Cambridge Gas*).

127. *See* Pottow, *supra* note 91, at 1913 (discussing the interests of "local creditors" due to the ambiguity in the subset of individuals that this term includes).

128. *See* Adams & Fincke, *supra* note 76, at 50 (discussing how modified universalism maintains the court discretion with respect to protection of local creditors' interests).

Another built-in safeguard is the fact that an outcome cannot be manifestly contrary to public policy.[129] "This signals that there is no natural conflict between public policy concerns and a departure from the established distribution structure."[130] The purpose of the expression "manifestly" used in the international legal texts as a qualifier of the expression "public policy" is to emphasize that public policy exceptions should be interpreted restrictively, and that the public order exception is only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting state.[131]

It is interesting to discuss the extent to which differences in priorities affect cooperation in numerous situations. In the case of *McGrath v. Riddell*, a difference in priorities was the main source of controversy in granting the cooperation request from the foreign court.[132] The fact that this difference in priorities could be overcome is what makes this case a good starting point for an analysis of the differences in priorities in international bankruptcy.

Priorities are ubiquitous, and differences in priorities are ubiquitous too. It is next to impossible to find countries that share exactly the same priorities. If science has shown that the saying "no two snowflakes the same" probably holds true,[133] it is hardly surprising that priority schemes are all dissimilar. As a matter of fact, there is some parallel in the reasons for these physical and legal phenomena: in both examples, the existence of differences is explained by the presence of different circumstances. These differences can be minimal—but they still exist—in countries with similar legal systems and social conditions, but they can be substantial where the countries present deep divergences in society, economy, or legal tradition. "The reality is that each national insolvency regime has a system of priorities."[134]

Indeed, every insolvency system, or in a broader sense, every credit protection system, needs to address the distributional question as the nucleus of credit regulation.[135] It is not surprising that the decisions taken by local legislatures are often idiosyncratic, as they respond to the pressure exerted by powerful local social groups, and it is easy to see why this creates an additional problem in the international coordination demanded by transnational bankruptcy.

There is no identity between credit protection systems: in fact, if identity were the requirement for cooperation, there would be hardly any international

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129. Model Law, *supra* note 74, art. 6 ("Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of this state."); Council Regulation 1346/2000, art. 26.

130. Mamutse, *supra* note 26, at 38–39 (discussing *McGrath v. Riddell* and noting "there is no natural conflict between public policy concerns and a departure from the established distribution structure").

131. UNCITRAL Model Law, *supra* note 74, Guide to Enactment para. 89.

132. *McGrath*, [2008] UKHL 21, [2], 1 W.L.R. at 855 (Lord Hoffmann) ("It is agreed that if the English assets are sent to Australia, the outcome for creditors will be different from what it would have been if they had been distributed under the 1986 Act. Some creditors will do better and others worse. [...] Generally speaking, insurance creditors will be winners and other creditors will be losers.").

133. John Roach, *"No Two Snowflakes the Same" Likely True, Research Reveals,* NAT'L GEOGRAPHIC, Feb. 13, 2007, *available at* http://news.nationalgeographic.com/news/2007/02/070213-snowflake.html.

134. *See* Westbrook, *supra* note 94, at 30 (explaining that national priority systems often have both commonalities and unique features).

135. *See generally* Jose M. Garrido, *The Distributional Question in Insolvency: Comparative Aspects*, 4 INT'L INSOLVENCY REV. 25 (1995) (arguing that distribution is the core of insolvency law).

cooperation in international bankruptcy.[136] Moreover, harmonization or unification of the law in this area is extremely unlikely, precisely because of the political nature of numerous priorities.

It is frequently asserted that cooperation takes place where there are no substantial differences in the graduation of credits,[137] but there are very different national experiences in this regard,[138] and it is not possible to establish the degree of similarity that makes cooperation possible. What is possible, however, is to include an analysis of the various differences and how they affect international cooperation.

In this respect, a taxonomy of differences is suggested: in it, a matrix of different situations is provided to illustrate the possible interactions of priorities in international insolvency cases. The matrix is built on the comparison of priorities, priority-related rules, and the possible results of that comparison. The possible situations are the following:

- Case A: a priority exists in the foreign law that does not exist in national law.
- Case B: a priority exists in national law that does not exist in the foreign law.
- Case C: a priority exists both in national law and in foreign law, but:
  - Case C1: Some elements of the priority are different.
  - Case C2: The position of the priority in the general graduation of credits is different.
- Case D: the same priority (or absence of priority) exists in both the foreign law and the national law.

These four different cases, or groups of cases, illustrate the complexities that differences in priority regimes bring to international cooperation in insolvency.[139]

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136. *See* Bank of N.Y. v. Treco (*In re* Treco), 240 F.3d 148, 158 (2d Cir. 2001) (holding "the priority rules of a foreign jurisdiction need not be identical to those of the United States," but "directs the court to consider whether the priority rules are '*substantially* in accordance' with United States law") (emphasis in original). The case shows that no abstract comparison should be drawn, but an analysis of the effects of the differences in the particular case.

137. *See* Mary Elaine Knecht, *Comment, The "Drapery of Illusion" of Section 304—What Lurks Beneath: Territoriality in the Judicial Application of Section 304 of the Bankruptcy Code*, 13 U. PA. J. INT'L BUS. L. 287, 292 (1992) (noting that "[a]s 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").

138. *See* Daniel M. Glosband & Christopher T. Katucki, *Claims and Priorities in Ancillary Proceedings under Section 304*, 17 BROOK. J. INT'L L. 477, 486 (1991) ("Courts have taken both territorial and universal approaches in the treatment of secured and unsecured claims, leading to the conclusion that no firm conclusions can yet be drawn about how claims will be treated in any particular instance."); Knecht, *supra* note 137, at 288 (observing that no two countries' insolvency laws are precisely the same).

139. It is not useful to oversimplify and disregard the differences. Instead, Franken argues that the national policies behind priorities do not differ in fundamental ways, and underestimates the importance of the differences in the priority of workers' claims. Franken, *supra* note 55, at 239 ("Notably, most bankruptcy régimes afford employee wage claims priority over unsecured creditors, albeit the scope of the priority right and the exact priority ranking may differ from jurisdiction to jurisdiction. However, such differences may not constitute serious problems if one considers that at the moment of filing for bankruptcy wage liabilities are generally low, since most corporate debtors will have an interest in paying their employees as long as possible if they want to continue their operations. Consequently, corporate

Naturally, international insolvency law is not algebra: these cases correspond to specific situations, with specific sets of circumstances. The sole justification for this classification is its usefulness of the allowing the study of common elements across those situations. In order to understand the possibilities for international judicial cooperation, it is helpful to analyze the different implications of each of these cases. Thus, this taxonomy is merely an analytical tool for understanding the issues involved in the treatment of priorities in international bankruptcy.

A quick analysis reveals that only in Case D is there no problem for cooperation between the courts of different countries, irrespective of the model for international cooperation that is adopted, and leaving aside the existence of other issues that may affect the relation of the courts. Case D assumes that there are no differences between the priority systems of two jurisdictions: the priorities recognized in the respective systems would be the same, with identical elements and requirements, and in the same ranking positions. The probability that this situation will arise in reality is extremely low: in practice, the existence of significant differences is the rule, and the existence of identical systems can be almost discarded.[140] If identity is used as a condition for cooperation, the possibilities for effective international bankruptcy cooperation will be severely limited.

Some insolvency systems demand that there be substantial similarity between priority systems.[141] This has led to the observation that similarity between bankruptcy laws is an important factor for international cooperation.[142] However, the consideration of "substantial similarity" introduces the question of what a "substantial difference" is. Substantial similarities may be easier to establish between legal systems that belong to the same family—like quasi-secured creditors in common law systems[143]—but may be considerably more difficult when comparing legal systems with different traditions and conceptual frameworks.

Thus, in virtually all of the cases that arise in practice, there are some differences between priorities in the jurisdictions involved. In those cases, there are problems associated with the differences in priorities, but it would be wrong to assume that all of those problems are similar. The distinction between cases A, B, C1, and C2 is therefore pertinent.

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debtors' incentives to forum shop ex post may not be strong as the de facto treatment of wage claims may not differ that much among jurisdictions."). It is submitted that this is an overoptimistic assessment of the situation.

140. Absolute coincidence is next to impossible. *McGrath*, [2008] UKHL 21, [21], 1 W.L.R. at 859 (Lord Hoffman) ("[I]n practice such a condition would never be satisfied. Almost all countries have their own list of preferential creditors.").

141. *See, e.g.*, 11 U.S.C. § 304 (repealed 2005) (stating that a factor for the court to consider is whether "distribution of proceeds of such estate [are] substantially in accordance with the order prescribed by this title").

142. Therefore, there is a need for some similarity in bankruptcy laws. *See* Westbrook, *supra* note 37, at 468–69 ("The second prerequisite to obtaining the benefits of universalism is general similarity of law. Similar laws about distributions, avoidance, and the like are not in principle necessary to the acceptance of universalism, but in practice similarity is very important.").

143. See, for examples of claimants under a constructive trust, *In re* Koreag 130 B.R. 705, 716 (Bankr. S.D.N.Y. 1991) (pointing out that a New York Court allowed assets to be turned over to Swiss courts for liquidation); Remington Rand Corp. v. Bus. Sys., 830 F.2d 1260, 1273 (3d Cir. 1987) ("The district court should bade fealty to the doctrine of comity and recognize the Dutch bankruptcy proceeding, but only if and to the extent that the Dutch court is willing to recognize the American judgment in its proceedings.").

In Case A situations, a priority exists in the foreign law that is unknown in the national law. The judgment in *McGrath v. Riddell* deals with a Case A situation, and Case A situations are those which are more likely to be solved in favor of the foreign law. The main reason for this tolerance of the difference is to be found in the nature of the conflict with the foreign priority. In fact, in Case A situations, conflict materializes between a foreign priority and the domestic *pari passu* principle. In Case A the two principles that clash are the priority in the foreign jurisdiction and the *pari passu* principle in the domestic jurisdiction.

Technically, the *pari passu* principle is not a priority (in fact, it is quite the opposite, as it is an *absence* of priority), but it constitutes a distributional option. The distributional questions admit different solutions. However, general creditors are not a protected category, and it is difficult to argue that general creditors are "local" creditors. They can be foreign creditors for all purposes (e.g., international financial institutions).

Given that *pari passu* is a default principle, and legislators do not place emphasis on it, there is less tension in recognizing a foreign priority, even if it means that the principle of equal distribution is further restricted in its allegedly already limited role.[144] The discussion of the real importance of the principle of equality of creditors has been a constant theme in bankruptcy literature, but it should be concluded that, in spite of pompous formulations, the principle is residual and expresses only that, absent a specific policy choice by the legislature, all creditors should be treated equally. Naturally, there is a conflict between asserting equality of creditors and recognizing the specific choice made by a foreign legislature in favor of a specific creditor group. However, the courts will have to decide between recognizing a preference that has not been admitted in the local law and inflicting some damage to the *pari passu* rule. As a default rule, the *pari passu* principle does not protect any specific group of creditors, so it is not easy to identify the rationale and objective of the rule with local creditors who would suffer prejudice by virtue of the recognition of the foreign priority. The policy in favor of equality is never as strong as the explicit option in favor of a group of creditors, expressed in a priority. This means that in Case A situations, the courts will be more inclined to recognize the foreign priority than in other cases,[145] because the recognition of a foreign priority does not automatically mean that local creditors are prejudiced. This is, of course, subject to an important qualification: in a Case A situation, the foreign priority has no equivalent in the local law—and that is precisely the source of the problem—but in order to be recognized, the foreign priority should not clash with some fundamental conception in the national law. This conflict with the local law mainly arises because of two different factors:

1) Substantial differences in legal traditions and legal conceptions; and

144. *See* Riz Mokal & Look Chan Ho, *The Pari Passu Principle in English Ancillary Proceedings,* 21 INSOLVENCY L. & PRACTICE 207, 210 (2005) (explaining that "insofar as English proceedings are ancillary to foreign insolvency proceedings, none of the versions of what is described as the *pari passu* principle, nor the *HIH* decision, necessarily constitute hurdles to English assets being handed over to a foreign insolvency official for distribution according to the foreign insolvency regime").

145. *Cf. McGrath,* [2008] UKHL 21, [21], 1 W.L.R. at 859 (Lord Hoffmann) ("But the existence of foreign preferential creditors who would have no preference in an English distribution has never inhibited the courts from ordering remittal.").

2) *Ordre public* considerations, as in the case of the recognition of a priority of foreign tax authorities.[146]

The analysis of the *McGrath v. Riddell* case suggests that all of the conditions for the recognition of a foreign priority were met: the conflict involved the Australian priority and the English *pari passu* rule; and the priority recognized in the foreign law did not clash with any fundamental legal principle or public order considerations in England.

Therefore, the conflict in Case A is less intense than in Case B and Case C situations, where the recognition of priorities may be more problematic.

In Case B situations, there is a national priority that is not recognized under the foreign bankruptcy law. A Case B situation is the reverse of a Case A situation. Because the tables are reversed in Case B, it means that cooperation with the foreign courts will in fact be much more difficult, if at all possible, unless the court is assured that the local creditor will in fact receive payment of its preferential claim. Otherwise the national courts would have to ignore a fundamental choice made by the national legislature in advancing the interests of a specific group of creditors, in order to benefit unsecured creditors in a foreign bankruptcy proceeding of universal reach. If courts enjoy discretion, it is unlikely that they would cooperate in that setting, as experience shows.

An example of Case B is the situation analyzed in *In re Bank of Credit and Commerce International*.[147] The bank was incorporated in Luxembourg, but had operations worldwide.[148] There were ancillary proceedings in England, the problem: the application of set-off before the assets were transferred to Luxembourg.[149] Scott VC stated several important points regarding the nature of ancillary proceedings, including its territorial character and the usefulness of a single distribution of dividends ("Since in order to achieve a *pari passu* distribution between all the company's creditors it will be necessary for there to be a pooling of the company's assets worldwide and for a dividend to be declared out of the assets comprised in that pool, the winding up in England will be ancillary in the sense that it will be the liquidators in the principal liquidation who will be best placed to declare the dividend and to distribute the assets in the pool accordingly"[150]). But all of these points were subject to the conditions that substantive rules of distribution under the English statutory scheme are mandatory and the court has no power to make an order, that will have the effect of misapplying them.[151]

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146. It is possible to enunciate a basic principle: the more intense the public policy element, the more difficult it is to deal with a priority internationally (that is the case with the priority of workers' claims and of taxes, as opposed to security interests, for instance).

147. *In re* Bank of Credit and Commerce Int'l, [1997] EWHC (Ch) 213 (Eng.) 2 W.L.R. 172.

148. *Id.*

149. *Id.* at 4–5.

150. *Id.* at 18, 21.

151. *McMahon*, [2005] EWHC (Ch) 2125, [175] (quoting an authority for not cooperating with the Australian liquidators in the McGrath case). *See McGrath*, [2008] UKHL 21, [17], 1 W.L.R. at 859–60 (Lord Hoffmann) ("I think that justice required that a remittal of the assets should have been qualified by a provision which ensured that the English set off was given effect. Luxembourg has not been designated a 'relevant country' under section 426 and there was accordingly no jurisdiction to apply Luxembourg law, but, as at present advised, I think that even if there had been, I would not have thought it appropriate to do so. The mutual debts were too closely connected with England.").

An interesting example of a Case B situation with a different solution can be found in the U.S. case *In re Griffin Trading Co.*[152] In this case, an unsecured creditor of a Chapter 7 debtor commodities broker argued that English law, instead of U.S. law, should apply to transactions executed in the debtor's London office. English law placed the claims of the debtor's general unsecured creditors on par with the debtor's customers. In contrast, U.S. law gave customers' claims a super-priority.[153] The court did apply U.S. law, although it eventually struck down the regulation that gave priority to customers.[154]

In Case A and in Case B it is possible to see the two extreme contrasts between jurisdictions: a priority exists in one legal system and does not exist in another. However, the most frequent situations are those grouped under the Case C heading. Case C reflects the fact that similar priorities exist in numerous legal systems, but there are substantial differences in those priorities, and those differences act as obstacles for cooperation. For instance, many jurisdictions share the existence of the "Big Three" priorities–tax, employees, and secured credit–but there are substantial differences as to the elements of those priorities.[155]

I have distinguished between Case C1 and Case C2 because I believe that differences in graduation (Case C2) deserve some special consideration. In Case C1, the priority exists in both the national and the foreign jurisdiction, but there are divergent elements in the priorities.[156] Certainly, there are priorities that appear in most legal systems that can be considered as "meta-norms," like employee protection,[157] but the elements of the priority can be different. The divergences can affect any of the elements of the priority: persons benefited by the priority (e.g., a priority in favor of workers, generally, versus a priority that favors only workers in the manufacturing sector); extent of the priority (e.g., an unlimited priority in favor of workers, and a priority capped at $5,000 per worker)[158]; and structure of the priority (there is a fundamental difference between general priorities, i.e., those that grant the creditor a general preference over all of the liquidation proceeds, and special priorities, that grant the creditor a preference over the proceeds of the sale of one or several specified assets in the debtor's estate).

Ideally, the courts should accord priority treatment to foreign creditors that comply with the requirements of the priority under national law, and should expect their national creditors to receive the same treatment under foreign law. In practice, there is considerable mistrust. Courts tend to ignore the fact that foreign creditors

152. *In re* Griffin Trading Co., 245 B.R. 291, 293–95 (Bankr. N.D. Ill. 2000).

153. *Id.* at 294–95.

154. *Id.* at 306–19; Anthony M. Vassallo et al., *Cross-Border Insolvency and Structural Reform in a Global Economy*, 35 INT'L L. 449, 456 (2001).

155. *See* Jay L. Westbrook, *Bankruptcy Control of the Recovery Process*, 12 AM. BANKR. INST. L. REV. 245, 253 (2004) (discussing different priority systems across several nations).

156. *See* Janis Sarra, *An Investigation into Employee Wage and Pension Claims in Insolvency Proceedings Across Multiple Jurisdictions: Preliminary Observations*, 16 NORTON J. BANKR. L. & PRAC. 835–72 (Oct. 2007) (discussing that the placement of employee claims on the hierarchy of secured and unsecured claims differs considerably across jurisdictions, which position employee claims before or after secured claims; before or after taxing authorities or other government claims; and before or after other specified claims that have been recognized as a public policy priority in a particular country).

157. *See* Pottow, *supra* note 91, at 1931 & n.144 (discussing the concept of meta-norms).

158. The extent of the priority can also be determined by reference to temporal limits (for instance, a priority for the wages corresponding to the last six months of employment). This can be accompanied by a cap on the amount of the priority.

could be entitled to priority status, and tend to protect local creditors against the risk that their priorities will not be recognized in a foreign insolvency.[159]

There is a strong case for recognizing the same priorities under national law: If Mexican creditors, especially priority creditors, know that their claims will be given Mexican-law treatment in the U.S. Courts to the extent of the Mexican assets, they have much less motive to institute Mexican proceedings.[160] Interestingly, this quotation of Jay Westbrook's work anticipates the result in a well-known case, *In re Collins & Ackman Corp. Group.*[161] In *Collins*, the English court decided to apply the Spanish and German distribution rules, in transgression of the English regime, in order to avoid the opening of ancillary proceedings in Germany and in Spain, so as to allow a sale of the whole corporate group at a better price.[162]

An additional difficulty comes from the nature and structure of priorities: priorities are exceptions to a general principle of equality of creditors.[163] As such, there is a rule against extensive construction of priorities, and against the creation of priorities by analogy.[164] In this regard, what the courts of a national system can do is recognize the foreign priority only in the more restricted version recognized under national law. If the foreign priority is more restrictive than the national one, it is unlikely that the national courts will offer foreign creditors better treatment than the treatment they would receive under their own national law, although that could be a theoretical possibility under the UNCITRAL Model Law.[165] In that situation, it may well be that the foreign creditors would be entitled to receive the same treatment accorded by their national law, in the foreign bankruptcy proceeding.

In Case C2 situations, the difference affects the position of the priority in the general graduation of creditors. This can be the only difference between the two laws, or, as it may be the case, the difference in graduation can be accompanied by differences in the elements of the priority (Case C1). Case C1 and Case C2 can manifest themselves independently, but they may arise at the same time as well. In Case 2, the problem is that both the national law and the foreign law recognize the priority, but the priority is accorded a different treatment in the graduation.

It is evident that a court lacks the discretion to alter the graduation order in its national system, as this order is imposed by the legislature, and there is no degree of discretion in dealing with it. This shows that, even in a situation where both the national and the foreign law recognize a priority that benefits the same group of

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159. Tung, *supra* note 61, at 45–46 (arguing that courts are "leery of granting recognition and giving local effect to determinations of foreign bankruptcy courts" and will therefore apply their own bankruptcy laws to the benefit of local creditors).

160. Westbrook, *supra* note 94, at 42.

161. *In re* Collins & Ackman Corp. Group, [2005] EWHC 1754 (Ch).

162. *See* Gabriel Moss, *Group Insolvency—Choice of Forum and Law: The European Experience Under the Influence of English Pragmatism*, 32 BROOK. J. INT'L. L. 1005, 1018 (2007) (discussing the court's holding and its effect on future proceedings).

163. 9D AM. JUR. 2D *Bankruptcy* § 3305 (2010).

164. *Id.*

165. *See* UNCITRAL Model Law, *supra* note 74, Guide to Enactment para. 104 (discussing UNCITRAL application of provisions that provide for the minimum ranking of claims for foreign creditors). If it is possible to give a special ranking to the claims of foreign creditors, this could include a *better* treatment than the treatment provided to a similar creditor under the local law of the forum. This is an interesting interpretation, although it is unlikely that this was the intention of the drafters.

creditors, the differences in the position in the graduation amount to a substantial conflict between the two laws.

This taxonomy could be further complicated with the introduction of reverse priorities (subordinated creditors).[166] This would create Cases A1, B1, and C3, but in practice the number of jurisdictions with these reverse priorities is very small. According to this sub-typology, there would be situations in which a preferential creditor in one country is a subordinated creditor in another one, and the opposite. An ordinary creditor is subordinated in another country, and vice versa. Creditors can be subordinated in different ways in two different systems (or different positions in the graduation).

In essence, what these different situations show is that under the umbrella of the "differences in priorities" is a whole range of situations that involve very diverse conflicts of interests, and that deserve separate treatment. Future analysis should concentrate in identifying all of these potential conflict situations, and international legal texts should take into account the issue of the differences in priorities.

V. CONCLUSION

It is not an exaggeration to assert that the differences in priority regimes constitute one of the most important barriers to the treatment of international insolvencies. Even in cases where the courts are willing to co-operate, it can be extremely complicated for the courts to ignore values that have been explicitly advanced by the legislature in national insolvency law. It is submitted that no two priority systems are identical, and that harmonization or unification of the law in this area is extremely unlikely to materialize. In fact, priority systems are but the expression of the hierarchy of values that permeate a given legal system. This means that graduation of creditors is primarily political, and that the influence of powerful groups of creditors, the inertia of legal tradition, or the conscious and deliberate choice to promote certain values are the factors that explain the fundamental differences encountered in various jurisdictions around the world.

Decisions like *McGrath v. Riddell* show that there are possibilities of co-operation beyond traditional territorialism in international insolvency cases, and illustrate the real implications and consequences of taking specific decisions in insolvency cases beyond the abstract discussions of theoretical approaches to international bankruptcy. The pragmatism that informs the decision of the House of Lords serves as an illustration for the classification of the various situations that differences in priorities can provoke in the context of international bankruptcies. The existence of divergences between graduations of creditors in the different legal system is likely to remain one of the biggest obstacles to co-operation in international insolvencies, and, unfortunately, it is a problem that tends to be consciously omitted in international legal texts. However, a clear understanding of the different conflicts contributes to raising awareness about this issue, and perhaps represents a step forward in the legal treatment of conflicts between different priority systems.

166. *See* Westbrook, *supra* note 94, at 36 (defining "reverse priorities" as "subordinations or disallowances that operate to reduce or eliminate recovery by specific classes of creditors or members of such classes").

"L'enfer, c'est les autres": Evolving Approaches to the Treatment of Security Rights in Cross-Border Insolvency

PROFESSOR IAN FLETCHER*

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ANNEX 508

I. PRELIMINARY: SECURITY AND PRIORITY

This paper addresses some contemporary issues concerning the approach to the so-called "Great Priority" generated by in rem security rights over a debtor's property. This is an institution that, in various forms, is embodied in the insolvency laws of many (indeed, most) countries whereby it is possible for a creditor to acquire a proprietary interest in assets which would otherwise have formed part of the estate available for distribution among the general body of creditors in the event of the debtor's insolvency. Then, upon the occasion of the debtor's default the secured creditor is able to look to the assets comprised within the security as a means of satisfying its claim against the insolvent debtor. It is thus one of the coveted characteristics of a security right; properly so called because it retains its efficacy during, and indeed in spite of, any formal insolvency proceedings that the debtor may undergo. If this were not the case, the commercial purpose of such security would be greatly diminished, and would somewhat resemble an umbrella that is capable of opening only when the sun is shining, but incapable of doing so when rain is falling (the more appropriate term for such an implement being a parasol). While it is certainly the case that some systems of insolvency law, or some types of proceeding within such systems, may impose restrictions on the secured creditor's freedom to exercise its security rights while the proceeding is running its course,[1] the economic advantage represented by the creditor's duly vested proprietary rights over the assets in question constitutes a *datum* which has to be respected, and thus adequately safeguarded, throughout the subsequent course of the process.[2]

A. *The distinction between preferential and secured creditors*

In considering the various ways in which certain creditors are able to enjoy a relative priority in the process of distribution of a debtor's estate, there is a crucial distinction to be made between the type of priority conferred upon so-called

1. This is especially typical of "rescue"-type proceedings, where it can be detrimental to the prospects of carrying out a successful reorganization of the debtor and/or its business if certain assets vital to the operation of that business are removed through the actions of a secured creditor seeking to realize its rights over the assets in question. *See*, 11 U.S.C. § 362 (describing "automatic stay" provisions in the U.S. Bankruptcy Code); Insolvency Act, 1986, c. 45, sched. B1, para. 43 (U.K.) (imposing a moratorium during administration proceedings).

2. It is, of course, essential that the security interest itself should be valid and unimpeachable according to the insolvency law, and additionally the general law, of the system of law by which the insolvency proceeding is governed. This entails full compliance with any formal requirements, such as registration, as well as non-infringement of any substantive rules whereby a debtor's pre-bankruptcy transactions may be adjusted or avoided at the instance of a suitably qualified party such as a liquidator or trustee in bankruptcy. While an in-depth discussion of such issues lies beyond the scope of the present paper, certain aspects of their cross-border impact are examined below. In the text above, the expression "duly vested proprietary rights" is intended to signify that the rights in question are valid and unimpeachable according to any potentially applicable laws under which they might in principle be challengeable.

"preferential" claims under a given system of insolvency law and the priority enjoyed by a secured creditor. In the former case, the system in question has actively imposed a discriminatory regime of administering the debtor's property for the benefit of certain categories of claimant so as to create an exception to the principle of *pari passu* treatment of the claims of all creditors as a single body.[3] Instead, there is substituted a sequential application of that principle under which the defined categories of claimant are entitled to receive payment in full in a prescribed order of priority before other, less privileged, categories of claimant are eligible to receive any payment at all.[4] Such a practice represents the outcome of a policy choice on the part of the authorities by whom the distributional rules of that system are given legislative effect at any given time, and the categories of preferential claims may be periodically revised in the light of changes to the prevailing policy.[5] In principle, however, such categories of preferential claims, as are sanctioned by the law in force at any given time, represent a manifestation of the public policy of the state in question. This becomes a factor that is likely to color the approach by the courts of that country when reviewing any request to authorize the transmission of assets from their own jurisdiction to that of a different state under whose insolvency law the said assets will be subject to a different order of distribution.

Just such an issue of preferential or discriminatory treatment was encountered by the English courts in each of the successive stages of the *HIH Case*.[6] Fundamentally, the question in that case concerned the consequences of divergent practices of two sovereign legal systems regarding the treatment of the assets available for distribution among the general body of creditors.[7] This involved a consideration of the point at which the divergent practice of the one system would be considered irreconcilable with the public policy of the other. Herein lies the point of distinction between questions of distributional priority and questions involving

3. McGrath v. Riddell (In re HIH Cas. & Gen. Ins. Ltd), [2008] UKHL 21, 1 W.L.R. 852 (H.L.) (Lord Hoffmann) (appeal taken from Eng.).

4. *Id.*

5. For example, the abolition of preferential status for most categories of liability owed to public and revenue authorities within the U.K.—known as "Crown preference"—together with the preference in respect of unpaid general rates on property was initially proposed in Chapter 32 of the *Cork Report* of 1982 (REPORT OF REVIEW COMMITTEE ON INSOLVENCY LAW AND PRACTICE, 1982, Cmnd. 8558, paras. 1409–27, 1450). In the ensuing Parliamentary process which resulted in the Insolvency Act 1986, the government strenuously resisted the abolition of many aspects of Crown preference, although certain species of revenue debts as well as liabilities for general rates were deprived of their preferential status. Ian F. Fletcher, *The Genesis of Modern Insolvency Law—An Odyssey of Law Reform*. J. BUS. L. 365 (1989). The complete removal of all such preference was not accomplished until the enactment of the Enterprise Act. Enterprise Act, 2002, c. 41, § 251 (eliminating all surviving examples of Crown fiscal preference from the Insolvency Act).

6. *McGrath*, [2008] UKHL 21, 1 W.L.R. One noteworthy, and ironic, feature of the case was that during the period in which the English proceedings progressed from first instance, via the Court of Appeal, to the House of Lords (the first judgment was delivered on October 7, 2005; the final judgment on April 9, 2008), U.K. domestic law concerning the treatment of creditors' claims against insolvent insurers had been amended in accordance with the harmonizing requirements of E.U. Directive 2001/17/EC, so that by the time of the final judgment of Their Lordships, it was closely similar to the Australian law provisions whose substance was initially seen as rendering it unacceptable to English public policy for the assets to be remitted for distribution under Australian rules. This alteration to the U.K. domestic law is noted in the judgments of Lord Hoffmann para. 32 and of Lord Phillips of Worth Matravers paras. 40–41. Judgments in the case were delivered on the basis of the law as it had existed at the time the proceedings were commenced.

7. *Id.*

security. The latter has the additional feature that certain assets are considered to have been removed from the debtor's available property to form a separate fund to which the secured creditor has exclusive access to the extent necessary to recoup what is owed to it by the insolvent debtor. The nature of the underlying liability to which the security relates is not of any particular relevance to the question whether the creditor is allowed to succeed in obtaining an outcome that is materially superior to that destined to be experienced by the general body of unsecured creditors (particularly those whose claims are of a non-preferential nature). Nevertheless, the same fundamental question resurfaces concerning the degree to which the divergent practices of foreign systems regarding the nature of security constitute an obstacle to international recognition and cooperation in matters of insolvency. Once again, considerations of public policy are very much engaged in the initial process whereby the various forms of security device gain acceptance in the eyes of the legal system under which they are created, thereby enabling them to provide the essential quality of protection already alluded to—namely that they shield the secured creditor from the full force of the elements when the rain is falling (i.e., a true umbrella, not a mere parasol).

B. Two hypothetical examples

In a cross-border context, therefore, it is possible for questions of public policy to be engaged when the nature of the security device is such that, while valid and effective according to the standards of some systems of law, it would be regarded as invalid and ineffective according to those of other systems which can properly be regarded as having a role in the insolvency process that is under way. Two contrasting scenarios are set out below to serve as illustrative examples.

1. Example (i)—Floating Security: a "limping" floating charge

To take what is perhaps the most vivid example, the device known as the "floating charge" has become widely used under English law following its acceptance by the courts in the nineteenth century as a valid and effective form of security, but it has been regarded in many other jurisdictions as transcending the limits of permissibility in that it facilitates the creation of universal security over present and future assets of the debtor.[8] Suppose that a debtor has granted a floating charge which would be valid according to the law of the state in which insolvency proceedings are opened, but which happens to be invalid according to the law of the situs of some (or all) of the collateral comprised within the scope of the charge. A clash of principles would be possible if a court in a state whose law regards the floating charge as an invalid and objectionable species of security were to be asked to authorise the transmission of assets presently within its jurisdiction, to enable them

8. Indeed, even in Scotland the floating charge was found to be incompatible with the fundamental principles of Scottish law relating to the grant of security. The conceptual impasse was only overcome by means of specific legislation in the form of the Companies (Floating Charges) (Scotland) Act 1961 (c. 46), subsequently amended and in large part replaced by the Companies (Floating Charges and Receivers) (Scotland) Act 1972 (c. 67), s. 30. *See* BOARD OF TRADE, REPORT ON THE COMPANIES (FLOATING CHARGES) (SCOTLAND) ACT 1961, 1970, Cmnd. 4336 (recommending repeal of the 1961 Act); On the diversity of national attitudes toward security, *see* PHILIP R. WOOD, COMPARATIVE LAW OF SECURITY INTERESTS AND TITLE FINANCE (2d ed., 2007).

to be administered according to the law of a state where the floating charge is accepted. If it were shown that, because of the debtor having granted a floating charge, the secured creditor is destined to receive the greater part of the proceeds from the repatriated assets while the ordinary, unsecured creditors will receive nothing, a situation would arise that would be strongly analogous to that which confronted the English courts in the *HIH Case*.[9] Suppose further that the insolvency proceedings take place in what is indubitably the debtor's center of main interests (COMI). Should the requested court invoke some kind of a veto in the name of upholding the dictates of its domestic public policy? Would this be true even at the expense of defying both the conventions of comity and the widely accepted principle of recognition of the legitimate claim of the court of the COMI[10] to serve as the jurisdiction for main insolvency proceedings? If so, the floating charge will suffer from the same kind of unevenness in terms of its effectiveness in an international context as can arise in the case of the so-called "limping marriage syndrome"[11] due to the lack of uniform standards for determining the validity of a marriage, especially following a divorce or annulment in relation to a previous marriage.

2. Example (ii)—A converse scenario

Conversely, suppose that a debtor grants floating charge security over assets that are situated in a state whose law regards such a device as valid and effective. Subsequently, however, the debtor is the subject of insolvency proceedings in a state whose law does not recognize the floating charge. Should the courts of the state where the assets are situated uphold the proprietary claims of the floating charge holder, or should they accord primacy to the effects of the law under which the debtor's insolvency is being administered?

We shall consider the above examples in more detail later in this paper.

II. CROSS-BORDER SECURITY: CHOICE OF LAW ISSUES

The very nature of real security—namely the creation of rights *in rem* in favor of a third party (the creditor) over property in which the debtor has proprietary rights up to and including ownership—ensures that, in a case with a cross-border dimension, a number of issues of conflict of laws may arise. Tensions may be encountered between the provisions of the law under which the insolvency proceeding is conducted (the *lex concursus*), and the law governing the transaction under which the right *in rem* is alleged to have been created.[12] A further element of diversity may be caused if the location of the collateral (its situs) is in a state whose

9. *See generally McGrath*, [2008] UKHL 21, 1 W.L.R.

10. Council Regulation 1346/2000, art. 3(1), recitals 12 & 13, 2000 O.J. (L 160) (EC).

11. *See* Sameer Ahmed, *Pluralism in British Islamic Reasoning: The Problem with Recognizing Islamic Law in the United Kingdom*, 33 YALE J. INT'L L. 491, 492 (2008) (describing "limping marriages" in British Muslim society).

12. Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2292 (2000) [hereinafter *Global Solution*] (indicating choice of law conflicts in insolvency proceedings). *See, e.g.*, Ulrich Drobing, *Secured Credit in International Insolvency Proceedings*, 33 TEX. INT'L L. J. 53, 66–67 (1998) (describing tension between *lex concursus* and situs in Germany).

law is neither the *lex concursus* nor the law governing the transaction.[13] If the collateral is of an immovable nature, the law of the situs will not vary over time, but this will not necessarily be true in the case of mobile collateral.[14] If it is of the latter type, the *lex situs* may change at any point between when the security right is first created, when insolvency proceedings are opened, and when the creditor seeks to exercise rights over the collateral, or indeed when the trustee or liquidator attempts to do so.[15] A highly unstable and unpredictable series of possible outcomes may occur depending on the precise content and effect of each of the potentially applicable laws.

As apparent from the above summary and will be apparent from the two illustrative examples given at the end of Section I, the treatment of security interests in a case of cross-border insolvency can give rise to some complex questions of choice of law, and can involve courts in delicate decisions when faced with contradictory outcomes produced under the respective laws controlling the different but inter-related elements of which a security-generating transaction is comprised. In the past, a notorious feature of the subject of conflict of laws was that states sought to develop their own individual solutions to the problems caused by the material diversity between the domestic laws of the various sovereign states, thereby giving rise to the paradoxical situation where there were effectively just as many systems of conflict of laws as there were national laws.[16]

In modern times, there have been numerous attempts to address this phenomenon by means of multilateral agreements and conventions aimed at harmonization of the rules applied in conflict of laws cases.[17] In the field of insolvency law, the most significant example to date is the E.U. Regulation on Insolvency Proceedings of May 29, 2000.[18] Its provisions now apply with mandatory force in twenty-six of the twenty-seven member states of the European Union.[19] Of particular interest for present purposes are the provisions of Article 3, which control the conditions under which the courts of a state are allowed to open insolvency proceedings in relation to a given debtor, and Articles 4 to 15 inclusive, which supply rules governing the choice of law issues that may arise during the course of such proceedings.[20] The key principle upon which the entire Regulation effectively operates is that in any given case the only E.U. member state whose courts are internationally competent to open insolvency proceedings is the state within whose territory the center of the debtor's main interests is situated.[21] Additionally, insolvency proceedings may be opened in any member state in which the debtor possesses an establishment, but with the proviso that the effects of such proceedings

13. Drobing, *supra* note 12, at 63.

14. *Id.*

15. *See id.* at 63–64.

16. *See, e.g.*, IAN F. FLETCHER, INSOLVENCY IN PRIVATE INTERNATIONAL LAW 7 (2d ed. 2005) ("[T]he rules which have been developed within each system of law for the purpose of accommodating the conflicting effects of different national laws have somehow contrived to perpetuate . . . the very syndrome of diversity which originally inspired them.").

17. *See* Hannah L. Buxbaum, *Rethinking International Insolvency: The Neglected Role of Choice-of-Law Rules and Theory*, 36 STAN. J. INT'L L. 23 (2000) (explaining that attempts to regulate international business have failed, resulting in a lack of reform to international insolvency regulations).

18. Council Regulation 1346/2000.

19. Denmark alone, by virtue of a treaty-based exemption, did not participate in the adoption of the Regulation and is not bound by its application. *Id.* recital 33.

20. *Id.* arts. 3–15.

21. *Id.* art. 3(1).

are restricted to the assets of the debtor situated in the territory of the state in question.[22]

The immense significance of the jurisdictional scheme imposed by Article 3 is quickly apparent from the terms of Article 4, which provides that the law applicable to insolvency proceedings and their effects shall be that of the member state within whose territory such proceedings are opened, save where there is specific provision to the contrary elsewhere in the Regulation.[23] A limited number of such exceptions to the governance of the law of the state of opening (the *lex concursus*) are found in Articles 5 to 15. Article 5 is the provision of primary interest in relation to cross-border security.[24] That article effectively provides that *in rem* security rights over property belonging to the debtor shall not be affected by the opening of insolvency proceedings (and, by implication, by any provision contained in the *lex concursus*) where the property in question is situated in the territory of another member-state at the time the proceedings are opened.[25] The article thus designates the law of the situs of the property as the system of laws by which the secured creditor's rights over the collateral shall be determined.[26] Significantly, however, Article 5(4) inserts a proviso allowing the validity of the transaction where the security right was generated to be tested according to the avoidance provisions of the *lex concursus*.[27]

III. ADDITIONAL FACTORS INFLUENCING THE INSOLVENCY PROCESS: THE UNIVERSALITY PRINCIPLE, TERRITORIALITY, AND COMMERCIAL EXPECTATIONS

Historically, the subject of cross-border insolvency has attracted a number of scholarly attempts to formulate a common international approach based upon agreed principles.[28] Among the various theories advocated over the years, two major principles have striven for prominence, the principles of universality and territoriality.[29] The universality principle contemplates that for each debtor there should be a single, legitimate forum in which insolvency proceedings are allowed to be opened, and that such proceedings should be recognised and given effect in all other jurisdictions.[30] The corollary of this principle is that all creditors worldwide

22. *Id.* arts. 3(2), 27. *See generally id.* art. 2(h) (defining the term "establishment").

23. *Id.* art. 4.

24. Council Regulation 1346/2000, arts. 5–15.

25. *Id.* art. 5.

26. *See id.* (implying that by not affecting *in rem* rights, the law governing creditors' rights remains that of the member state in which the property sits).

27. *See id.* art. 5(4) (allowing actions for voidness, voidability, or unenforceablility under the law of the state in which the proceedings are open).

28. Among the earliest such treatises of the modern era was that of Jabez Henry, whose *Outline of Plan of an International Bankrupt Code for the Commercial States of Europe*, published in London in 1825, was inspired by that author's own judicial experience in presiding over the trial proceedings in the seminal case of Odwin v. Forbes (1817) 1 Buck. 57 (P.C.). For a brief account of the case, and of the evolution of doctrinal writing about cross-border insolvency, see FLETCHER, *supra* note 16, at 17–23.

29. FLETCHER, *supra* note 16, at 12–13 (addressing the "antithetical propositions" of universality and territoriality).

30. *See id.* (defining "unity" principle as when the insolvency process "is opened at the place with which the debtor's affairs, interests, and general circumstances have their closest affinity" and "universality" as a process which "advances the claim that such [insolvency] proceedings enjoy

should be allowed the right to participate in the administration and distribution of the debtor's property on a non-discriminatory basis.[31] Conversely, the principle of territoriality is based on the view that insolvency laws are intimately associated with the public policy of the state that promulgates them, and they should not be accorded extraterritorial effects as against persons or property found in other sovereign states. Consequently, under this principle only the property situated in the state in which insolvency proceedings are opened is comprised in that proceeding.[32] Further, in the more extreme versions of the theory, the right to participate in the distribution of the debtor's estate would be restricted to local creditors (so-called "ring-fencing").[33]

Each of the rival theories has certain features to commend it, offset by a number of reservations. The territoriality theory appears to concede that multiple, localized proceedings are an inevitable consequence of insolvency whenever there is an international dimension to the case. It also embodies serious possibilities for abuse and evasion through the tactical placement of assets in certain jurisdictions, thereby rendering them less accessible (or wholly inaccessible) to creditors based elsewhere.[34] The prospect of unequal treatment of creditors is a significant negative feature of this theory. However, the theory can claim the virtue of realism by acknowledging the enduring inclination of courts and administrators, to seek to impose the solution demanded by the public policy of the state in which they function when confronted by some significant discrepancy between their domestic law and its foreign counterpart. Conversely, the universality theory holds out the prospect of a unified process whereby the "hallowed" principle of equal treatment of creditors would be applied on a global basis. The onus would be on prospective creditors to pre-calculate the jurisdiction and law to which the debtor would be subject in the event of insolvency, so as to appraise the potential impact of that law on the creditor's interests.[35] One major weakness of this idealized model is that it depends on there being a standard test for attributing international jurisdiction. It is also essential that the test is applied uniformly by all states across the world. Neither of these conditions is currently satisfied at the global level.[36] Even if such a condition of universal harmony could be attained, practical difficulties would remain due to the need for parties, at the moment of engaging in a transaction, to reconcile the known or ascertainable facts regarding the debtor with the criteria employed by the jurisdictional test. In reality, it could prove quite hard to identify with absolute certainty the insolvency forum to which a given debtor will be subject at some time in the future (or even, at the present time), and there is an ever-present possibility that

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worldwide—hence, 'universal'—effect over all property and interests of the debtor wheresoever these may be found").

31. *See id.* at 11–12 (discussing the "unity" principle as one in "fullest harmony with the principle of collectivity and the equal treatment of all creditors on a global basis").

32. *See* FLETCHER, *supra* note 16, at 13 (describing the principle of territoriality).

33. *See id.* (implying that "by denying the capability of the foreign proceedings to produce any effects regarding that part of the debtor's patrimony," local creditors have a clear path to the debtor's estate).

34. *See* Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 723–24 (1999) (arguing that debtors will have the freedom to forum shop under the universalist approach, while creditors will have little ex ante predictability about which forum or law will govern proceedings).

35. *See id.* at 723–24 (arguing that debtors will have the freedom to forum shop under the universalist approach, while creditors will have little ex ante predictability about which forum or law will govern proceedings).

36. *See Global Solution, supra* note 12, at 2292–94 (explaining that a single international law and court is needed, but right now may be implausible).

a creditor may be misled, wittingly or unwittingly, by information provided by the prospective debtor.

There exists a further difficulty that can readily ensue from the application of a "pure" universality doctrine: it may not be readily apparent to a party entering into a transaction in what is to them their "home" state that the counterparty and prospective debtor is ultimately subject to the insolvency law of some foreign state, whose laws are materially different in a way which will affect the creditor's interests in the event of default. This represents but one of a number of scenarios under which a creditor may be destined to suffer a detrimental defeat of its "legitimate" expectations due to the effects of a foreign insolvency law whose application the creditor did not anticipate. Although the issue of whether any particular set of expectations can properly be regarded as "legitimate" begs several additional questions, it is suggested that there are at least some situations in which it would be reasonable for a party to enter into a transaction without having to take the precautionary step of making a "due diligence" investigation of the other party's personal circumstances to the extent necessary to establish the proper forum in which any future insolvency proceedings are destined to take place.

The aspiration to protect, and, where possible, to give effect to, "justified expectations" has an established place as a choice-influencing factor in the conflict of laws.[37] This aspiration was espoused, for example, by the American Law Institute, in formulating the general choice of law principles that are placed within paragraph 6 of the Restatement Second of Conflict of Laws.[38] Although this is but one among a selection of factors intended to serve as a guide to decision making in the context of a choice of law process, the commercial importance of enabling parties to engage in transactions in the confidence that the declared policy of the law is inclined to support honest agreements, rather than to allow them to be frustrated or confounded by a dogmatic and inflexible choice of law process, is surely not without importance.[39] A similar rationale can be applied in relation to the development of a conflict of laws regime tailored to serve the particular requirements of cross-border insolvency. While the appeal of the universalist model has tended to gain favor among those seeking to produce a framework for international governance of international insolvencies, it has been necessary to find a realistic way of responding to the inescapable fact that the national laws of insolvency, and, similarly, the laws governing credit and security, are likely to remain diverse and unharmonized for the foreseeable future.[40] That being the case, some degree of compromise seems

37. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 cmt. g (1971) (stating "justified expectations" "is an important value in all fields of the law"). *See generally* Symeon C. Symeonides, *Symposium: The Silver Anniversary of the Second Conflicts Restatement: The Judicial Acceptance of the Second Conflicts Restatement: A Mixed Blessing*, 56 MD. L. REV. 1248, 1250 (1997) (summarizing criticisms of the current Restatement but also explaining that the current Restatement is not likely to change soon and is still good law).

38. RESTATEMENT (SECOND) OF CONFLICT OF LAWS, *supra* note 37.

39. Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 457–60 (1991).

40. At a very early stage in the gestation of the European Union Convention on Bankruptcy and Related Matters, which ultimately morphed into the very different creature now known as the E.U. Regulation on Insolvency Proceedings, the group of expert negotiators representing the then six member states commissioned a study of the feasibility of harmonizing the member states' domestic laws regarding priority and security. Ian F. Fletcher, *Historical Overview: The Drafting of the Regulation and its Precursors*, *in* THE EC REGULATION ON INSOLVENCY PROCEEDINGS 1, 10–11 (Gabriel Moss, Ian F.

inevitable if the perceived advantages of an internationally standardized approach are not to be marred due to an unduly strict adherence to a "pure" form of the universality principle—a further example of how the best can become the enemy of the good. The pragmatic response to this challenge has been the innovation known as "modified universalism."[41]

IV. MODIFIED UNIVERSALISM

A. *A lesson from history*

A striking demonstration of the impracticality of any attempt, under present circumstances, to impose a system embodying "pure" universalism on the conduct of international insolvency cases can be found in the early drafts of the projected Convention on Bankruptcy and Related Matters, undertaken by the European Economic Community (as it then was) in the years between 1960 and 1970.[42] Negotiating on behalf of a community of only six states, whose laws were all linked to the civil law tradition, the national representatives enthusiastically embraced the twin principles of "universality and unity of bankruptcy," and they duly incorporated them into Article 2 of their draft text in the following terms:

> The proceedings to which this Convention applies shall, when opened in one of the Contracting States, have effect *ipso jure* in the other Contracting States and so long as they have not been closed, shall preclude the opening of any other such proceedings in those other States.[43]

Despite such a robust and unequivocal assertion of the virtuous principles, by which cross-border insolvencies would be administered under the Convention's master plan, the negotiators were quickly forced into making a series of fatal

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Fletcher & Stuart Isaacs eds., 2009) [hereinafter *Historical Overview*]. The conclusion of the study conducted by Professor Sauveplanne was that such harmonization was technically and politically unfeasible for the foreseeable future. *Id.* at 11. The expansion of the E.U. in subsequent years from its original membership of six to a current membership of 27 states inevitably renders such an ambitious project even more difficult to achieve. Further aspects of the initial period of the evolution of the E.U. Convention are considered in Section IV of this article.

41. A leading protagonist in the development of the "modified universalism" school of thought is Professor Jay L. Westbrook, whose writings have proved especially influential. *See, e.g.*, Westbrook, *supra* note 39 (discussing a universalist approach that yields "an approximation of equality and fairness across a range of cases."); Jay Lawrence Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT'L L. 499, 516–18 (1991) (describing the challenges facing an avoiding court when deciding whether to apply local or home country law in transnational bankruptcy cases); Westbrook, *supra* note 12, at, 2299–2302 (explaining interim solutions to multinational insolvency issues before universalism is attainable). Professor Westbrook's endorsement of the doctrine of modified universalism was noted with approval by Lord Hoffmann in his judgment in McGrath v. Riddell (In re HIH Cas. & Gen. Ins. Ltd), [2008] UKHL 21, 1 W.L.R. 852 (H.L.) (Lord Hoffmann) (appeal taken from Eng.).

42. *See* IAN F. FLETCHER, CONFLICT OF LAWS AND EUROPEAN COMMUNITY LAW 188–91 (1982) [hereinafter EUROPEAN COMMUNITY LAW] (discussing the initial justification for a European bankruptcy convention and its subsequent evolution).

43. *Id.* at 327.

compromises, which largely negated the values supposedly established by Article 2.[44] These compromises were designed in response to the unpalatable nature of the perceived consequences of actually applying such a system of governance to a typical scenario of insolvency in the context of the unified internal market of the Economic Community, in which internal frontiers were to be effectively dismantled, while the national insolvency laws would remain unharmonized.[45] Foreseeably, where the debtor had taken full advantage of the economic and commercial freedoms conferred by the rules of the internal market, there would have been dealings with counterparties in various member states who would reasonably have assumed that the transactions into which they entered would be legally indistinguishable from those which they might have concluded with their fellow nationals in a purely domestic context.[46] Similarly, it was perfectly foreseeable that assets of the debtor could come to be located in various member states, and that security interests might well be created in respect of some or all of the assets in accordance with local law and practice.[47] Since it was one of the motivations for concluding the Convention that there was no prospect of effecting a harmonization of the domestic insolvency laws of the member states, the inevitable consequence of applying the principle expressed in Article 2 to a cross-border insolvency such as the above would be that certain creditors would suffer a defeat of their expectations as to the priority of their claims in any distribution of the debtor's estate.[48] Other creditors would be in peril of experiencing a similar defeat of expectations as to the effectiveness of any security interests which, though initially valid according to such factors as the situs of the collateral, or the place of concluding the transaction, or the law by which the transaction was governed (expressly or by implication), might nevertheless be treated as invalid or impeachable according to the law of the state, in which insolvency proceedings were subsequently opened.[49] It was readily foreseeable that such a wholesale overturning of settled assumptions and practices would be politically unacceptable.[50]

In the face of such an unwelcome prospect, the national negotiators took refuge in a series of provisions whose effect was to derogate from the uniform application of the *lex concursus* so as to enable creditors to retain, as against any property of the

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44. *See id.* at 191–94 (detailing how the drafters of the convention endeavored to ensure unity and universality and how future drafts of the convention retreated from these ideals for political and practical reasons).

45. According to Article 3 of the Treaty Establishing the European Community (both as originally concluded in Rome on March 25, 1957 and in its current, consolidated version resulting from the Treaty of Amsterdam of October 2, 1997), "the activities of the Community shall include ... (b) a common commercial policy; (c) an internal market characterized by the abolition, as between member states, of obstacles to the free movement of goods, persons, services and capital; ... (g) a system ensuring that competition in the internal market is not distorted; (h) the approximation of the laws of member states to the extent required for the functioning of the common market ...." Moreover, the first paragraph of Article 6 of the original Treaty of Rome (now Article 12 of the Consolidated Treaty) provides: "Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited." Consolidated Version of the Treaty on the Functioning of the European Union art. 3, Mar. 30, 2010, 2010 O.J. (C 83) 47.

46. *See* EUROPEAN COMMUNITY LAW, *supra* note 42, at 188–89 (explaining the difficulties created by disharmony in insolvency laws across member states).

47. *Id.*

48. *Id.* at 191–92.

49. *Id.* at 188–90.

50. *Historical Overview*, *supra* note 40, at 10–11.

debtor located in other member states, the benefit of any preferential status they might enjoy according to the provisions of domestic law of that state.[51] Similarly, the law of the situs of any asset as at the time of opening of the insolvency proceedings would determine the subject matter, extent and ranking of secured rights to which the property was subject.[52] In this way, the Draft Convention established a series of sub-estates (also termed "asset-pools") whose treatment and distribution would be governed by the local law of the situs of the assets in question.[53] The unacknowledged truth was that the convention would, in substance, operate according to the principle of territoriality, while ostensibly pledging allegiance to the principle of universality.

B. A pragmatic solution

Mercifully, the flawed and schizophrenic Draft Convention of 1970 was tacitly abandoned by the Community authorities sometime after 1980.[54] When a fresh initiative was launched in 1989, a more pragmatic and transparent spirit was quickly evident.[55] The principle of modified universality was embodied in the new structure, now contained in the E.U. Regulation of May 29, 2000 on Insolvency Proceedings, as outlined in Section 2 above, whereby the universal effects of main proceedings opened under Article 3(1) can be attenuated through the opening of one or more territorial proceedings under the limited circumstances permitted by paragraphs (2) to (4) of the same article.[56] This willingness to accept compromise is again evident in the choice of law provisions contained in Articles 4 through 15 inclusive, whereby defined exceptions are created to the otherwise dominant role of the *lex concursus*, each of which represents a concession to creditors' expectations, which happen to have been founded upon a different law to that of the state where insolvency proceedings were opened.[57]

The spirit of modified universalism that is captured within the provisions of the E.U. Regulation is also found within the UNCITRAL Model Law on Cross-Border Insolvency, adopted by the United Nations Commission on International Trade Law on May 30, 1997, and subsequently endorsed by the General Assembly in December of that year.[58] The nature, function, and scope of the Model Law are very different from those of the E.U. Regulation, since the purpose of the Model Law is to bring about change in the domestic laws of states throughout the world in relation to the recognition of foreign insolvency proceedings, and to enable courts and office holders to engage in cooperation in international insolvency proceedings.[59] Significantly, the criterion employed for identifying the state whose competence to open main insolvency proceedings is to be internationally recognized is the location

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51. *Id.* at 11.

52. *Id.* at 10. For a detailed, and critical, account of the 1970 Draft, see EUROPEAN COMMUNITY LAW, *supra* note 42, at ch. 6. (The English version of the text of the 1970 Draft is contained in Appendix C.).

53. *Historical Overview*, *supra* note 40, at 11.

54. *Id.*

55. *Id.* at 3, 12.

56. Council Regulation 1346/2000, art. 3(1)-(4).

57. *Id.* art. 4–15.

58. Model Law on Cross-Border Insolvency, G.A. Res. 52/158, U.N. Doc. A/RES/52/158, art. 20 (Jan. 30, 1998) [hereinafter Model Law].

59. *See id.* pmbl. (explaining purpose of model cross-border insolvency law).

of the center of the debtor's main interests.[60] Upon recognition as a foreign main proceeding, automatic effects can be produced within the territory of the recognizing state that effectively mimic many of the attributes of universality.[61] These include a stay on proceedings and executions against the debtor's assets, as well as a right for the foreign representative to initiate proceedings under local law to avoid acts detrimental to the general body of creditors.[62] The adherence of the Model Law to the doctrine of modified universalism is demonstrated by the inclusion of an additional criterion by which jurisdictional competence to open insolvency proceedings of a non-main character is accorded, based upon the presence of an establishment of the debtor within the territory of the state in question.[63] Upon recognition as a foreign non-main proceeding, certain effects in the form of discretionary relief and assistance become available under the law of the recognizing state, and the foreign representative also has standing to invoke specified transaction avoidance actions under the law of the recognizing state, in relation to assets which properly belong to the estate being administered in the foreign non-main proceeding.[64] It is thus apparent that the Model Law operates conceptually along the same lines as the E.U. Regulation in that it endeavors to facilitate international recognition of insolvency proceedings opened at the COMI of the debtor so that, as far as possible, the consequences will be analogous to those which obtained under the idealized conditions of universalism. However, the current global realities are acknowledged through the provision that recognizes concurrent insolvency proceedings as having a more limited scope, being effectively restricted to the administration of assets which are, or which should be, located within the state in which the debtor has an establishment.[65]

V. VIRTUES AND VICES OF THE CURRENT COMPROMISE: HOW SECURE IS YOUR SECURITY?

Taken together, the E.U. Regulation and the UNCITRAL Model Law furnish a powerful endorsement of the argument that under prevailing circumstances it is necessary to adopt a pragmatic stance by conceding the possibility that one or more secondary, or ancillary, insolvency proceedings may take place as non-main proceedings, concurrently with the main administration based in the state of the debtor's COMI, and, for almost all purposes, conducted according to the law of that state. In essence, modified universalism amounts to the familiar practice of making a virtue out of necessity. The key to making the current position a workable success, based as it is upon a compromise, is to ensure that the criteria on which main and secondary jurisdictional competence are to be based are clearly defined and can be applied in a uniform and consistent manner by courts operating in diverse jurisdictions. Early experience, particularly regarding the interpretation of the concept of COMI, indicates that there is space for improvement and refinement of

60. *Id.* art. 2(b).

61. *Id.* arts. 20, 28.

62. *Id.* arts. 20, 23; *see also id.* arts. 21, 24 (describing, upon recognition, what relief may be granted and when a foreign representative may intervene).

63. *See id.* art. 2(c), 2(f) (defining "foreign non-main proceeding" and "establishment").

64. Model Law, *supra* note 58, art. 21.

65. *Id.* art. 28.

the criteria employed in this, the most crucial of all the steps in the international insolvency process. But that debate must be set aside for treatment on another occasion. For present purposes, attention must be focused on the extent to which, in relation to the creation of security interests, the flexibility conceded by modified universalism for the purpose of safeguarding legitimate expectations is capable, in the wrong hands, of becoming an instrument of evasion and abuse, carrying negative consequences for the shared interests of the general body of creditors.

Section I above sketched two hypothetical cases in which the validity and enforceability of a species of security might be placed in doubt in the course of a cross-border insolvency due to divergent policy positions adopted by the various laws potentially engaged. It will be useful here to reflect on the probable impact of the Regulation and of the Model Law on the outcome of such cases.

A. Example (i) revisited

The first example supposes a situation where the collateral is located in a state that does not recognize the validity of the security interest claimed to have been created by the debtor, whereas the *lex concursus* does so recognize its effectiveness. In a case governed by the E.U. Regulation, the law of the situs (assuming it to be an E.U. member state) would be obliged to yield to the authority of the *lex concursus*, whose prerogative it is to administer the debtor's assets located in any of the member states on a universal basis.[66] An exception could materialize if the debtor has an establishment in the state where the collateral is situated, and if steps are taken to open secondary, territorial proceedings there. It would then be for the law of the latter state to determine the extent to which, if at all, the alleged security interest will be respected in the course of those insolvency proceedings.[67]

In the absence of a secondary proceeding, the state of the situs could possibly resist the claims of the *lex concursus* to control the fate of the collateral by invoking the exception based on public policy under Article 26.[68] However, that provision has been drafted with a view to limiting the ability of any member state to refuse to recognize insolvency proceedings or to enforce a judgment handed down in the context of such proceedings, on the ground that to do so would be contrary to the public policy of that state.[69] Article 26 only permits such a refusal where recognition or enforcement would be "manifestly contrary to that state's public policy, in particular its fundamental principles or the constitutional rights and liberties of the individual."[70] Quoting previous judgments that involved a similarly drafted provision in the Brussels Convention,[71] the European Court of Justice has explained in its

66. Council Regulation 1346/2000, art. 4. r.
67. *Id.* art. 28.
68. *Id.* art. 26.
69. *Id.*
70. *Id.*
71. The Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (generally known as "the Brussels Convention") was originally concluded on September 27, 1968 by the six founding member states of the European Community. It was progressively amended, and was acceded to by new member states as one of the conditions of joining the Community. Since March 1, 2002 the Brussels Convention has been largely replaced by the Brussels I Regulation, which applies to all the current member states with the exception of Council Regulation 44/2001, 2000 O.J. (L 12/1) (EC).

ruling in the *Eurofood Case* that recourse to the public policy exception "is reserved for exceptional cases."[72]

> [Recourse] can be envisaged only where recognition or enforcement . . . would be at variance to an unacceptable degree with the legal order of the State in which enforcement is sought inasmuch as it infringes a fundamental principle. The infringement would have to constitute a manifest breach of a rule of law regarded as essential in the legal order of the State in which enforcement is sought or of a right recognised as being fundamental within that legal order.[73]

The Court expressly affirmed that it is not permissible for the national court to transpose its own conception of the requirements of due process for the purpose of arriving at a conclusion that there has been a breach of a fundamental right, such as the right to be heard: Article 26 must be interpreted and applied in conformity with the fundamental aims of the Regulation.[74] It therefore appears that, in a case such as our first example, there would not be a valid basis for invoking Article 26 as a means of resisting the application of the *lex concursus*.

If the same set of facts were to occur in a case where the collateral is situated in a state that has enacted the Model Law, there would seem to be a greater possibility of resisting a request by a foreign representative, pursuant to Article 21, for the court of the situs to allow the collateral to be administered, and in due course distributed, in accordance with the regime of the *lex concursus*. Article 21 makes it a matter to be determined according to the discretion of the requested court, with the additional proviso that, before entrusting local assets to the foreign representative for the purpose of distribution, the court must be satisfied that the interests of local creditors are adequately protected.[75] If it is demonstrable that, as a consequence of allowing the asset to be administered according to a law under which the secured creditor is destined to enjoy an advantage not replicated in the law of the assets' present situs, local creditors may be denied any prospect of receiving benefit from that part of the debtor's property, turnover may be refused. The assets in question may then become the subject of a local, territorial insolvency proceeding, based upon Article 28 of the Model Law.[76] That article specifically authorizes the opening of local, territorial proceedings, based upon the fact that the debtor has assets in the state in question.[77] It can also be observed that the drafting of the public policy exception in Article 6 of the Model Law is considerably less elaborate than in the case of Article 26 of the E.U. Regulation,[78] and that an enacting state is permitted to refuse to take any action

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72. Case C-341/04, Eurofood IFSC Ltd, 2000 E.C.R. I-3813, para. 62.

73. *Id.* para. 63., (citing Case C-7/98, Krombach v. Bamberski, 2000 ECR I-1935, paras. 23, 37); *see also* Case C38/98, Renault SA v. Maxicar SpA, 2000 ECR I-2973.

74. *Eurofood*, 2000 E.C.R. 1-3813, paras. 64–68.

75. Model Law, *supra* note 58, art. 21.

76. *Id.* art. 28.

77. *Id.*

78. *Compare id.* art. 6 (stating that nothing prevents courts from refusing to take action consistent with this law, if contrary to public policy) *with* Council Regulation 1346/2000, art. 26 (stating that member states may refuse to recognize proceedings only where recognition or enforcement would be "manifestly contrary to that state's public policy, in particular its fundamental principles or the constitutional rights and liberties of the individual.").

based on the requirements of the Model Law if that action would be "manifestly contrary to the public policy of this state."[79] Therefore, national standards can be brought to bear for the purpose of deciding what kinds of action are unacceptable from the standpoint of public policy.

B. *Example (ii) revisited*

It is cases that resemble the scenario of the second example which give rise to the greater potential for abuse. If the *lex concursus* denies the effectiveness of a particular species of security, any creditor who has accepted that form of security in respect of collateral, situated within the territory of the state to whose jurisdiction the debtor was known to be subject, may be considered to have knowingly run the risk that the security would prove worthless in the event of the latter's default.[80] If, however, the collateral is located outside the state where the insolvency proceedings are opened, and the security interest is held to be valid by the law of the situs, the principle of modified universality embodied in Article 5 of the E.U. Regulation provides an avenue of escape from the application of the *lex concursus*, which would otherwise apply by virtue of Article 4.[81] The position of the secured creditor is not entirely immune from challenge however, because Article 5(4) imports a proviso whereby actions for voidness, voidability, or unenforceability of legal acts detrimental to the general body of creditors may still be brought in accordance with the provisions of the *lex concursus* as referred to in Article 4(2)(m).[82] In the event of any such challenge to the validity of the transaction whereby the security was created, the creditor is accorded a further, albeit narrow, avenue of defense by Article 13, which provides that Article 4(2)(m) "shall not apply where the person who benefited from an act detrimental to all the creditors provides proof that the said act is subject to the law of a member state other than that of the state of the opening of proceedings, and that that law does not allow any means of challenging that act in the relevant case. "[83] Therefore the creditor's defense based on Article 13 will be successful if it can be shown that the governing law of the transaction whereby the security was created is that of some other member state, apart from the state where the insolvency proceedings are based, and that, according to all elements of the governing law the transaction could not be successfully impeached in the light of the circumstances under which it took place.[84] However, the narrowness of the terms of this defense should be emphasized: the governing law of the transaction must be that of another E.U. member state. It will not suffice if the transaction is governed

79. Model Law, *supra* note 58, art. 6.

80. More difficult issues arise if the debtor has misled the creditor with regard to the matter of the location of its COMI, particularly if the nature of the misrepresentation was to the effect that any insolvency proceedings would be destined to take place in a state under whose law the security would be valid (thus placing the matter in the scenario considered in *Example (i)*). This variation on the facts is not explored here, but it can be noted that any attempt to recover compensation for the loss incurred through the debtor's deception—even if that had demonstrably amounted to fraud—would simply become one more unsecured claim against an already insolvent estate.

81. *See supra* Section II, where the effects of Articles 4 and 5 of the E.U. Regulation are summarized.

82. Council Regulation 1346/2000, arts. 4(2)(m), 5(4).

83. *Id.* art. 13.

84. *Id.*

by the law of some third state, even if it can be shown that the security is valid and unimpeachable according to the law of that state.[85]

In a case not falling within the scope of the E.U. Regulation, but where the collateral happens to be situated in a state which has enacted the Model Law, the court of the situs would, as in *Example (i)*, retain a discretion whether to entrust the administration or realization of local assets to the foreign representative, and also whether to allow the foreign representative to take control of the process of distribution of those assets.[86] Once again, the consequences for local creditors of allowing the assets to be assimilated into the centralized distribution that takes place according to the terms of a foreign system of law must be taken into consideration, and the court must ensure that such local interests are adequately protected. Accordingly, if the creditor who seeks to claim the benefit of a locally recognized form of security can also claim to be a "local creditor" of the state of the situs, this would strengthen the case for opening a local, territorial proceeding under Article 28 for the purpose of administering the collateral and any other assets that are locally situated in accordance with the insolvency law of the situs. In general, the discretion conferred on the court of the situs under Article 21, together with the possibility of invoking the public policy exception under Article 6, give scope for mounting a successful resistance to the claims of the foreign representative.

C. *Scope for abuse*

As stated, one of the principal arguments in favor of modified universalism is that it offers a controlled means of protecting the legitimate expectations of parties whose security interests, or entitlement to priority, would be detrimentally affected under the regime of the *lex concursus*. In the case of the E.U. Regulation, the concessions enabling secured creditors to retain the benefit of the status accorded to them under an alternative law are tightly circumscribed, both by the restricted possibilities available under Article 3 for bringing about the opening of secondary insolvency proceedings, and by the condition implanted in Article 5 that requires the collateral to be situated in one of the other member states.[87] Similarly, for the special defense under Article 13 to be available in resisting a transaction avoidance action brought under the *lex concursus*, the transaction must be governed by the law of another member state.[88] Limiting as the above conditions are, there is no specific provision in the Regulation itself to counteract the possibility that parties may select the location of the collateral, and may likewise select the governing law of the transaction giving rise to the security. This may be done purely to choose a law more favorable than that of the state to whose insolvency jurisdiction the debtor would be subject, or that of the state with which the parties' business relationship is actually most closely connected. There is thus a certain potential for evasion or abuse—somewhat akin to forum shopping—even within the confines of the European Union's current membership.

85. *See id.* (explaining that the transaction must be subject to the law of a member state).
86. Model Law, *supra* note 58, arts. 21(1)(e), 21(2).
87. Council Regulation 1346/2000, arts. 3(2), 5(1).
88. *Id.* art. 13.

VI. COMBATING POTENTIAL ABUSE

In cases that fall outside the scope of the E.U. Regulation, the concessions offered by modified universalism give many more opportunities for evading the rigor of the anticipated *lex concursus* by means of an astute choice of law and a complementary choice of the situs in which to locate the collateral.[89] As we have seen, the provisions of the Model Law are not particularly robust in equipping the foreign representative with countermeasures against calculated evasion of the *lex concursus*.[90] One has no desire, naturally, to interfere with bona fide business arrangements where, for example, a creditor from a jurisdiction where a particular species of security is a standard feature of the legal furniture is willing to do business with a debtor based in a jurisdiction whose law regards such devices as anathema. If the parties agree that security shall be created in favor of the creditor using collateral that is located in the creditor's own country, or in a country that has some material connection with the underlying business transaction itself, then that is arguably a reasonable solution which enables the creditor to continue to operate within a legal environment that is familiar to it. On the other hand, if both parties happen to be linked to legal systems whose laws would deny them the capability of creating a particular form of security, it is difficult to find a principled basis on which to support their use of the law of an otherwise unconnected system as a means of clothing their security arrangement with an ostensible legitimacy. Hence, the mischief here aimed at is the possible tendency on the part of would-be secured creditors to abuse the hospitality of the institution of modified universalism by means of synthetic security transactions having no genuine relation to the actual business being conducted between the parties in an international context. In order to provide some means of combating the said mischief it is suggested that, in the future, suitably-designed provisions should be included in the various types of international instruments—conventions, model laws, legislative guides, and the like—that are nowadays increasingly in use.[91] If the cause of modified universalism is to gather strength and support among independent states across the world, inbuilt mechanisms to counteract potential abuse by parties must be put in place, and must be seen to operate effectively.

One attempt to respond to the need for developing such countermeasures has been incorporated into a project on which the present author has been engaged in recent years. In February 2006, the American Law Institute (ALI) and the International Insolvency Institute (III or "Triple-I") announced the inception of a joint dissemination and extension project with respect to the Principles of Cooperation developed within the ALI Transnational Insolvency Project, concluded in May 2000 with Professor Jay L. Westbrook as its Reporter.[92] The stated objective

89. *Global Solution, supra* note 12, at 2301–02.

90. *See* Model Law, *supra* note 58, arts. 21, 26.

91. *Global Solution*, *supra* note 12, at 2298.

92. The product of the ALI Transnational Insolvency Project was a four-volume publication based upon an intensive investigation of the laws of the three NAFTA countries: the United States, Canada, and Mexico. Each of the four volumes bears the main title: "*Transnational Insolvency: Co-operation among the NAFTA Countries,*" followed by the appropriate subtitle. In the case of the three national reports, the subtitle is specific to the country in question: "*International Statement of Mexican/Canadian/United States Bankruptcy Law*" (as appropriate). The fourth volume, bearing the subtitle "*Principles of Cooperation among the NAFTA Countries,*" has come to be known as "The ALI-NAFTA Principles." All four volumes were published for the American Law Institute in 2003 by Juris Publishing, Inc. The American Law Institute, *Transnational Insolvency: Principles of Cooperation* (2005) http://www.ali.org/index.cfm?

of the project was to establish acceptance of the ALI's *Principles of Cooperation among the NAFTA Countries* in "jurisdictions across the world, subject to any necessary local modifications, and to obtain the endorsement of leading domestic associations, courts, and other groups in those jurisdictions. "[93] The present author has had the honor of serving as Co-Reporter, together with Professor Bob Wessels, for what has come to be known as the ALI-III Global Principles Project.[94] In April 2010, the Draft Report of the Global Principles Project was circulated on a restricted basis among the panels of international advisors to the project, who are mostly drawn from the two organizations under whose auspices it has been conducted. At the present time of writing, the text is provisional and is subject to further revision, although it is intended that it should become generally available in due course. The Report contains the texts, together with commentary, of forty-one Global Principles for Cooperation in Global Insolvency Cases, and there are two Appendixes containing, respectively, eighteen Global Guidelines for Court-to-Court Communication in International Insolvency Cases, and twenty-three Global Rules on Conflict of Laws Matters in International Insolvency Cases (in each case accompanied by a commentary). Among the Global Rules are included several provisions whose purpose is to serve as a countermeasure against potential abuse of the opportunities offered by the principle of modified universality, whose basic tenets are incorporated into the overall approach taken in the Report. These rules are reproduced below as an Annex to this article. They offer an example of a possible means of combating the mischiefs identified above as an unwanted side-effect of the otherwise laudable policy aimed at protecting creditors' justified expectations in the event of their debtor's insolvency.

VII. FINAL REMARKS: ACCOMMODATING THE ALIEN IN OUR MIDST

As Lord Hoffmann has noted in his Symposium Comment delivered during the proceedings at which this article was originally presented, the task of formulating choice of law rules that would allow uniform application in every state is fraught with difficulties.[95] Noting that "it is unlikely to be sufficient to rely upon the national locus of the assets since this may well be adventitious . . . artificial or, indeed, contrived," he draws the pessimistic conclusion that "if the negotiation of the modest European bankruptcy regulation took nearly 40 years, the negotiation of uniform choice of law rules may well take longer."[96] That is a chastening observation, although doubtless a realistic one. Nevertheless, the challenge ought to be taken up, not merely for the benefit of those creditors who, at regular intervals, happen to find themselves among the ranks of the unhappy non-winners in the forensic lottery that is cross-border insolvency, but also because common sense informs us that any reduction of the

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fuseaction=projects.proj_ip&projectid=18.

93. The American Law Institute, *Transnational Insolvency: Principles of Cooperation* (2005) http://www.ali.org/index.cfm?fuseaction=projects.proj_ip&projectid=18.

94. Professor Jay L. Westbrook has been associated with this project since its inception in his capacity as Co-Chair of the International Advisory Group. Working Group on ALI Principles of Cooperation in International Cases, International Insolvency Institute, http://www.iiiglobal.org/committees/ali-principles-cooperation-international-cases.html (last visited April 2, 2011).

95. Leonard Hoffmann, Baron Hoffmann, Keynote Address at the Texas International Law Journal International Insolvency Symposium: The Priority Dilemma (May 11, 2010).

96. *Id.*

current state of uncertainty and instability in the matter of the international treatment of *in rem* security rights is likely to be beneficial to the conduct of commercial activity between parties who are rated as aliens in the eyes of each other's respective laws. National attitudes toward the treatment of security and security-like devices themselves are so varied, and so intimately related to fundamental aspects of socio-legal ordering within the state concerned, that it is difficult to foresee a time when such matters will become subject to a unified scheme of treatment at the global level. Consequently, national courts will continue for the indefinite future to encounter issues involving an infelicitous collision of mutually contradictory legal policies toward species of security, along the lines considered above as *Examples (i)* and *(ii)*. A worthwhile advance may be made if, through the instrumentality of international negotiations and standard-setting agreements, some measure of consensus can be achieved for a common approach to the choice of law process that should be applied in such circumstances, with some suitable safeguards against the more predictable forms of evasion or abuse, and with a prudent degree of acceptance of the inevitability of the role of public policy where truly fundamental principles are seen to be at stake. Thereby, reasonable and rational business arrangements may be allowed to enjoy an enhanced element of certainty, without unwarranted encroachment upon the dignity or sovereign integrity of any individual legal system.

ANNEX

ALI-III Global Principles Project
Draft Report (April 2010)

(A)

Global Principles for Cooperation in International Insolvency Cases
(selected provisions)

* * *

Principle 2 Aim

2.1. The aim of these Global Principles is to facilitate the coordination of the administration of insolvency proceedings involving the same debtor, including where appropriate through the use of a protocol.

2.2. In particular, these Global Principles aim to promote:

(i) The orderly, effective, efficient and timely administration of proceedings;

(ii) The identification, preservation and maximisation of the value of the debtor's assets (which includes the debtor's undertaking or business) on a world-wide basis;

(iii) The sharing of information in order to reduce the costs involved; and

(iv) The avoidance or minimization of litigation, costs and inconvenience to all parties affected by proceedings.

2.3. In every separate insolvency proceeding, the Global Principles require cases to be administered with a view:

(i) To ensure that the creditors' interests are paramount and that they are on an equal footing;

(ii) To save expense;

(iii) To deal with the debtor's estate in ways which are proportionate to the amount of money involved, to the importance of the case, to the complexity of the issues, and to the number of countries involved; and

(iv) To ensure that the case is dealt with timely and fairly.

Principle 3 International Status; Public Policy

3. Nothing in these Global Principles is intended:

(i) To interfere with the independent exercise of jurisdiction by national courts involved, including their respective authority or supervision over an insolvency administrator;

(ii) To interfere with national rules or ethical principles by which an insolvency administrator is bound according to applicable national law and professional rules;

(iii) To prevent a court from refusing to take an action which would be manifestly contrary to the public policy of the state to which that court belongs; or

(iv) To confer substantive rights or to interfere with any function or duty arising out of applicable law or to impinge on such applicable national law.

* * *

Principle 13 International Jurisdiction

13.1. For the purposes of these Global Principles the courts or other authorities of a state shall have jurisdiction to open insolvency proceedings in respect of a debtor when either:

(a) the centre of the debtor's main interests is situated within the territory of the state in question; or

(b) the debtor has an establishment within the territory of that state.

13.2. Where insolvency proceedings are opened on the basis of Principle 13.1(b), the effects of those proceedings shall normally be restricted to the assets of the debtor situated in the state in question. By way of exception however, such proceedings may be accorded more extensive effect if it is the case that insolvency proceedings cannot be opened under Principle 13.1(a) because of conditions laid down by the law of the state in which the centre of main interests is situated.

13.3. For the purposes of these Global Principles:

(a) "Centre of main interests" means the place where the debtor conducts the administration of its interests on a regular basis and in a manner that is known to or readily ascertainable by third parties.

(b) In the case of a company or legal person, unless the contrary is proved, the place of the registered office is presumed to be the centre of its main interests.

(c) In the case of an individual, unless the contrary is proved, the debtor's habitual residence is presumed to be the centre of his or her main interests. However, in the case of an individual who is engaged in a business, trade or profession, unless the contrary is proved, the debtor's professional domicile or [published] business address is presumed to be the centre of main interests.

(d) An "establishment" means a place of operations where or through which the debtor carries out an economic activity on a non-transitory basis. Such activities may be commercial, industrial or professional.

13.4. Where insolvency proceedings are opened on the basis of Principle 13.1(a), it must be determined that the centre of main interests is situated within the territory of the state where the proceedings are to take place. For this purpose, the location of the centre of main interests must be determined as at the date on which a party with standing to do so first seeks to invoke the jurisdiction to open the insolvency proceeding in question.

13.5. If there is evidence to show that the centre of main interests of the debtor has previously been situated in a different state from that in which it is determined to be for the purposes of Principle 13.4, the international jurisdiction of the state where the centre of main interests was formerly situated is not displaced unless it is further proved either that at the time of the alleged relocation of the centre of main interests the debtor was able to pay all debts and liabilities incurred prior to that time or that the debtor has fully paid or compounded for all debts and liabilities incurred prior to the time of relocation of the centre of main interests.

Principle 14 Recognition

14.1. When an insolvency proceeding is pending in a state which, with respect to the debtor concerned, has jurisdiction for that purpose by virtue of the rules of international jurisdiction established by these Global Principles, courts and authorities in all other states should hold themselves accessible to the duly appointed representative of such foreign proceeding and should be prepared, upon application and, if appropriate, after hearing, to grant recognition to that proceeding and its representative.

14.2. Recognition should be denied when the effects of recognition would be manifestly contrary to public policy in the recognizing state.

* * *

(B)

Global Rules on Conflict of Laws Matters in International Insolvency Cases

(selected provisions)

* * *

C. General rule of law applicable to insolvency proceedings

Global Rule 12 Law of the state of the opening of proceedings

12.1. Save as otherwise provided in [this Act/these Rules] the law applicable to insolvency proceedings and their effects shall be that of the state within the territory

of which such proceedings are opened, hereafter referred to as "the state of the opening of proceedings".

12.2. The law of the state of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct, administration, conversion and their closure.

Global Rule 13 Law of the state of the opening of non-main proceedings

If insolvency proceedings are opened in a jurisdiction other than that where the centre of main interests of the debtor is situated ("non-main" proceedings), the effects of the application of the law of the state of the opening of such proceedings shall be restricted to those assets of the debtor situated in the territory of that state at the time of the opening of those proceedings.

Global Rule 14 Cross-border movement of assets

In relation to any asset of the debtor which is of a moveable character, Global Rules 12 and 13 shall apply subject to the following modifications:

(a) Any rule of insolvency law which is applicable by virtue of the localization of an asset in the territory of the state of the opening of insolvency proceedings at the time of the opening of the proceedings shall not apply if it is shown that the asset in question has been moved to that location from the territory of another state, to whose insolvency law it would otherwise have been properly subject, in circumstances which suggest that the transfer was effected wholly or primarily for the purpose of avoiding the effects of the law of the other state, including its insolvency law.

(b) Conversely, where an asset has been moved from the territory of one state to that of another state under the circumstances stated in paragraph (a), the effects of any insolvency proceedings which are opened in the former state shall apply to the asset in question.

(c) In the absence of evidence to the contrary, it shall be presumed that any asset which has been removed from the territory of the state in which insolvency proceedings are opened within sixty days prior to the opening of such proceedings was made with intent to avoid the effects of the law of that state. It is for the party who seeks to maintain the validity of the act whereby the property was removed from the territory of that state to provide evidence that the transfer was made for a bona fide and legitimate purpose.

(d) Except in a case to which paragraph (c) is applicable, it is for the party who alleges that the provisions of paragraphs (a) and (b) of this Rule are applicable in relation to a particular asset to prove that this is the case.

D. Exceptions to the general rule of law applicable to insolvency proceedings

Global Rule 15 Rights of secured creditors

15.1. Insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets—both specific assets and collections of indefinite assets as a whole which change from time to time—belonging to the debtor which are situated within the territory of another state at the time of the opening of proceedings.

15.2. The rights referred to in Global Rule 15.1 shall in particular mean:

(a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;

(b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;

(c) the right to demand the assets from, and/or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;

(d) a right in rem to the beneficial use of assets.

15.3. The right, recorded in a public register and enforceable against third parties, under which a right in rem within the meaning of Global Rule 15.1 may be obtained, shall be considered a right in rem.

Global Rule 16 Exception

16.1. By way of exception to Global Rule 15, a right in rem ("in rem security right") shall not be exempted from the effects of insolvency proceedings if proof is provided that the state where the assets are situated at the time of the opening of insolvency proceedings has no substantial relationship to the parties or the transaction in relation to which the security right was created and there is no other reasonable basis for the fact that the assets are so situated.

16.2. It is for the party who claims that the conditions specified in Global Rule 16.2 are met in relation to a particular security right to prove that those conditions are in fact met in the relevant case.

* * *

Global Rule 22 Defences to the avoidance of detrimental acts

Global Rules 12 and 13 shall not apply where the person who benefited from an act detrimental to the general body of creditors provides evidence that:

(i) the said act is subject to the law of a state other than that of the state of the opening of proceedings; and

(ii) that law does not allow any means of challenging that act in the relevant case.

Global Rule 23 Exception

23.1. By way of exception to Global Rule 22, a transaction detrimental to the general body of creditors shall not be exempted from the effect of the avoidance rule of the law of the state of the opening of insolvency proceedings if proof is provided that the state to whose law the transaction is subject has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the selection of the law of that state as the law to govern the transaction in question.

23.2. It is for the party who claims that the conditions specified in Global Rule 23.1 are met in relation to a particular transaction to prove that those conditions are in fact met in the relevant case.

Sacred Cows: How to Care for Secured Creditors' Rights in Cross-Border Bankruptcies

THE HON. LEIF M. CLARK & KAREN GOLDSTEIN*

SUMMARY

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INTRODUCTION

Cross-border insolvencies are not a new phenomenon. However, it was only relatively recently that great strides have been made toward more coordinated and efficient cross-border bankruptcies. Despite these advances, it must be acknowledged that some problems continue to resist solution in any consistent fashion. One of those persistent problems, and the topic of this paper, is whether property subject to security interests should be funneled through the "main" court overseeing the bankruptcy when doing so will abridge the secured creditor's remedies or entitlements. How sacrosanct should security interests be when cooperation is sought in the context of an international bankruptcy case?

When cross-border insolvency occurs, tribunals in different countries oversee aspects of the international bankruptcy case. Which court will collect, administer, and distribute the various assets of the debtor in light of the differing priorities that exist among the countries overseeing the case? And to what extent will one tribunal impinge on the rights of a secured creditor in order to cooperate with another tribunal's collection, administration, and distribution efforts? The issue of how to treat property subject to the claims of secured creditors is neither small nor merely academic. The issue has been sharpened by two developments. First, the international presence of companies has reached an unprecedented level. The entire globe now furnishes both the tools for enterprises' operations and the customers for enterprises' products. Second, the legal landscape has changed substantially with the promulgation (and adoption by a number of countries) of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross Border Insolvency Proceedings.

This article is divided into three sections. The first briefly discusses international bankruptcy theories. In the second section, the article gives an overview of Chapter 15 of the Bankruptcy Code, which represents United States' adoption of the Model Law. Lastly, the article focuses on how, based on the modern statutory regime and relevant case law, assets that are subject to security interests are to be remitted for distribution to "home" countries. We argue that the scheme available in the current statutory regime is sufficient to resolve the tension between appropriate protection of secured creditor interests and the cooperation required to achieve the ends of modified universalism.

I. THEORIES OF AND APPROACHES TO INTERNATIONAL BANKRUPTCIES

A. *International Bankruptcy Generally*

In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act (the "Bankruptcy Code").[1] The Act contained a new Chapter 15, essentially adopting the Model Law on Cross Border Insolvency promulgated by UNCITRAL in 1997.[2] Although Chapter 15 is discussed at length in Section II of this paper, and is the backbone of the analysis therein, it is important to provide a

1. Edward S. Adams & Jason K. Fincke, *Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism*, 15 COLUM. J. EUR. L. 43, 46 (2009).

2. 11 U.S.C. § 1501(a) (2005).

brief overview of the general cross-border bankruptcy theories that informed the development of the Model Law.[3]

Prior to the Model Law, there was largely a void with respect to a global substantive framework to deal with international bankruptcies.[4] As a result, companies with an international presence focused first on where—in what country—they would file for bankruptcy.[5] The country of filing would be the bankruptcy's home court.[6] The focus on which country would act as the home court was done in anticipation of that country applying its own laws, including choice of law rules.[7] The choice of forum decision was clearly influenced by an analysis of which country had laws that favored the debtor's needs.[8] Unsurprisingly such debtors often had assets in more than one country that were subject to security interests of creditors located in different jurisdictions. By choosing a given country as a forum, the debtor might avoid a priority that would otherwise be enjoyed by a particular creditor constituency in another country where some assets or operations were located.

Of course, choosing the forum of its bankruptcy case is only half the battle for any enterprising international debtor. The home court might have great difficulty in convincing a court in another country (the ancillary or helper court) to funnel assets in the ancillary country through the home court for administration and distribution in accordance with the home court's rules of priority and distribution. This difficulty may be especially acute when a local creditor's priority or security interest might be impaired or lost in the home court proceeding. For instance, Country A, as the home court, might ask that Country B, as the ancillary court, remit assets located in Country B to Country A for distribution to all of the debtor's creditors, including the creditors that are located in Country B. Country B, however, notes that the local secured creditors will be harmed by the distribution scheme of Country A's insolvency laws because they do not enjoy the same priority as they do under Country B's insolvency laws. Whether Country B decides to cooperate with Country A's request will depend on Country B's views of the duties it owes to the local creditor, relative to its views of its obligation to cooperate with the larger insolvency goals of achieving a coordinated global resolution of the enterprise's financial problems.

Although different countries' insolvency laws may be poles apart on specific issues—such as the order in which creditors are to receive distributions from the bankruptcy estate—it is also true that there are common principles that tend to be found in most insolvency laws worldwide.[9] One such common principle is the "Principle of Collectivity," which is the "recognition that insolvency constitutes an

3. After all, as Vern Countryman noted, "[t]o understand how we got where we are, it is necessary to understand where we were." Marshall v. Stern, 600 F.3d 1037, 1050 (9th Cir. 2010) (quoting Vern Countryman, *Scrambling to Define Bankruptcy Jurisdiction*, 22 HARV. J. ON LEGIS. 1, 2 (1985)).

4. *See* Adams & Fincke, *supra* note 1, at 45 (stating that until recently the international community had not been able to effectively coordinate cross-border insolvencies).

5. *Id.* at 47.

6. *See id.* (stating that "no court will conduct bankruptcy proceedings pursuant to the laws of another jurisdiction").

7. *See id.* ("The choice of forum and the choice of law are intertwined in the area of international insolvency because no court will conduct bankruptcy proceedings pursuant to the laws of another jurisdiction.").

8. *See id.* at 45 (classifying domestic insolvency laws as either "debtor-or creditor-oriented").

9. IAN F. FLETCHER, INSOLVENCY IN PRIVATE INTERNATIONAL LAW 8, para. 1.07 (James J. Fawcett ed., 2d. ed. 2005).

example of the so-called 'common pool problem' which arises whenever conditions are such that more than one person has rights over the same finite fund of resources."[10] Even within a given country, there is always a tension between the broader distributional purposes of a bankruptcy proceeding and the more individualized concerns expressed as priorities of one sort or another. We include here the *de facto* priority that results from secured creditor status when that status is recognized and preserved in the insolvency proceeding.

That tension is heightened when the insolvency involves more than one country. Two competing notions regarding how to resolve that tension in the cross-border context have emerged over the years, roughly grouped under two basic doctrines—universalism and territorialism.[11] The doctrine to which Country B, the helper court, subscribes will largely determine whether it will grant Country A's request to funnel assets though Country A for purposes of administration and distribution, or deny the turnover request and retain those assets to administer and distribute pursuant to Country B's laws.

B. Pure Universalism and Pure Territorialism

Country B's reaction to a request by Country A is likely to depend on whether its laws have a universalist slant, or a territorialist slant. Unsurprisingly, both doctrines have both benefits and drawbacks.[12] The following is a concise description of the doctrines.

> Universality is the conflict of laws approach to international insolvency disputes[,] which favors resolution of all claims against the debtor's estate in one proceeding initiated in the debtor's domicile country. All the debtor's property, wherever located, is removed to that jurisdiction for consolidation; all creditors must pursue their claims in the same forum. Under principles of comity, the judgment that results is recognized and enforced by all foreign courts. Two factors are said to support this approach: increased economy (by avoiding the chaos of multiple duplicative proceedings around the world), and greater equality of treatment for creditors (through consolidation of assets and claims). The opposing doctrine of territoriality or pluralism accords no extraterritorial effect to the laws of a foreign country; a bankruptcy proceeding under domestic law may be initiated against a foreign debtor and his domestically held assets without regard for concurrent insolvency proceedings or judgments of other countries.[13]

Under pure universalism, "[t]he dominant case in the home country is called the 'main' case or proceeding. A case in any other country is called a 'secondary' or 'non-main' case or proceeding. Territorialism does not require such specialized

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10. *Id.* para. 1.08, at 9.

11. *See* Adams & Finke, *supra* note 1, at 47 (describing universalism and territorialism as principles of international insolvency law).

12. *See id.* at 52–55, 57–58 (describing the strengths and weaknesses of universalism and territorialism).

13. Stacy A. Morales & Barbara A. Deutsch, *Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity*, 39 BUS. LAW. 1573, 1586 n.70 (1984) (citing John D. Honsberger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W. RES. L. REV. 631, 633–34 (1980)).

terminology because every case filed in a separate country is its own main case."[14] Thus, if Country B subscribes to pure universalism, it is likely to grant Country A's (the home country) request to send to Country A assets to be distributed under Country A's laws. However, if Country B adheres to territorialism as the right approach, it will keep the assets in question and distribute them according to its own distribution rules.

But which doctrine is the "right" doctrine, prescriptively? Answering that question (if it can be answered at all) must start with understanding the underlying principles that inform each theory. Professor Fletcher noted that the two doctrines encompass two pairs of contradictory hypotheses that are based upon (i) the philosophy of bankruptcy on the one hand, and (ii) the effects of bankruptcy on the other.[15] Universalism has as its core the notion of "unity of bankruptcy," which ideally would "preclude any subdivision of insolvency proceedings into two or more distinct administrations governed by the laws of separate states."[16] For every debtor there should be a unified process of administration with all claims and interests channeled through the one main proceeding.[17] Territoriality, by contrast, has at its core the principle of plurality, which accepts the "possibility of plurality of proceedings, their exact number and jurisdictional location to be determined by the circumstances of the instant case."[18] Implicit in this principle is the recognition that insolvency laws do not, of themselves, have an extraterritorial reach, dealing as they must with the application of a given country's rules to a collection of property within the jurisdictional reach of that country.[19]

On the one hand, universalism has the benefit of being most in line with the common fund ideal of bankruptcy itself in that it appears to be "in fullest harmony with the principal of collectivity and the equal treatment of all creditors on a global basis."[20] On the other hand, however, universalism may lead to injustice among creditors in that parties in jurisdictions other than the debtor's home country may have their expectations defeated because of the imposition of the home country's laws on their dealings with the debtor.[21] Another negative might be the cost associated with funneling all claims and assets through one home bankruptcy because, practically, it might be cheaper to deal with far-flung assets in the country in which they are located.[22] Additionally, states are "averse to allowing foreign laws to operate with extraterritorial effect in relation to property located within their jurisdiction."[23] Absent a treaty or some other kind of relationship, states are less likely to let property located in their jurisdiction be administered under anything

14. Adams & Fincke, *supra* note 1, at 48.
15. FLETCHER, *supra* note 9, paras. 1.11–1.13, at 11–13.
16. *Id.* para. 1.12, at 11–12.
17. *Id.*
18. *Id.*
19. *Id.* para. 1.13, at 13.
20. *Id.* para. 1.12, at 11–12.
21. FLETCHER, *supra* note 9, para. 1.12, at 12.
22. *Id.* Though in fairness it is recognized that a foreign representative might "realize" the assets in their country of location, moving only the proceeds of such realization to the home country for distribution. This, it might be noted, is certainly contemplated by the Model Law. *See* Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, U.N. Doc. A/RES/52/158 (Jan. 30, 1998) [hereinafter Model Law] (noting that "the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in this State to the foreign representative or another person.").
23. FLETCHER, *supra* note 9, para. 1.12, at 12.

other than local laws.[24] Lastly, especially with regard to corporate groups, some critics of universalism assert that "the home country standard is vulnerable to strategic manipulation," for example, forum shopping.[25]

Being the opposite side of the coin, the benefits of territoriality are obviously the detractions for the universalist approach, to wit, a territorialist approach may be more cost-effective in certain circumstances, local creditors do not have their expectations defeated, and property is administered and distributed in each bankruptcy case according to the local law in which the property resides.[26]

With respect to the *effects* of a bankruptcy, universalism expects that the effects—on both the property and the interests of the debtor—will be worldwide, regardless of whether the property and/or interests are located in the home country.[27] The drawbacks to this ideal are the same as noted above regarding the philosophical interests in universalism: additional costs, frustrated creditor expectations, and applicable law being inconsistent with traditional choice of law rules. Moreover, there is the practical reality that a given country's law can only have an effect in another country if the second country lets it.[28] "Thus, while it is not uncommon to find the national law expressed in terms which declare that the insolvency proceedings of that system shall enjoy universal effect, . . . no state has yet adopted, freely and unilaterally, a policy of according matching effect to insolvency proceedings conducted under the laws of foreign states."[29]

Conversely, under the territorialist point of view, the effects of a bankruptcy proceeding are limited to property and interests that are located in that specific territory.[30] The main problem with limiting the effects of a bankruptcy under the territoriality model is that it simply does not address more complex cases in which the debtor has its hands in varied interests in a number of countries.[31] That in turn means inconsistent and uncoordinated rulings that are likely to frustrate a unified restructuring of a global enterprise.

C. *Modified Universalism and Cooperative Territorialism*

Today, because neither pure universalism nor pure territorialism is practical, "modified universalism" and "cooperative territorialism" have emerged as plausible alternatives.[32] Although modified universalism already has its expression in the

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24. *Id.*

25. Lynn M. LoPucki, *Cooperation In International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 709, 720–21 (1999).

26. *See* FLETCHER, *supra* note 9, para. 1.12, at 12 (discussing the drawbacks of universalism).

27. *Id.* para. 1.13 at 12–13.

28. *Id.*

29. *Id.*

30. *See id.* (discussing territorial jurisdiction).

31. *See id.*(discussing drawbacks with the territoriality model).

32. *See* LoPucki, *supra* note 25, at 700–02 (describing the evolution away from pure universalism in response to historical problems and introducing LoPucki's theory of cooperative territoriality). Professor LoPucki notes that "bankruptcy literature generally disparages territoriality and sometimes equates it with a lack of cooperation between countries. Perhaps because of this history, territoriality has failed to emerge as an alternative to universalism as a foundation for ordering the international bankruptcy regime." *Id.* at 701–02. This has some truth. As such, this article endeavors to use the terms "universalism" and "territorialism" without passing judgments on either doctrine, except to note that neither is perfect.

Model Law,[33] both theories are worth examining. Treating universalism and territorialism as two ends of a spectrum, modified universalism begins with the idea of pure universalism and then moves toward the center of the spectrum by incorporating certain territorialist tendencies.[34] "Modified universalism recognizes the problems of a global system where debtors can easily choose a substantive law that will govern their insolvency and that is contrary to the expectations and interests of creditors."[35] For this reason, under modified universalism, ancillary courts retain the right to administer the assets located within their jurisdiction pursuant to local law when circumstances so require.[36]

Certainly, modified universalism has its critics. Professor LoPucki believes that the very territorialist nature of modified universalism—for example, allowing ancillary courts to retain their right to protect local creditors—is its downfall.[37] One of the main benefits of pure universalism is considered to be the predictability it gives the debtor's lenders because they will know the debtor's home country in advance (whether this is actually the case is also the subject of vigorous dispute).[38] But, under modified universalism, predictability is sacrificed because the "regime or regimes that will ultimately distribute the debtor's assets may depend on the country in which the assets are located at the time of bankruptcy."[39] Additionally, the lenders will have to predict "what intercountry differences in bankruptcy law the forum court will consider substantial."[40] Given the differences in bankruptcy laws among countries, LoPucki believes that, under modified universalism, the ability of each court to enforce its own laws eviscerates one of the principal benefits of pure universalism, even though modified universalism purports to retain it.[41]

Moreover, LoPucki believes that modified universalism does not provide any solution to the problem of forum shopping, which he takes to be one of the main evils underlying pure universalism.[42] Although LoPucki does admit that modified universalism lowers the *stakes* that are affected by forum shopping under pure universalism, he believes that fact to be irrelevant because debtors will still forum shop, regardless of whether the stakes are a bit lower.[43] As an example, LoPucki points to the fact that, in the United States—where bankruptcy laws and procedures are generally uniform, and, consequently, the benefits of forum shopping are not as palpable—debtors engage in "rampant forum shopping among bankruptcy courts . . . ."[44] LoPucki also believes that because corporate bankruptcy is a big business, countries can and do compete for bankruptcy business, which presumably leads to a "race to the bottom" with respect to bankruptcy laws that are favorable to

33. *See* Adams & Fincke, *supra* note 1, at 59–64 (describing the Model Law and identifying modified universalism as the "key concept used by the Model Law").

34. *See id.* at 50 (noting that "[m]odified universalism embraces universalism's core belief of cooperation, but maintains the primacy of local courts' power to exercise discretion with respect to the 'fairness of the home country procedures' and with respect to protecting the interests of local creditors").

35. *Id.* at 51.

36. *Id.*

37. LoPucki, *supra* note 25, at 728.

38. *Id.* at 728–29.

39. *Id.* at 729.

40. *Id.*

41. *Id.* at 728.

42. *Id.* at 730.

43. LoPucki, *supra* note 25, at 730.

44. *Id.*

debtors.[45] For all these reasons, LoPucki believes that modified universalism is not a viable alternative to pure universalism.[46]

Cooperative territorialism, proposed by Professor LoPucki, starts from the other end of the spectrum—with the idea of pure territorialism—and incorporates aspects of universalism, albeit in a purely discretionary manner.[47] Under cooperative territorialism, each country is expected to administer its own bankruptcy case, with no one case to be considered a main case or an ancillary case, and with each country administering the assets located within its jurisdiction pursuant to local law.[48] "No nation need recognize foreign authority over domestic assets or sacrifice the interests of local debtors or creditors in particular cases. The elimination of that universalist tension provides the foundation for cooperation among courts and representatives that will be mutually beneficial in each case."[49] LoPucki suggests five areas that he believes ought to be the subject of cooperation:

> (1) the establishment of procedures for replicating claims filed [in a bankruptcy proceeding] in any one country in all of them; (2) the sharing of distribution lists by representatives to ensure that later distributions do not go to creditors who have already recovered the full amounts owed to them; (3) the joint sale of assets, when a joint sale would produce a higher price than separate sales in multiple countries or when the value of assets within a country is not sufficiently large to warrant separate administration; (4) the voluntary investment by representatives in one country in the debtor's reorganization effort in another; and (5) the seizure and return of assets that have been the subject of avoidable transfers.[50]

Cooperative territorialism is said to have a number of advantages. It solves the "home" country problem, it provides greater predictability to lenders, and it is a much less complex system than universalism.[51] LoPucki does recognize that cooperative territorialism comes with its own set of problems, but he believes that they are still less onerous than the problems encountered by modified universalism.[52] Among the evils he identifies with cooperative territorialism are: the requirement of multiple claim filing and prosecution, the fact that voluntary cooperation is not a requirement, the strategic removal of assets from one country to another before bankruptcy is filed, and the general lack of protection for what he terms "involuntary" creditors.[53]

The most serious problem that has emerged with LoPucki's cooperative territorialism appears to be that the regime does not *require* cooperation. When courts eschew cooperation, cross-border bankruptcies become messy fairly quickly. For instance, in *Lehman Brothers*, the English Court of Appeal came down with a

45. *Id.*
46. *See id.* at 720–32 (identifying the problems caused by modified universalism, and explaining why it is inferior to pure universalism). The authors here reserve any judgment regarding whether this conclusion is warranted, as it is beyond the scope of this article.
47. Adams & Fincke, *supra* note 1, at 56–58.
48. LoPucki, *supra* note 25, at 742–43.
49. *Id.* at 750.
50. *Id.*
51. *Id.* at 751–52.
52. *Id.* at 753–60.
53. *Id.* at 753–59.

decision that directly conflicted with a later U.S. bankruptcy court decision on the same exact issue.[54]

The weakness of cooperative territorialism has also been highlighted in the liquidation of Allen Stanford's banks,[55] which, due to the lack of cooperation among the various courts overseeing such liquidation, has led to some very interesting—and conflicting—rulings from Canadian and English courts. Broadly speaking, in the Stanford case there was a ruling from the Court of Appeals in England, recognizing the liquidation that is taking place in Antigua as a foreign main proceeding,[56] while two rulings of the Quebec Superior Court held to the contrary, finding the U.S. receivership to be the proper foreign main proceeding.[57] The recognition fights are important because the recognized proceeding will be able to recover assets in the ancillary country for purposes of distribution in the foreign main proceeding.[58] In addition to the battles taking place in Canada and England, the Antiguan liquidators and the U.S. receiver were gearing up for fights over assets situated in other locations, such as Switzerland.[59] In early 2010, there was also a pending application for recognition in the United States by the Antiguan liquidators as well as pending motions by creditors in the U.S. receivership for permission to file involuntary bankruptcy proceedings against Mr. Stanford's entities.[60] Apparently, in late January or early February 2010, the U.S. District Court judge presiding over the SEC receivership and the petition for recognition in the United States agreed to cancel various matters pending settlement discussions that were taking place between the U.S. receiver and the Antiguan liquidators.[61] Notably, as of February 2010, the U.S. receiver had collected approximately $145 million and spent 40% of that recovery—almost $58 million—in fees and costs for operating expenses, receivership costs, and fees.[62]

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54. Lehman Bros. Special Fin. Inc. v. BNY Corporate Tr. Servs. Ltd. (*In re* Lehman Bros. Holdings Inc.), 422 B. 407, 412 (Bankr. S.D.N.Y. 2010); Perpetual Tr. Co. Ltd. v. BNY Corporate Tr. Servs. Ltd. [2009] EWCA (Civ) 1160, [2010] Ch. 347 (Eng.); Stephen Lubben, *Lehman, Synthetic CDOs, Sapphires, etc.*, CREDIT SLIPS (Jan. 28, 2010), http://www.creditslips.org/creditslips/2010/01/lehman-synthetic-cdos-sapphires-etc.html (describing the two opinions).

55. For a somewhat outdated but informative description of the various ongoing cases that are liquidating Allen Stanford's banks, please see *The Stanford Sag—Chapter 16: Settlin' Words? Or Something Else?*, THE S. BAY L. FIRM L. BLOG (Feb. 15, 2010), http://www.southbaylawfirm.com/blog/?tag=stanford-financial-group.

56. *In re* Stanford Int'l Bank [2010] EWCA (Civ) 137, [2010] W.L.R. 941 (Eng.).

57. *In re* Stanford Int'l Bank Ltd., 2009 QCCS 4109 (Can.); *In re* Stanford Int'l Bank Ltd., 2009 QCCS 4106 (Can.). The decisions were later upheld by the Quebec Court of Appeals. *In re* Stanford Int'l Bank Ltd., 2009 QCCA 2475 (Can.). For a thoughtful analysis of these decisions, see Fraser Hughes, *Are We Moving Further Away From Common Principles: The Stanford Bank Decisions in England and Quebec*, 2010 CARIBBEAN INSOLVENCY SYMP. (Am. Bankr. Inst.) 243, *available at* http://www.abiworld.org/committees/newsletters/international/vol7num2/index.html.

58. *See* Matthew Campbell, *Stanford's Antigua Liquidators in Talks With Janvey*, BLOOMBERG (Feb. 5, 2010), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aw6RVvY6ASnU (discussing Janvey and the U.S. Department of Justice's appeal of a United Kingdom ruling prohibited them from controlling Stanford's U.K. assets and Vantis's consideration of appealing a Canadian court ruling that Janvey controls Stanford's Canadian assets).

59. *Id.*

60. Hughes, *supra* note 57, at 260; *The Stanford Saga—Chapter 10: "Bleak House" Redux?*, THE S. BAY L. FIRM L. BLOG (Oct. 19, 2009), http://www.southbaylawfirm.com/blog/?tag=jaime-alexis-arroyo-bornstein.

61. *The Stanford Saga—Chapter 16*, *supra* note 55.

62. Laurel Brubaker Calkins & Andrew M. Harris, *Stanford Lost It All in a Year: Fortune, Yachts, Right to Name*, BLOOMBERG (Feb. 17, 2010), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aV6OHeNbWQLo.

Suffice it to say that cooperation has been slow in coming in both the Lehman case and the Stanford case. The conflicting positions that have been taken in these cases undermine LoPucki's assumption that cooperation will take place between parties that are interested in an international insolvency, or even that cooperation will occur when there is enough money at stake to make it in everyone's best interests to cooperate.

Ultimately, despite the various benefits and costs associated with each modern model, what has currently emerged as the dominant theory is that of modified universalism. That is certainly the case in those countries that have adopted the Model Law. Still, aspects of cooperative territorialism emerge in the practice and the case law. It is far from irrelevant.

II. STATUTORY FRAMEWORK AVAILABLE IN THE UNITED STATES

Cross-border insolvencies do not exist in a vacuum. They occur against the backdrop of a given country's statutory law and common law (if any).[63] Consistent rules enhance the ability of creditors to assess risk and consequences in the event insolvency ensues.[64] It was to that end that such consistent effort was put into the development of a model law for handling the difficult issues of cooperation and coordination among countries when international insolvency cases occur.

The work and consensus-building involved in formulating and passing the Model Law was formidable, and not likely to be easily repeated.[65] Even if there were another, better model for handling cross-border insolvency cases, it is unlikely that such a model could supplant the existing Model Law—at least not in the foreseeable

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63. *See* Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings plc, [2006] UKPC 26, [16], [2007] 1 A.C. 508, (appeal taken from Isle of Man) (U.K.) (discussing the common law principle of universalism, which has been applied in England since 1764); SAMUEL L. BUFFORD, ET. AL., INT'L INSOLVENCY 1 (Fed. Judicial Ctr. 2001), *available at* http://www.fjc.gov/library/fjc_catalog.nsf/autoframepage!openform&url=/library/fjc_catalog.nsf/DPublication!openform&parentunid=5039C7BED064416285256CA30068DF69, (noting that the "legal rules governing insolvency law and practice are rooted deeply in the legal traditions of individual countries. In part this arises because insolvency law preempts and supersedes many rules of both substantive and procedural law . . . .").

64. Judge Bufford puts it this way:

> In calculating expected economic benefits, parties are assumed to take into account the legal systems and rules that will likely govern how their transactions are carried out and the benefits are allocated. In addition, the parties must evaluate the risks undertaken, including how these risks will be handled under the applicable legal system. If it is uncertain what legal system will govern the risks, it is difficult to quantify them. Where the distribution rules of legal systems are different, the ultimate beneficiaries of transactions may differ from those the parties have anticipated ex ante. Thus the application of varying distribution rules may result in the parties' entering into sub-optimal transactions, and leave them poorer than they would have been otherwise.

Samuel L. Bufford, *Global Venue Controls Are Coming: A Reply to Professor LoPucki*, 79 AM. BANKR. L.J. 105, 112 (2005).

65. After over two years of work and negotiation, UNCITRAL formally adopted the Model Law on Cross-Border Insolvency in 1997. *See* Rep. of the Working Grp. on Insolvency Law on the Work of Its Twenty-First Session, U.N. Gen. Assembly, U.N. Doc. A/CN.9/435; UNCITRAL, 30th Sess., paras. 1–9 (1997) (providing an overview of the parties involved and the work performed that ultimately resulted in the Model Law). In 2005, the United States enacted its version of the Model Law as Chapter 15 of the Bankruptcy Code. Jay Lawrence Westbrook, *Chapter 15 at Last*, 79 AM. BANKR. L.J. 713, 719 (2005). The long delay in adoption by the United States was caused by its inclusion in a larger reform bill whose consumer provisions were highly controversial. *Id.*

future. If we are to arrive at a sensible construct for when assets should or should not be turned over to a foreign proceeding when those assets are subject to a security interest, it must as a practical matter be done within the existing statutory schemes available to courts, creditors, and counsel. And this is so even though many countries have yet to adopt the Model Law. Already, the Model Law has gained sufficient traction that even countries that have not formally adopted it are nonetheless influenced by it in the manner in which they handle cross-border insolvency proceedings.

In fact, for two reasons, it is appropriate to further confine the analysis to the language of Chapter 15 of the Model Law as adopted in the United States. If the analysis offered here is to be of any real use to U.S. courts, one of the principal jurisdictions with a developed system of secured transactions, then it ought to be firmly linked to the law that U.S. courts must apply. Additionally, decisions in the United States are published and easily available via the Internet. Their sheer currency gives them greater persuasive power.

Moreover, as noted above, the law that U.S. courts are required to consult is unlikely to change in any significant way for the near term. First, it is extremely doubtful that the U.S. Congress will be able to obtain the consensus in the near term to modify, much less re-write, Chapter 15—and that assumes that Congress would even care to do so. Frankly, international insolvency issues do not generate much political excitement. Second, abandoning Chapter 15, or even specific terms of Chapter 15, in favor of some other, non-uniform provision would contravene one of the main goals of the Model Law: uniformity.

Consequently, we limit our analysis to what is available to courts in the United States: Chapter 15, and, when relevant, common law and case law interpreting the statute. Even within these constraints, however, there is ample room for creative analysis.

A. Former § 304

When Congress enacted § 304 of the Bankruptcy Reform Act,[66] it made a dramatic turn away from a history of territorialism and committed itself full tilt to the

66. Section 304, titled 'Cases ancillary to foreign proceedings,' provides in full:

> (a) A case ancillary to a foreign proceeding is commenced by the 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–
> (i) a debtor with respect to property involved 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

principles of modified universalism. Section 304 was "little short of revolutionary . . . [and] there is a broad consensus of scholarly acclaim for their inspired originality of vision."[67] In 2005, when the United States enacted the Model Law as Chapter 15 of the Bankruptcy Code, it continued its commitment to the ideals of modified universalism.[68] Not surprisingly, the case law under former § 304 is still relevant to the interpretation of Chapter 15, especially as it concerns the remedies available to a foreign representative once recognition has been granted.[69] Indeed, certain provisions of former § 304 survived the enactment of Chapter 15. For instance, § 304(c) was incorporated into § 1507 (although not in an identical fashion), which represented a studied elaboration of the language of Article 7 of the Model Law.[70]

Additionally, courts deciding issues that arise under §§ 1521(a)(5), (b), and 1522 have looked for guidance to decisions written under former § 304.[71] In *Atlas Shipping*, the court looked to former § 304 for guidance in determining the scope of relief that ought to be available to a foreign representative seeking turnover of accounts subject to garnishment liens considering the relief available under either § 1507 or § 1521(b), and in facing the prohibition on the use of Chapter 5 avoidance actions in Chapter 15 proceedings.[72] *Atlas Shipping* supported its use of § 304 jurisprudence by finding that:

> The philosophies underlying former § 304 were deference to the foreign proceeding and the prevention of the piecemeal distribution of the

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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 [11 U.S.C. §§ 101 et seq.];
(5) comity; and
(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns. Bankruptcy Reform Act of 1994, § 304, 108 Stat. 4132 (repealed 2005).

67. FLETCHER, *supra* note 9, para. 4.27, at 247.

68. The following countries have also implemented some version of the Model Law: "Australia (2008), British Virgin Islands; overseas territory of the United Kingdom of Great Britain and Northern Ireland (2003), Canada (2009), Colombia (2006), Eritrea (1998), Great Britain (2006), Japan (2000), Mauritius (2009), Mexico (2000), Montenegro (2002), New Zealand (2006), Poland (2003), Republic of Korea (2006), Romania (2003), Serbia (2004), Slovenia (2007), South Africa (2000), and the United States of America (2005)." *Status: 1997-Model Law on Cross-border Insolvency,* UNCITRAL, http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html (last visited August 26, 2010).

69. *See* Alan Gropper, *Current Developments in International Insolvency Law: A United States Perspective*, 927 PLI/COMM 867, 883–84, 898 (2010); *see also In re* Artimm, S.r.L., 335 B.R. 149, 158–166 (Bankr. C.D. Cal. 2005) (applying § 304 prior to its repeal but comparing and contrasting the new provisions of Chapter 15 to the former provisions in § 304); *see also In re* Iida, 377 B.R. 243, 256 (B.A.P. 9th Cir. 2007) (comparing old § 304 to the new provisions of Chapter 15).

70. Article 7 of the Model Law provides: "Nothing in this Law limits the power of a court or a *[insert the title of the person or body administering a reorganization or liquidation under the law of the enacting State]* to provide additional assistance to a foreign representative under other laws of this State." *Model Law*, *supra* note 22, art. 7.

71. *See, e.g.*, *In re* Milovanovic, 357 B.R. 250, 257 (Bankr. S.D.N.Y. 2006) (ordering the turnover of property subject to a judgment lien, with the creditor being permitted to assert its lien rights in the Serbian court where the main insolvency proceedings were then pending); *In re* Atlas Shipping A/S, 404 B.R. 726, 735 (Bankr. S.D.N.Y. 2009) (examining case law under former § 304 in deciding whether property subject to a garnishment lien should be turned over to a Danish insolvency representative, with the lien validity to then be determined by the Danish court pursuant to the Danish insolvency regime).

72. *In re* Atlas Shipping A/S, 404 B.R. 733, 741–42 (Bankr. S.D.N.Y. 2009).

> debtor's estate. Section 304 provided a bankruptcy court with broad discretion in fashioning an appropriate remedy in a particular case. Section 304(c) outlined several factors, including comity, which a court must consider before granting a foreign representative any type of relief .... [M]any of the principles underlying § 304 remain in effect under Chapter 15. Significantly, Chapter 15 specifically contemplates that the court should be guided by principles of comity and cooperation with foreign courts in deciding whether to grant the foreign representative additional post-recognition relief. This is evidenced by the pervasiveness with which comity appears in Chapter 15's provisions.[73]

Thus, when the foreign representative suggested that, under the principles of comity developed under § 304,[74] the U.S. court could apply Danish insolvency law rather than U.S. insolvency law to avoid the garnishment liens, the court agreed, going so far as to say that:

> Both *Cunard* [*Cunard S.S. Co. Ltd. v. Salen Reefer Servs. AB,* 773 F.2d 452 (2d. Cir. 1985)] and *Milovanovic* [*In re Milovanovic*, 357 B.R. 250 (Bankr. S.D.N.Y. 2006)] [both cases decided under § 304] stand for the proposition that attachments that would be void under foreign law should not be accorded special status just because the foreign representative initiated an ancillary proceeding here. Both cases also stand for the proposition that in such circumstances, the attachments would be dissolved and the funds returned to the foreign forum without prejudice to any of the creditors raising arguments in the foreign proceedings. Therefore, unless the adoption of Chapter 15 altered the principles of comity recognized in *Cunard* and *Milovanovic*, the Court would grant comity to the Danish proceedings and dissolve the seven attachments filed after the Danish bankruptcy was announced.[75]

Ultimately, *Atlas Shipping* voided the garnishment liens, turned over the accounts to the foreign representative, and held that the Danish courts would determine the rights of the creditors at issue in the case.

Historically, comity played a leading role in the United States' analytical approach to international bankruptcies;[76] however, with the enactment of § 304,

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73. *Id.* at 738 (internal citations omitted).

74. *Id.* at 733.

75. *Id.* at 736. More recently, in *In re The Int'l Banking Corp. B.S.C.,* 439 B.R. 614 (Bankr. S.D.N.Y. 2010), the court agreed with *Atlas Shipping* and denied (without prejudice) the request by a foreign administrator to (i) vacate two state court attachments, and (ii) turn over the cash subject to those attachments to the foreign administrator for distribution in the Bahraini proceeding, which had been recognized as a foreign main proceeding under Chapter 15. The court noted that it "would not hesitate to vacate the Attachment Orders and order the turnover of the Attached Funds if the attachment occurred after the commencement of the Bahraini proceeding ... or the Attachment Orders were plainly voidable under the law of the jurisdiction where the foreign bankruptcy is pending." *Id.* at 628.

76. *See In re* Artimm, S.r.L., 335 B.R. 149, 160–161 (Bankr. C.D. Cal. 2005) (saying that the sufficient protection of creditors language that exists in §§ 1521(b) is informed by the old § 304(c) factors.); *see also In re Atlas Shipping A/S*, 404 B.R. at 741–742 (saying that, although it is unclear how §§ 1507 and 1521 interact, "the legislative history confirms that Congress expected courts to interpret the provisions consistently with prior law under § 304."); *see also* McGrath v Riddell (*In re* HIH Cas. & Gen.Ins. Ltd.), [2008] UKHL 21, [30], [2008] 1 W.L.R. 856 (H.L.) (Lord Hoffmann) (appeal taken from Eng.) (U.K.)

comity became just one of six factors that were to be used to inform a cross-border insolvency issue. Specifically, in deciding whether to grant relief under § 304(b), courts were directed to measure the request against *all* six factors listed in subsection (c).[77] Ultimately, although courts took this directive to heart,[78] it could have been argued that because subsection (c)(5) explicitly listed "comity" as a factor, the remaining subsections of (c) existed merely to amplify the considerations that had always made up the comity analysis; such a reading of § 304(c) would have put foreign representatives right back into the dark ages of U.S. insolvency law (i.e., prior to 1978).[79] Thankfully, as noted above, courts did not so treat these additional § 304(c) subsections.[80] Instead, courts used § 304(c) as it was intended—to direct courts away from traditional comity analysis, thereby preventing them from simply invoking comity *vel non* to make its decision.[81] Indeed, in *Bank of N.Y. v. Treco,* the Second Circuit said:

> § 304(c) supplants the federal common law comity analysis conducted by courts pursuant to *Hilton*. It directs courts instead to use the statutory factors to balance the reasons for and against affording comity. But the statutory factors reflect the considerations that "have historically been considered within a court's determination whether to afford comity to a proceeding in a foreign nation." And application of those factors requires that comity not be extended in some circumstances.[82]

Ultimately, by giving courts a set of tools *other than* just comity with which they could work on cross-border bankruptcy issues, § 304 substantially advanced the idea of modified universalism in the United States.

(noting that principles of universalism have informed English courts' decisions with respect to turnover of assets).

77. Bank of N.Y. & JCPL Leasing Corp. v. Treco (*In re* Treco), 240 F.3d 148, 154 (2d Cir. 2001).

78. *Id.* at 148–58.

79. *See* Morales & Deutsch, *supra* note 13, at 19 (arguing that although the result in *In re* Culmer, 25 B.R. 621 (Bankr. S.D.N.Y. 1982), which was one of the first decisions interpreting § 304, was correct, the court's analysis was wrong in that it "equate[d] § 304(c) with the comity doctrine itself, [so as] to render comity the *only* controlling criterion . . .").

80. *See, e.g.*, *In re* Treco, 240 F.3d at 154 (citing to the legislative history of § 304 for the proposition that the guidelines in § 304 were "designed to give the court the maximum flexibility in handing ancillary cases"). The *Treco* court went on to note that, notwithstanding the clear directive to adhere to notions of comity in evaluating a request for assistance, the listing of factors also indicated Congress' clear intent that a given request be measured against each of those factors. "Section 304 does not implement pure universalism, however. The statute expressly directly courts to consider several factors before deferring to the foreign court." *Id.* In *Treco*, as will be discussed in greater detail later, the court concluded that one of those factors so strongly militated against according relief that relief was denied, regardless of its implications for comity. *Id.* at 159 (holding against the principle of comity based on the difference in prioritization under U.S. and Bahamian law).

81. Morales & Deutsch, *supra* note 13, at 19.

82. *In re* Treco, 240 F.3d at 158 (noting that, although courts in the Second Circuit had "decided a number of cases involving foreign bankruptcy proceedings based on principles of comity as developed by federal common law . . . [and] these cases inform our understanding of comity, our decision must ultimately rest on the statutory provision, § 304(c)"). The irony is that, in *Treco*, it was believed that a slavish adherence to common law comity analysis might lead to excessive *cooperation*. The court's insistence that all factors be consulted resulted in the court's concluding that cooperation should *not* be accorded in the case *sub judice*.

B. *Chapter 15*

Under Chapter 15, a foreign representative seeks recognition of a foreign bankruptcy proceeding with a view to being afforded certain "automatic" rights if the petition for recognition is granted as a main proceeding.[83] Chapter 15 differs from § 304 by divorcing the issue of recognition from the issue of relief sought upon recognition.[84]

Once a foreign representative gains access to United States courts via the recognition process (which is a fairly routine endeavor), judicial discretion once again plays a much larger role in the nature and scope of assistance afforded.[85] Even if the foreign proceeding is recognized as a foreign main proceeding, there is a sizable reservoir of additional relief available to the foreign representative.[86] And it is here, in these additional reservoirs, that the tension relating to property subject to a local security interest is likely to be most acute.[87]

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83. 11 U.S.C. § 1520 (2005). The distinction between a main and a non-main proceeding, contemplated under the Model Law, goes to the core of modified universalism, which presumes that global insolvency cases ought to be managed from a single forum under that forum's insolvency law. Getting that forum right matters much more in a scheme of modified universalism than it might in a scheme of, say, cooperative territorialism, as championed by Professor LoPucki. In deference to the importance of the main proceeding, § 1520 of the U.S. law (Article 20 of the Model Law) puts in place an automatic stay in favor of the foreign main proceeding–even if that proceeding's own laws does not afford a similarly broad remedy. It applies the expansive powers to use, sell, or lease property of the debtor within the territorial jurisdiction of the United States, a power which includes the realization of assets free of interests (including security interests). It authorizes the operation of the debtor's business within the United States by the foreign representative, without having to initiate a full bankruptcy case under Chapter 11. These are extraordinary powers, and they are automatically conferred upon recognition as a *main* proceeding. *See* 11 U.S.C. § 1520 (2005) (describing the effects of recognition of a foreign main proceeding).

84. *See In re* Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122, 132 (Bankr. S.D.N.Y. 2007) ("[S]ection 304 did not have a recognition requirement as a first step . . . Section 304 simply gave the United States courts the authority to open an ancillary proceeding and grant various broad forces of relief . . . . Chapter 15, on the other hand, imposes a rigid procedural structure for recognition of foreign proceedings.").

85. U. N. COMM. INT'L TRADE LAW, LEGISLATIVE GUIDE ON INSOLVENCY LAW, para. 154, U.N. Sales No. E.05.V.10 (2005) [hereinafter LEGISLATIVE GUIDE] ("Post-recognition relief under article 21 [§ 1521] is discretionary, as is pre-recognition relief under article 19 [§ 1519]."); *id.* para. 157 ("The 'turnover' of assets to the foreign representative . . . as envisaged in paragraph 2 [§ 1521(b)], is discretionary.").

86. 11 U.S.C. §§ 1519, 1521, 1507, 1522 (2005); Model Law, *supra* note 22, art. 21; LEGISLATIVE GUIDE, *supra* note 85, paras. 135–137, 154–157.

87. Consider that the automatic relief permitted in a main proceeding is couched in terms of the preexisting protections accorded secured creditors under other chapters of the Bankruptcy Code. Section 1520 makes § 362 applicable, but that section in turn self-refers to § 361, which defines "adequate protection" for purposes of the Code. 11 U.S.C. §§ 1520(a)(1), 361 (2005). "Adequate protection" is an essential element in § 362, and is a term of art with a well-developed body of case law. *See* United Savings Ass'n of Tex. v. Timbers of Inwood Forest Ass'n, 484 U.S. 365, 370 (1988) (discussing the meaning of adequate protection in light of §§ 361 and 362). Similarly, the use, sale, or lease of property subject to a security interest is governed by notions of adequate protection, and all of these concepts are imported into § 1520 by virtue of its express incorporation of § 363. 11 U.S.C. §§ 1520(a)(2), 363(e) (2005). And § 1520 by its own terms only authorizes the realization of assets. It does not authorize the transfer of those assets (or their proceeds) out of the jurisdiction of the United States, or their distribution in accordance with the distribution scheme of the foreign insolvency regime. Those remedies are only available under the discretionary provisions in § 1521. Thus, the foreign representative who wishes to actually remove the assets to another jurisdiction, and to distribute them in a manner that may be inimical to the interests of the secured creditor will have to seek relief under the discretionary provisions found in §§ 1521 and 1507. That, then, is where the tension arises.

As did former § 304(b)(2), §§ 1521(a)(5) and 1521(b) of Chapter 15 explicitly anticipate that foreign administrators might want to gain possession of assets located in the United States for administration and ultimate distribution elsewhere.[88] Unfortunately (or perhaps fortunately, for those who favor broad discretion in the hands of a U.S. bankruptcy judge), beyond the limitations found in §§ 1521(b) and 1522, no further specific guidance[89] is provided to help a court determine when it is appropriate to grant a request to remit local assets to the main case.[90]

The task of informing the court's discretion is especially difficult when security interests are involved.[91] In particular, § 1521(b), requires that, before allowing local assets to be taken to a home court for distribution, the bankruptcy court be "satisfied that the interests of creditors in the United States are *sufficiently protected.*"[92] Likewise, § 1522 also limits a court's ability to grant relief under § 1521 to situations in which "the interests of the creditors and other interested entities, including the debtor, are *sufficiently protected.*"[93] All that we are told about this phrase, so important to the task of moderating relief, is that it is not to be considered the same as "adequately protected," a term that has history and baggage that Congress intended not to import into these provisions of Chapter 15.[94]

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88. Bankruptcy Reform Act of 1994, § 304, 108 Stat. 4132 (repealed 2005); 11 U.S.C. §§ 1521(a)(5), 1521(b) (2005).

89. Of course, there are the broad policy directives of §§ 1501, 1506, and 1508, as well as the direction in §§ 1525 and 1527 that courts cooperate with one another. And there is the directive in § 1508 that the statute be interpreted consistent with its international origins. However, these broad principles are frustratingly unhelpful when a court is faced with a specific request. *See, e.g.*, Rubin v. Eurofinance SA, [2009] EWHC (Ch) 2129, [71], [2010] All E.R. (Comm.) 81 (noting that "what was contemplated was that there should be practical co-operation and communication within the framework of the law in both States, but not that one State should disregard important provisions of its own legal system").

90. 11 U.S.C. §§ 1508, 1519, 1521(b), 1522(a), 1522(b) (2005). Section 1521(b) says that "the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in the United States to the foreign representative . . . provided that the court is satisfied that the interests of creditors in the United States are *sufficiently protected.*" 11 U.S.C. § 1521(b) (2005) (emphasis added). Section 1522(a) says that the court "may grant relief under § 1519 or 1521, or may modify or terminate relief under subsection (c), only if the interests of the creditors and other interested entities, including the debtor, are *sufficiently protected.*" 11 U.S.C. § 1522(a) (2005). Section 1522(b) adds that the court can condition the grant of relief under §§ 1519 or 1521 "to conditions it considers appropriate, including the giving of security or the filing of a bond." 11 U.S.C. § 1522(b) (2005). The discretion is accordingly broad, and the intention to protect affected parties is similarly clear, but the statutory scheme is light on the details. The court's discretion is accordingly broad, but it is informed only by the court's own good judgment, and the directive in § 1508 that the statute be interpreted with a consideration for its international origins, a clear reference to the Model Law's adoption of modified universalism as its underlying theme and thrust.

91. *But see In re* Tri-Cont'l Exch., 349 B.R. 627, 637–38 (Bankr. E.D. Cal. 2006) (believing the tools available under Chapter 15 to deal with a foreign representative's request under § 1521(a)(5) to be ample based upon the language of § 1522 and § 1506). This paper does not quarrel with the *Tri-Continental* court's description of Chapter 15's provisions, its citation to the Model Law's Guide to Enactment, or its analysis. But our point goes further in that Chapter 15 does not provide much guidance for purposes of determining whether, in granting relief under § 1521, the court is also sufficiently protecting the interests of creditors and other interested entities, including the debtor. The devil is always in the details. We will return to *Tri-Continental* later to discuss its handling of a judgment lien creditor claiming to be secured, and a foreign representative's efforts to gain control over property potentially subject to that judgment lien.

92. 11 U.S.C. § 1521(b) (2005) (emphasis added).

93. 11 U.S.C. § 1522(a) (2005) (emphasis added).

94. *See* H. R. REP. NO. 109-31, § 1521, at 115 (2005) ("The word 'adequately' in the Model Law, articles 21(2) and 22(1), has been changed to "sufficiently" in sections 1521(b) and 1522(a) to avoid confusion with a very specialized legal term in United States bankruptcy, 'adequate protection'.").

An additional section that a foreign representative might think to use in making a request for a turnover of assets is § 1507.[95] Although "[t]he interplay between the relief available under §§ 1507 and 1521 is far from clear,"[96] it is probably true that relief available under § 1521 is not limited by the factors of § 1507.[97] The converse is probably true as well: courts should not construe the range of relief under § 1507 to be bound by the same limitations that apply in § 1521. Section 1507 is titled "additional assistance," after all.[98] But additional assistance under § 1507 *is* "subject to the specific limitations stated elsewhere in this chapter . . . ."[99] More significantly, additional assistance is permitted only after consideration of the specific factors listed in § 1507(b)—the old § 304(c) factors.[100] Given its lineage, it is unlikely that relief

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95. 11 U.S.C. § 1507 (2005), titled "Additional assistance" provides in full:

> (a) Subject to the specific limitations stated elsewhere in this chapter [11 USCS §§ 1501 et seq.] the court, if recognition is granted, may provide additional assistance to a foreign representative under this title or under other laws of the United States.
> (b) In determining whether to provide additional assistance under this title or under other laws of the United States, the court shall consider whether such additional assistance, consistent with the principles of comity, will reasonably assure--
> (1) just treatment of all holders of claims against or interests in the debtor's property;
> (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
> (3) prevention of preferential or fraudulent dispositions of property of the debtor;
> (4) distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by this title; and
> (5) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

In contrast to § 1507, Article 7 of the Model Law provides: "Nothing in the present Law limits the power of a court or a [*insert the title of the person or body administering a reorganization or liquidation under the law of the enacting State*] to provide additional assistance to a foreign representative under other laws of this State." Model Law, *supra* note 22, art. 7. Congress thus made a studied decision to preserve the former § 304(c) standards in § 1507, as an additional reservoir of judicial discretion. *See In re* Atlas Shipping A/S, 404 B.R. 726, 740 (Bankr. S.D.N.Y. 2009) (discussing the additional protections that maybe available under § 1507 as additional protections to § 1521).

96. *In re Atlas Shipping A/S*, 404 B.R. at 741.

97. *See id.* at 741 n.11 ("The legislative history makes clear that '[§ 1507] is intended to permit the further development of international cooperation begun under *§ 304, but is not the basis for denying or limiting relief otherwise available under this chapter*.'" (quoting H. R. REP. NO. 109-31, at 115 (2005)).

98. In *Atlas Shipping*, Judge Glenn noted the difference of the actual language used in § 1507 compared to § 1521. Section 1507 allows a "court to grant '*additional assistance*' to the trustee . . . [compared to] the language in § 1521 allowing the court to fashion *'any appropriate relief'* to fit the circumstances of the case." *In re Atlas Shipping A/S*, 404 B.R. at 741. The court rejected the contention that the factors in § 1507 should be read to *limit* the scope of relief intended by the phrase 'any appropriate relief' in § 1521. *Id.*

99. 11 U.S.C. § 1507(a) (2005). It is possible to argue that this "subject to" language is intended to invoke the considerations contained in § 1522. However, the lack of a cross reference to § 1507 in § 1522 itself more likely means that additional assistance is not necessarily subject to the "sufficiently protected" standard in § 1522. Instead, only the factors in § 1507(b) would function as delimiters on "additional assistance." If that approach is taken, then the "subject to" language in § 1507(a) must refer to limitations other than those stated in § 1522. Possible candidates (by way of example) might be the limits imposed on foreign representatives of non-main proceedings, or the limits specified in § 1513(b) regarding allowability or priority of certain kinds of claims, or the prohibition on foreign representatives bringing Chapter 5 avoidance actions under the aegis of Chapter 15.

100. *In re Atlas Shipping A/S*, 404 B.R. at 740–41. The redesign of § 1507 is likely to permit courts to color slightly more outside the lines than they might free to do under former § 304(c). The comity consideration was moved from the listing of factors up to the chapeau of the statute, indicating Congress' intent that courts, in applying § 1507(b) give greater attention to comity considerations when considering a request for additional assistance under this section. *See, e.g.*, *In re* Metcalfe & Mansfield Alt. Inv., 421

under § 1507 will much exceed the sort of relief that would have been permitted under former § 304(c)—at least insofar as handing over assets that are subject to a security interest.[101]

As alluded to above, a request for turnover of assets that constitute the collateral of a local secured creditor for distribution in a main case is no doubt one form of relief that is specifically contemplated by, and allowed by, Chapter 15.[102] However, in a scheme of modified universalism, as opposed to pure universalism, the ancillary court retains the power to deny such relief in certain circumstances.[103] Just what those "certain circumstances" might be is the question that is left unanswered by the language of the statute. Clearly, denying relief will be appropriate when to grant it would be manifestly contrary to the public policy of the United States,[104] or when the interests of creditors are clearly unprotected.[105] On the other hand,

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B.R. 685, 696 (Bankr. S.D.N.Y. 2010) ("Here, the Monitor asks the Court to provide 'additional assistance' under § 1507, specifically an order enforcing the Canadian Orders in the United States. *Section 1507* directs the court to consider comity in granting additional assistance to the foreign representative.").

101. That said, not all security interests are created equal. In *Atlas Shipping*, the security interest in question was a garnishment lien in favor of a previously unsecured creditor, obtained within a suspect period prior to the commencement of proceedings in Denmark. *In re Atlas Shipping A/S*, 404 B.R. at 730. The court turned over the asset in question (a bank account) without imposing any special conditions for the preservation of the lien. *See id.* at 747 (noting that the foreign representative could take the funds if "such funds are hereby subjected to the jurisdiction and administration of the Danish bankruptcy court" but not imposing other conditions). The court relied on § 1521(b) as its primary authority, declining to use the factors in § 1507 to *limit* the relief that would otherwise there be available. *Id.* at 741. It also declined to find that any special protection needed to be accorded under § 1522(b) (which permits the imposition of a security or bond in order to "sufficiently protect" a creditor's interest), because the real question had less to do with *protecting* the security interest, and more to do with whether the creditor was even *entitled* to a security interest at all. *See id.* at 739–42 (discussing available protections under § 1522(b), but focusing its discussion on whether U.S. creditors were "sufficiently protected." The Court then granted relief to the foreign representative.). That question, the court concluded, was best decided by the court presiding over the foreign proceeding, and not by the ancillary court—especially as the ancillary court would first have to make a choice of law decision regarding whether to apply Danish insolvency law or local non-insolvency law. *See id.* at 742 (ordering turnover to the foreign representative subject to its administration by the Danish bankruptcy court because it was "economical and efficient"); *see also In re Int'l Banking Corp.*, 439 B.R. at 629–30 (noting that the preferable course in that case was to defer to the Bahraini court decision on whether the attachment orders in that case were avoidable under Bahraini law.). What was clear to the *Atlas* court at the very least was that the U.S. insolvency law would only be relevant by analogy—there would be no reason to apply U.S. insolvency law to the question of the validity of the garnishment lien when there was no U.S. insolvency proceeding then pending. *See In re Atlas Shipping A/S*, 404 B.R. at 744 (distinguishing *Condor* as "inapplicable to this case since the foreign representative had not commenced an avoidance action under U.S. or foreign law").

102. 11 U.S.C. § 1521(b) (2005).

103. *See* Westbrook, *supra* note 65, at 726 (describing the United States' "discretion to fashion and limit relief depending on the circumstances of the case, including the fair treatment of United States creditors in the foreign proceeding" under a system of modified universalism).

104. 11 U.S.C. § 1506 (2005).

105. 11 U.S.C. §§ 1521(b), 1522 (2005). As noted above, in *In re Int'l Banking Corp.*, Judge Bernstein denied the request of a foreign administrator that the court vacate two state order attachments and remit the cash subject to the attachments to the foreign administrator to distribute in the Bahraini proceeding. Judge Bernstein denied the request without prejudice because the foreign administrator did not show how it would protect those attachments in the Bahraini proceeding. In other words, the foreign administrator "put[] the cart before the horse. The Attachment Orders created [perfected liens under New York law]. If the Court vacates the Attachment Orders and 'unseizes' the Attached Funds, entrusting the Attached Funds to the Administrator for administration in Bahrain, the Banks are justifiably concerned that 'there will be no attachments that could be 'upheld' in the Administration. Thus, the Administrator essentially asks this Court to destroy [the secured creditors'] security interest even though it might be found valid (as it should be) in the Administration.' In short, a turnover order may grant the Administrator the ultimate relief it seeks but is not entitled to in the first place." *In re Int'l Banking Corp.*, 439 B.R. at 629. Judge Bernstein also noted that the foreign administrator did not say how it intended to protect the secured creditors' interests until such time as the assets could be administered in the Bahraini proceeding. *Id.*

granting relief is an easy decision when the secured creditor consents to the turnover, or when the foreign regime to which the assets will be subject is equally as solicitious of protecting the secured creditor's interests as would be a U.S. court in a U.S. insolvency proceeding. This article accomplishes nothing if it only addresses the easy scenarios. Our task is to attempt to find guidance for the meaning of "sufficiently protected" when the interests of a secured creditor are at stake, to explore when (if ever) a secured creditor's rights ought to be held paramount as a matter of public policy, and to consider how § 1507 relief ought to be shaped when that relief threatens a secured creditor's rights. Already, there is some guidance in the case law, from both the United States and England.

III. SECURED CREDITORS' RIGHTS IN BANKRUPTCY

Long before the enactment of either the Model Law in 1997, or its adoption in the United States as Chapter 15 in 2005, and outside of the arena of international bankruptcy law, courts have grappled with the manner in which insolvency laws should be permitted to alter secured creditors' rights. A case worth special consideration, because of its influence on the intersection of insolvency law and secured transactions, is the Supreme Court's decision from 1935 in *Louisville Joint Stock Land Bank v. Radford.*[106] In *Radford*, the Court struck down the Frazier-Lemke Act because it violated the Takings Clause of the Fifth Amendment of the U.S. Constitution.[107] Broadly speaking, the Frazier-Lemke Act provided that "a farmer who has failed to obtain the consents requisite to a composition under section 75 of the Bankruptcy Act, may, upon being adjudged a bankrupt, acquire alternative options in respect to mortgaged property[.]"[108] The Court found that the Frazier-Lemke Act was unconstitutional because it compelled the mortgagee to relinquish the property to the mortgagor free of the lien notwithstanding the fact that the mortgage was not paid in full at some point in time through application of the security interest: in other words, it deprived the creditor of its interest in property—the mortgage—without just compensation.[109] The Court distinguished the Frazier-Lemke Act from the mere restructuring of secured debt in a bankruptcy case, which

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Ultimately, Judge Bernstein denied the administrator's request without prejudice, directing the parties to seek a ruling by the Bahraini court as to whether the attachments were avoidable. *Id.* Once the Bahraini court had ruled, Judge Bernstein would allow the prevailing party to come back before him to "ask that comity be afforded to the Bahraini court's decision." *Id.* It is clear that in *Int'l Banking Corp.* Judge Bernstein put a little meat on the bones that make up the term "sufficiently protected." It seems that Judge Bernstein's intent was to ensure that the secured creditors had the ability to enforce their interests in the *Bahraini proceeding*, without regard to the manner in which the Bahraini court decided the issue. In other words, Judge Bernstein felt that, if he voided the attachments in the U.S., it would preclude those creditors from enforcing their liens in the foreign proceeding at all.

106. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935).

107. *Id.* at 601–02.

108. *Id.* at 575.

109. *Id.* at 581–82. Note that the right that is preserved is not the "right" to be paid in full (there is no such right), but rather the right to seek payment in full through the application of the mortgage, *i.e.*, through recourse to the collateral; *id.* at 582 (stating that "[s]tatutes for the relief of mortgagors, when applied to preexisting mortgages, have given rise, from time to time, to serious constitutional questions. The statutes were sustained by this Court when, as in *Home Building & Loan Assn. v. Blaisdell*, 290 U.S. 398, 78 L. Ed. 413, 54 S. Ct. 231, they were found to preserve substantially the right of the mortgagee to obtain, *through application of the security*, payment of the indebtedness. They were stricken down, as in *W. B. Worthen Co. v. Kavanaugh, ante*, p. 56, when it appeared that this substantive right was substantially abridged." (emphasis added)).

involves intrusions into the creditor's unfettered right to access to its interest in property, but not the entire elimination of its property right.[110] Here is what the Court said:

> No bankruptcy act had undertaken to modify in the interest of either the debtor or other creditors any substantive right of the holder of a mortgage valid under federal law. Supervening bankruptcy had, in the interest of other creditors, *affected in some respects the remedies available to lien holders.* In *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry.*, 294 U.S. 648, 79 L. Ed. 1110, where, in a proceeding for reorganization of a railroad under section 77 of the Bankruptcy Act (11 USCA s 205), the District Court was held to have the power to enjoin temporarily the sale of pledged securities, this court said: 'The injunction here in no [way] impairs the lien, or disturbs the preferred rank of the pledgees. It does not more than suspend the enforcement of the lien by a sale of the collateral pending further action. It may be, as suggested, that during the period of restraint the collateral will decline in value; but the same may be said in respect of an injunction against the sale of real estate upon foreclosure of a mortgage; and such an injunction may issue in an ordinary proceeding in bankruptcy. *Straton v. New*, 283 U.S. 318, 321, 75 L. Ed. 1060, and cases cited.' 'The injunction here goes no further than to delay the enforcement of the contract. *It affects only the remedy.*' . . .
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> Nor do the provisions of the bankruptcy acts concerning compositions afford any analogy to the provisions of paragraph 7 [of the Frazier-Lemke amendment]. So far as concerns the debtor, the composition is an agreement with the creditors in lieu of a distribution of the property in bankruptcy—an agreement which 'originates in a voluntary offer by the bankrupt, and results, in the main, from voluntary acceptance by his creditors.' So far as concerns dissenting creditors, the composition is a method of adjusting among creditors rights in property in which all are interested. In ordering the adjustment, the bankruptcy court exercises a power similar to that long exercised by courts of law; and of admiralty. It is the same power[,] which a court of equity exercises when it compels dissenting creditors, in effect, to submit to a plan of reorganization approved by it as beneficial and assented to by the requisite majority of the creditors. In no case of composition is a secured claim affected except when the holder is a member of a class; and then only when the composition is desired by the requisite majority and is approved by the court. Never, so far as appears, has any composition affected a secured claim held by a single creditor. Compositions are comparable to the voluntary adjustment with the mortgagee provided for in Paragraph 3 of the Frazier-Lemke amendment (11 USCA s 203(s)(3). They are not analogous to the so-called adjustment compelled by paragraph 7 (11 USCA s 203(s)(7).[111]

110. *Id.* at 583–86.

111. *Louisville Joint Stock Land Bank*, 295 U.S. at 583–86 (citations omitted) (emphasis added).

As strong a statement of rights as *Radford* may appear (and despite the fact that it has never been overruled), it has been substantially limited over the years. *Radford* itself set out what it claimed were five essential attributes of a secured creditor's property rights, suggesting that all five such rights are protected from incursion by the Takings Clause.[112] As one court candidly stated, were *Radford* in its unadulterated state still the law, many provisions of the current Bankruptcy Code (including the very heart of Chapter 12) would be rendered unconstitutional.[113] The Supreme Court, over the years, has diluted the apparent holding of *Radford* itself. In *Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke,* the Court interpreted *Radford* as having struck down the Frazier-Lemke Act only because "the effect of the statute *in its entirety* was to deprive the mortgagee of his property without due process of law."[114] Then, in 1940, the Court completed its departure from *Radford*'s strict limits in *Wright v. Union Central Life Ins. Co.*[115] The *Union Central* Court said that "[s]afeguards were provided to protect the rights of secured creditors . . . to the extent of the value of the property. There is no constitutional claim of the creditor to more than that."[116] The Supreme Court opted for the *Union Central* approach over the *Radford* rationale in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.* holding that a secured creditor did not have a right to relief from stay solely because it was not receiving compensation for the lost opportunity cost resulting from not having immediate recourse to its collateral.[117]

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112. *Id.* at 594–95, 601–02. (listing the following rights):

> 1. The right to retain the lien until the indebtedness thereby secured is paid.
> 2. The right to realize upon the security by a judicial public sale.
> 3. The right to determine when such sale shall be held, subject only to the discretion of the court.
> 4. The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.
> 5. The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt.

Louisville Joint Stock Land Bank, 295 U.S. at 594–95. In fairness, it must be noted that these rights were themselves gleaned from what the Court understood the state law there in question (in that case, Kentucky) assured to secured creditors.

113. Albaugh v. Terrell, 93 B.R. 115, 118 (E.D. Mich. 1988), *rev'd on other grounds*, 892 F.2d 469 (6th Cir. 1989).

114. 300 U.S. 440, 457 (1937) (emphasis added).

115. 311 U.S. 273, 278 (1940).

116. *Id.* at 278 (citation omitted) (emphasis added).

117. 484 U.S. 365, 375 (1988). The Court in *Timbers* does not cite to either *Union Central* or *Radford*, and never directly discusses the Fifth Amendment implications of Chapter 11 of the 1978 Bankruptcy Code. Were *Radford* the controlling precedent, it is difficult to see how the Court could have avoided the constitutional implications of the Code's treatment of a secured creditor's claim, however. Admittedly, the automatic stay is the equivalent of a temporary injunction, and so is arguably not a "taking" as such. Still, under *Radford*, even that would be an issue because of the impact of an extended Chapter 11 on one or more of the "bundle of rights" that makes up a secured creditor's interest in property. Instead, the Court in *Timbers* simply said "[i]t is common ground that the "interest in property" referred to by § 362(d)(1) includes the right of a secured creditor to have the security applied in payment of the debt upon completion of the reorganization; and that that interest is not adequately protected if the security is depreciating during the term of the stay." *Id.* at 370. In other words, the secured creditor's rights during the course of the proceeding were sufficiently protected so long as the *value of the collateral* was protected

The principles articulated in *Radford, Union Central*, and later Supreme Court decisions are reflected in the structure of the current U.S. Bankruptcy Code, which clearly allows for the *rights* of holders of secured claims to be altered—even significantly altered—so long as their collateral *value* is preserved.[118] It is only a complete taking of a secured creditor's property interests that is proscribed by the Fifth Amendment. Put another way, "the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral. Compare *Hanover National Bank v. Moyses*, [186 U.S. 181, 188 (1902)] with *Louisville Joint Stock Land Bank v. Radford, supra*, and *Kaiser Aetna v. United States*, 444 U.S. 164 (1979)."[119] The Bankruptcy Code offers an example of a statute that permits considerable intrusion into a secured creditor's contractual rights, but cannot be said to entirely extinguish those rights.[120] For instance, § 506(a) provides:

> [a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title [11 U.S.C.S. § 553], is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in

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from diminution. That is consistent with the approach taken in *Union Central*.

118. *But see* United States v. Sec. Indus. Bank, 459 U.S. 70, 75–76 (1982) (holding that § 522(f) could validly extinguish non-possessory non-purchase money liens on consumer goods on a prospective basis, though it could not be construed to apply retroactively to liens created prior to the statute's enactment, because that would constitute a taking under the Takings Clause of the Fifth Amendment). The Court explained:

> Since the governmental action here would result in a *complete destruction* of the property right of the secured party, the case fits but awkwardly into the analytic framework employed in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978), and *Prune-Yard Shopping Center v. Robins*, 447 U.S. 74 (1980), where governmental action affected some but not all of the "bundle of rights" which comprise the "property" in question. The Government argues that the interest of a secured party such as was involved here is "insubstantial," apparently in part because it is a nonpurchase-money, nonpossessory interest in personal property. The "bundle of rights" which accrues to a secured party is obviously smaller than that which accrues to an owner in fee simple, but the Government cites no cases supporting the proposition that differences such as these relegate the secured party's interest to something less than property. And our decisions in *Radford, supra*, and *Armstrong v. United States*, 364 U.S. 40 (1960), militate against such a proposition.

Sec. Indus. Bank, 459 U.S. at 75–76 (emphasis added). The statute survived constitutional muster on a prospective basis because it described a particular category of liens which, as a matter of public policy, could be extinguished and the holders of such liens would know, *before taking the lien*, that existing law made such liens vulnerable to extinguishment as a matter of federal law. No taking takes place in that circumstance because the property right itself is subject to the risk of extinguishment as a matter of law. In other words, the federal enactment constitutes part of the nature of the property right that can be acquired by a lender.

119. *Id.* at 75.

120. However, a federal enactment *could* deprive a secured creditor of its property rights if those rights were obtained after a federal statute was enacted, *supra* text accompanying note 118.

> conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.[121]

Obviously, when a secured creditor's claim is bifurcated, the creditor is no longer getting the absolute benefit of the bargain it struck with the debtor pre-petition. Its contractual rights have been abridged. That is permitted. Its lien rights, to the extent required by the Takings Clause of the Fifth Amendment, as construed by the Supreme Court, are preserved because § 506 properly equates the secured creditor's property interests with the value of its collateral.[122] Similarly, in a Chapter 11 plan, under § 1129(b)(2)(A), the value of a secured creditor's claim may not be what he or she had bargained for pre-petition.[123]

The *Philadelphia Newspapers* decision is particularly instructive regarding the extent to which a secured creditor's "bundle of rights" may be affected without in the process destroying that creditor's rights. The court there said that a plan could provide for the sale of the assets of the debtor and could also bar the creditor from credit bidding.[124] It reached that conclusion by noting that § 1129(b)(2)(A) provides for a third alternative basis for confirming a plan over the objection of a secured creditor, namely a finding by the court that the plan provides for "the realization by such holders of the indubitable equivalent of such claims."[125] According to the Fifth Circuit, in a decision quoted with favor by the *Philadelphia Newspapers* court,

> Congress did not adopt indubitable equivalent as a capacious but empty semantic vessel. Quite the contrary, these examples focus on what is really at stake in secured credit: repayment of principal and the time value of money. Clauses (i) and (ii) explicitly protect repayment to the extent of the secured creditors' collateral value and the time value compensating for the risk and delay of repayment. Indubitable equivalent is therefore no less demanding a standard than its companions.[126]

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121. 11 U.S.C. § 506(a)(1) (2005).

122. *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. at 365–66.

123. *See, e.g.*, *In re* Phila. Newspapers, LLC, 599 F.3d 298, 316–17 (3d Cir. 2010) (stating that "the Code provides for a variety of treatments of secured claims, all of which are calculated to balance the interests of the secured lender and the protection of the reorganized entity, and none of which ensure an advantageous return on a secured investment.").

124. *Id.* at 301. Credit bidding means simply that, in a sale of assets subject to a security interest, the secured creditor may "bid" for the assets using the debt owed to it, rather than having to make a cash bid for the assets. Credit bidding not only permits the creditor to make use of its offset rights, but also allows the creditor to prevent the asset from being sold for an amount that is less than the amount of the debt owed the secured creditor. *See* 11 U.S.C. § 363(k) (stating that a lender may "offset" the claim against the purchase price). Credit bidding assures that the asset will not be sold for less than what the debtor owes the creditor. However, credit bidding could also be used as a holdup tactic, with the secured creditor insisting on payment that exceeds the true value of the asset.

125. 11 U.S.C. § 1129(b)(2)(A)(iii) (2005); *In re Phila. Newspapers*, 599 F.3d at 318–19.

126. *In re Phila. Newspapers*, 599 F.3d at 311, (quoting *In re* Pacific Lumber Co., 584 F.3d 229, 246 (5th Cir. 2009); *see also In re* Sun Country Dev., Inc., 764 F.2d 406, 409 (5th Cir. 1985) (holding that notes at issues "were the indubitable equivalent" of a creditor's lien on property). It was the time value of money that created the problem in *Radford*. Under the Frazier-Lemke Act, a debtor could, under some circumstances, keep the property for 10 years, while repaying the creditor for the value of the property over that period at one percent. The Court noted that, under that repayment scheme, the creditor would not receive the value of its collateral, because, at that rate, the present value of the deferred payments would be less than the appraised value of the property. *See* Louisville Joint Stock Land Bank v. Radford,

Thus, secured claims, while deserving of a level of protection under U.S. law (and of course under the U.S. Constitution), are nonetheless subject to considerable modification in the course of a U.S. insolvency proceeding: the interest rate may change, the maturity date may be altered, the terms of payment may be amended, the creditor's credit bid rights may be suspended, its right to resort to its remedies against its collateral may be delayed, and its deficiency claims may be reduced or eliminated. In short, many sticks may be removed from the bundle of rights that constitute a secured creditor's property interest arising from its security interest.

IV. LEARNINGS FROM THE JURISPRUDENCE

While it is certainly the case that, under Chapter 15, the ancillary court is not to measure its relief on the basis of whether the main proceeding's insolvency laws mirror those of the United States, there is nonetheless a lesson from the foregoing exercise. A security interest is not sacrosanct. It can be subjected to substantial alteration in the course of an insolvency proceeding. Boiled down to its essence, the question for a court considering a request to release assets subject to a security interest is not whether a turnover of assets subject to a security interest changes the creditor's recovery—the creditor's remedy is often altered by virtue of bankruptcy, be it an American bankruptcy or a foreign bankruptcy. Rather, the question is whether the turnover of assets subject to a secured creditor's claim would so undermine the creditor's secured claim that it could be said that the creditor would, as a result, no longer have a security interest at all.

Still, the inquiry is not an easy one. Consider, for example, the fact that, by virtue of our federalist system of governance, a secured creditor's property right is created by state law, while our insolvency system is a creature of federal law.[127] Article VI, clause 2, of the constitution permits a federal enactment to preempt state law. Thus, a secured creditor's rights, although created by state law, may be altered by the Bankruptcy Code.[128] Once such a statute is enacted, the fact that it places a secured creditor's entitlements in jeopardy does not raise a takings problem unless the law deprives a creditor of a right created *prior* to the enactment of that law.[129] No such similar pre-emption analysis can be said to apply if a *foreign* insolvency regime impinges on those same rights. Consider the following hypothetical: a U.S. court, acting under the authority of § 1521(b), turns over assets to a foreign representative such that a secured creditor's interest in the collateral is destroyed. Could it be argued that the court's action should be proscribed by the Takings Clause of the Fifth Amendment? Should the answer be different if the secured creditor's rights in its collateral would be merely impinged? Merely affected?

There is also the question of whether the court's reasons for resisting turnover would spring from the existing conceptual notions in Chapter 15 or from elsewhere.

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295 U.S. 555, 575, 595–99 (1935) (finding that "all deferred payments [would] bear interest at the rate of 1 per cent per annum," and holding in favor of the bank).

127. *See, e.g.*, Graber v. Fuqua, 279 S.W.3d 608, 623 (Tex. 2009) ("The disposition of the debtor's property is governed by federal law, although a debtor's property interests are generally created and defined by state law unless a federal purpose requires otherwise.")(Internal quotation omitted).

128. *See* U.S. CONST. art. VI, cl. 2 (providing that federal law should be the "the supreme Law of the Land; and the Judges in every state shall be bound thereby").

129. *See* United States v. Sec. Indus. Bank, 459 U.S. 70, 81 (1982) ("No bankruptcy law shall be construed to eliminate property rights which existed before the law was enacted in the absence of an explicit command from Congress.").

Should a court decline turnover as a matter of public policy? If so, then the court must recall that § 1506 restricts use of the public policy exception to actions that would be "manifestly contrary" to U.S. public policy.[130] The "manifestly contrary" phraseology was intentionally used in the Model Law to invoke the international usage designed to "restrict[] the public policy exception to 'the most fundamental policies of the United States.'"[131] In the *Ephedra* case, the district court overruled an objection filed by certain creditors to the enforcement of a Canadian order setting procedures for claim objections that did not include a right to a jury trial.[132] It said that "neither § 1506 nor any other law prevents a U.S. court from giving recognition and enforcement to a foreign insolvency procedure for liquidating claims simply because the procedure alone does not include a right to jury."[133] The court added,

> In adopting Chapter 15, Congress instructed the courts that the exception provided therein for refusing to take actions "manifestly contrary to the public policy of the United States" should be "narrowly interpreted," as "[t]he word 'manifestly' in international usage restricts the public policy exception to the most fundamental policies of the United States." . . . Determining what foreign procedures are "'manifestly contrary to the public policy of the United States" is, moreover, familiar territory to federal courts, who have long had to confront similar issues when determining whether or not to enforce foreign judgments rendered on the basis of foreign proceedings that were plainly fair but that did not include some commonplace American practice.[134]

If the statutory basis for resisting turnover is drawn from §§ 1521(b) and 1522(a), then the court must ground its decision on the statute's directive that the interests of the secured creditor are "sufficiently protected." Yet, here too a court will face the difficulty of infusing this expression with content in view of the legislative history, which noted that this phraseology was employed expressly to *avoid* importing the body of jurisprudence that has built up around the expression "adequately protected."[135] That clear a directive must surely steer courts away from simply re-importing that jurisprudence.

Nor should any of the foregoing musings be mistaken for a frustration that courts ought to have adequate tools to resist turnover; quite the opposite. In a scheme of global insolvency committed to the principles of modified universalism, courts should rightly eschew the temptation suddenly to become territorialist when it is a secured creditor waving the bloody shirt of the Takings Clause in the face of efforts to centralize the insolvency process in a single forum. The Model Law, even as adopted in the United States, dictates that, in interpreting its provisions, a court "shall consider its international origin, and the need to promote an application of [the law] that is consistent with the application of similar statutes adopted by foreign jurisdictions."[136] That principle of necessity should warn off territorialist

130. 11 U.S.C. § 1506 (2005).
131. H. R. REP. NO. 109-31, § 1506, at 109 (2005).
132. *In re* RSM Richter Inc. v Aguilar (*In re* Ephedra Prods. Liab. Litig.) 349 B.R. 333, 335–36.
133. *Id.*
134. *Id.* at 336 (internal citations omitted).
135. H.R. REP. NO. 109-31, § 1521, at 115 (2005).
136. 11 U.S.C. § 1508 (2005).

retrenchments.[137] In *Artimm*, Judge Sam Bufford said that "[i]n the insolvency context, U.S. courts should require only that the foreign forum have subject-matter jurisdiction, recognize fundamental creditor protections, and provide fair treatment to all claim holders."[138]

Already, the case law has begun to poke at this conundrum, in ways that are only just now revealing the tensions. In this section, we examine a few significant cases, starting with some American decisions.

A. *U.S. Decisions*

Atlas Shipping A/S and *Atlas Bulk Shipping AS* (together, "Atlas") were Danish corporations that were debtors in a bankruptcy proceeding taking place in Denmark; the Danish proceedings were filed on December 17, 2008.[139] Under Danish insolvency law, "all existing attachments lapse upon commencement of the bankruptcy [case], and no further attachments may be levied against the [debtor's] assets."[140] Between November and December 2008, a number of Atlas' unsecured creditors obtained maritime liens—so-called Rule B attachments—against approximately $4.3 million of Atlas' funds located in New York.[141] Two of the liens attached pre-petition, the remainder were post-petition attachments. All the attachments, however, were obtained before the Chapter 15 petitions were filed.[142] In January 2009, the Danish foreign representatives filed a Chapter 15 petition seeking recognition of the foreign bankruptcy case as a foreign main proceeding, and requesting, upon recognition and pursuant to § 1521, that the court vacate the attachments and turn over the funds to them for distribution in the Danish bankruptcy case.[143] The court granted recognition on February 20, 2009.[144]

Two creditors objected to the turnover of Atlas' funds: Dormin Shipping and Allied Maritime.[145] The creditors argued that the foreign representatives should be required to file a full-blown Chapter 7 or 11 case, and attempt avoidance under U.S. bankruptcy law.[146] Otherwise, their request for turnover should be rejected.[147] The court overruled the creditors' objections and turned over the funds to the foreign representative.[148]

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137. *See In re* Artimm, S.r.L., 335 B.R. 149, 160–61 (Bankr. C.D. Cal. 2005) (describing factors courts must consider before "deciding whether to turn over property of a foreign bankruptcy estate to that estate's representative," the first of which is "what will best assure an economical and expeditions administration of the foreign bankruptcy estate"); *see also In re* Atlas Shipping A/S, 404 B.R. 726, 741–42 (Bankr. S.D.N.Y 2009) (laying out five factors for courts to consider, including "protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding").

138. *In re Artimm S.r.L.*, 335 B.R at 161 (citing *In re* Schimmelpenninck, 183 F.3d 347, 352, 365 (5th Cir. 1999)).

139. *In re Atlas Shipping A/S*, 404 B.R. at 730.

140. *Id.*

141. *Id.* at 730–31.

142. *Id.* at 731.

143. *Id.*

144. *Id.*

145. *In re Atlas Shipping A/S*, 404 B.R. at 731.

146. *Id.*

147. *See id.* (stating that the "[c]reditors argued that the attachments could only be vacated" if certain criteria were met. Therefore, if the criteria were not met the request for turnover should be rejected.).

148. *Id.* at 742–43.

The court first concluded that the foreign representative's request to apply Danish insolvency law to dissolve the attachments for turnover would be granted under basic principles of comity, even were there no Chapter 15.[149] The court explained:

> American courts have long recognized the particular need to extend comity to foreign bankruptcy proceedings. The equitable and orderly distribution of a debtor's property requires assembling all claims against the limited assets in a single proceeding; if all creditors could not be bound, a plan of reorganization would fail. Congress implemented this policy by enacting section 304 as part of the Bankruptcy Reform Act of 1978. This provision allows foreign bankrupts to prevent piecemeal distribution of assets in this country by filing ancillary proceedings in domestic bankruptcy courts. Under general principles of comity as well as the specific provisions of section 304, federal courts will recognize foreign bankruptcy proceedings provided the foreign laws comport with due process and fairly treat claims of local creditors.[150]

The court went on to explain, with respect to attachments obtained after the commencement of the Danish insolvency proceeding, that the attachments would not enjoy any special status simply because the foreign representative initiated an ancillary proceeding in the United States.[151] Those attachments would be resolved under prior law, without prejudice to the creditors' right to raise their arguments for special status in the Danish proceeding.[152]

The court then considered whether the result is altered by the enactment of Chapter 15.[153] In particular, the court focused on the specific limitations applicable to turnover that are built into § 1521.[154] The court concluded that the "sufficiently protected" language did not significantly alter the outcome from what it would have been under former § 304.[155] Consistent with the principles of comity, Judge Glenn said that the creditors are "protected by making those funds subject to administration by the bankruptcy court in Denmark."[156] In other words, "the relief granted . . . is without prejudice to creditors' rights, if any, to assert in the Danish bankruptcy court their rights to the previously garnished funds. This is sufficient protection to the creditors here."[157] He continued:

> The Objecting Creditors' rights, if any, are not being avoided; rather, whether they have superior claims to the previously garnished funds will be for the Danish court to decide. The Objecting Creditors' argument is also belied by their motives: it appears that their strategy is to try to avoid the reach of both this Court and the Danish court to further

149. *Id.* at 734–35.
150. *Id.* at 737 (quoting *In re* Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B., 825 F.2d 709, 713–14 (2d Cir. 1987)).
151. *In re Atlas Shipping A/S*, 404 B.R. at 736.
152. *Id.*
153. *Id.* at 738.
154. *Id.* at 739.
155. *Id.* at 741.
156. *Id.* at 742.
157. *In re Atlas Shipping A/S*, 404 B.R. at 742.

> enhance their leverage in negotiations with Atlas or to provide an avenue to recover their claims in full.[158]

The *Atlas Shipping* decision is enlightening because the court permitted a fund subject to a security interest to leave the United States without the imposition of special conditions, protections, directives, or bond (distinguishing the case from *Tri-Continental Exchange*, where the funds remained in the United States).[159] True enough, the security interest in question was suspect, and vulnerable to attack under the insolvency regimes of either the United States or Denmark. And true enough, the creditors' real motive might have been to prevent (at least as a practical matter) any court from cancelling their liens. Still, it cannot be denied that, with the transfer of the funds to the foreign representative, the effective value of the security interest obtained was destroyed. The court said that the creditors could make their case to the court in Denmark that they ought to be treated as secured creditors, while knowing full well that their argument would fail. This result, it should be noted, was said to be the same regardless whether former § 304 or current provisions of Chapter 15 were controlling.

There are valuable lessons to be gleaned from *Atlas Shipping*. One of them is that a security interest that would be vulnerable under the foreign insolvency law is less deserving of special protection in a regime of modified universalism. This is because the creditor should not be able to take refuge behind the law of the ancillary jurisdiction to avoid an outcome that is a legitimate and familiar outcome under the insolvency regime of the foreign proceeding. It is worth emphasizing here that the court in *Atlas Shipping* did not rule that the Danish law was appropriately applied because it looked like U.S. law. Instead, it looked like the sort of rule commonly found in many insolvency systems around the world—provisions designed to prevent last minute tactics to improve one's position relative to other similarly situated creditors.[160] The law of the foreign insolvency proceeding need not be identical; it need only be consistent with the sort of rule one might expect to find in an insolvency regime that bears the indices of fundamental fairness, as noted in *Artimm*.[161]

Thus, perhaps one marker of the level of cooperation that ought to be accorded to a given insolvency regime's request for turnover of a given asset subject to a secured creditor's interest might be the found in a comparison of that regime's treatment of secured claims in a manner that one might expect of an insolvency regime that would pass muster in the world community as fundamentally fair. And one source that courts might think of consulting if they are to take this tack might be the UNCITRAL Legislative Guide on Insolvency Law. The text represents a five-year effort to derive a best practices guide for the enactment of a modern insolvency

158. *Id.* at 745.

159. *Id.* at 747; *In re* Tri-Cont'l Exch., 349 B.R. 627, 639 (Bankr. E.D. Cal. 2006) (stating "the funds . . . would be maintained in a deposit account within the jurisdiction of this court").

160. *See* LEGISLATIVE GUIDE, *supra* note 85, at 268 (discussing the "equitable subordination" doctrine, which prevents creditors from using legal mechanisms to gain advantages in priority relative to other creditors).

161. As an aside, it is worth noting that the Fifth Circuit ruled in 2010 (after *Atlas Shipping*), that nothing in Chapter 15 prohibited a foreign representative from utilizing the avoidance provisions of the foreign proceeding by way of a suit instituted within a Chapter 15 proceeding in the United States. *In re* Condor Ins. Ltd., 601 F.3d 319, 320 (5th Cir. 2010). *Condor* tells us little more about how one should answer the issue under discussion in this article, but it is at least circuit ratification that *Atlas Shipping* was not wrong to rule that Danish law could be invoked in a Chapter 15 proceeding regarding the avoidability of a security interest obtained within a suspect period.

law, as an aid to countries engaged in just such a task. Because the text was the result of input from a number of expert groups and non-governmental organizations, as well as healthy debate among delegates from the thirty-six member nations of UNCITRAL, representing countries around the globe, both common law and civil, both developed and developing, its provisions are drafted with sufficient breadth to encompass a fairly wide variety of insolvency systems, while still offering concrete recommendations that, in the aggregate, could serve as a template for a modern insolvency law to be enacted by a country that never before had such a law.[162] The text, of course, presumes a number of basics: a transparent rule of law, supervised by a judicial or administrative system designed to assure due process and fair treatment, and at least a moderately developed commercial law regime (one that may, but need not necessarily, include a scheme for security interests).[163]

The Legislative Guide states, in Recommendation 3, that "[t]he insolvency law should recognize rights and claims arising under law other than the insolvency law, whether domestic or foreign, except to the extent of any express limitation set forth in the insolvency law."[164] In Recommendation 4, it says that "[t]he insolvency law should specify that where a security interest is effective and enforceable under law other than the insolvency law, it will be recognized in insolvency proceedings as effective and enforceable."[165] Finally, the Legislative Guide discusses what a regime of avoidance actions might look like, discussing what the criteria ought to be, what purpose such provisions ought to serve, what a suspect period might look like, and the like.[166] Were the court in *Atlas Shipping* to have consulted the Legislative Guide, it would no doubt have found the Danish law to be consistent with the principles described there. Other provisions of the Legislative Guide relating to the expected treatment of secured claims (both those within the jurisdiction of the court and those arising under the law of another country) would be similarly helpful to a court attempting to evaluate a given insolvency regime's expected treatment of a claim subject to a security interest in the jurisdiction of the ancillary court.[167]

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162. *See* LEGISLATIVE GUIDE, *supra* note 85, at 20 (discussing the common features that require consideration in designing an effective and efficient insolvency law).

163. *See id.* at 2, para. 5 (discussing how the proper implementation of an insolvency regime requires establishment of underlying factors that go beyond which is focused upon in the guide); *see generally* Cambridge Gas Transp. Corp. v. The Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26, [15], [2007] 1 A.C. 508 (appeal taken from Isle of Man) (U.K.) ("The important point is that bankruptcy, whether personal or corporate, is a collective proceeding to enforce rights and not to establish them.").

164. LEGISLATIVE GUIDE, *supra* note 85, at 14.

165. *Id.*

166. *See id.* at 135–52 (discussing the subject of avoidance proceedings which include avoidance criteria, types of transactions subject to avoidance, transactions exempt from avoidance actions, the effect of avoidance, establishing the suspect period, the conduct of avoidance proceedings, liability of counterparties to avoided transactions, and the conversion of reorganization to liquidation).

167. *See id.* at 71, para. 88 (stating the choice of law relating to the allowance or recognition of a secured claim). The Guide reads:

> Some insolvency laws also adopt the approach of providing an exception to the application of the *lex fori concursus* with respect to security interests. This solution means that the law governing a right *in rem* would determine not only its creation and general validity, but also its effectiveness in the case of insolvency proceedings. In other words, the position of the real security interest in insolvency proceedings commenced abroad will not be established by *lex fori concursus*, but by the insolvency rules of the law application to the security interest. Application of the *lex fori concursis* otherwise may affect the legal framework for secured lending, introducing a factor of instability

When the insolvency law of a given regime appears to depart substantially from what a given court might expect with respect to the treatment of a secured claim, it ought to meet resistance. Prior to the adoption of the Model Law in the United States, and prior to the publication of the Legislative Guide, just such an issue was presented to the Second Circuit in *Bank of N.Y. v. Treco*.[168] In *Treco*, the Second Circuit considered whether to grant a foreign liquidator's request to remit assets (that may have been subject to a security interest) located in the United States to the Bahamas, which was where the main bankruptcy case was proceeding.[169] The facts were the following: on April 25, 1995, the Supreme Court of the Bahamas put Meridien International Bank Limited (MIBL) into involuntary liquidation and appointed Alison Treco and David Hamilton as liquidators (Liquidators).[170] The Liquidators of MBIL then, pursuant to § 304, filed an application for recognition in New York, and requested the turnover of certain funds then held by the Bank of New York (BNY).[171]

Prior to the bankruptcy, MIBL pledged the money in its account (and any future money or accounts) to BNY as security for MIBL's future obligations to BNY.[172] At the time the § 304 petition was filed, there was $600,000 on account at BNY, which funds were, according to BNY, subject to the pledge.[173] As of May 1998, only $1.75 million remained in MIBL's estate in the Bahamas.[174] Under Bahamian law, secured creditors are paid *after* administrative expenses are paid.[175] Although the Liquidators had collected close to $10 million during the course of their administration, most of the money (some $8 million) did not go to creditors.[176] It went instead to pay the Liquidators and their professionals.[177] Thus, BNY feared that, if its collateral were given over to the Liquidators, it would be consumed for yet more administrative expenses, permanently depriving BNY of its collateral.[178] Thus, if BNY had to turn over the $600,000, it was unlikely to get any money back via the Bahamas proceeding; if they did get anything, it would be negligible.[179]

The *Treco* court was clearly troubled by the level of administrative costs in the Bahamian proceedings.[180] However, it also understood the mandate to cooperate

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> that may increase the domestic cost of finance. If foreign proceedings intrude upon local security interest, the value of those security interests may be seriously impaired. Similarly, a transfer of the debtor's centre of main interests to a different State can bring about a radical change in the positions of the secured party. Rights of set-off may also be subject, as noted above, to law other than the law of the forum, for reasons related to the parties' expectations, especially if they engage in regular dealings with each other.

Id.

168. *In re Treco*, 240 F.3d at 154.
169. *Id.* at 151.
170. *Id.*
171. *Id.* at 152.
172. *Id.*
173. *Id.* at 153.
174. *In re Treco*, 240 F.3d at 153.
175. *Id.* at 155.
176. *Id.* at 159.
177. *Id.*
178. *See id.* (reasoning that because 70% of the $300 million in claims had not been resolved, the Liquidators would continue to incur significant fees).
179. *See id.* ("Viewing this evidence in the light most favorable to BNY, it appears probable that BNY would recover only a fraction, if any, of the $600,000 it holds as a secured creditor if it were ordered to turn over those funds.").
180. *See In re Treco*, 240 F.3d at 159 (disagreeing with the district court ruling that the prioritization

with foreign proceedings, and not to condition that cooperation on either a quid pro quo or an insistence that the foreign insolvency law offer identical treatment.[181] The court focused on § 304(c)(4), one of the factors to be considered when evaluating a request for assistance.[182] The Second Circuit said that:

> the priority rules of a foreign jurisdiction need not be identical to those of the United States .... [A] comparison of the priority rules cannot be conducted in the abstract. A court must consider the effect of the difference in the law on the creditor in light of the particular facts presented.[183]

Thus, the court demurred from holding that cooperation should be withheld simply because the distributional scheme was different.[184] However, it felt that, based on the egregious facts of the case, it was inappropriate to force BNY, who might have been a secured creditor, to turn over the money if it were in fact secured.[185]

The Second Circuit noted that the rules are different when the turnover request involves property subject to a security interest. The court stated:

> One consideration that informs our analysis of § 304(c)(4) and weighs against turnover is the special protected status that secured creditors enjoy under United States law. *See* 4 *Collier on Bankruptcy* ¶ 506.02 at 506–6 ("As a general matter, the Code recognizes and prescribes a number of special rights and protections for the holders of secured claims."). Indeed, security interests have been recognized as property rights protected by our Constitution's prohibition against takings without just compensation. *See* U.S. Const. amend. V; *United States v. Security Indus. Bank*, 459 U.S. 70, 75, 74 L. Ed. 2d 235, 103 S. Ct. 407 (1982); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 602, 79 L. Ed. 1593, 55 S. Ct. 854 (1935); *id.* at 589 ("The position of a secured creditor, who has rights in the specific property, differs fundamentally from that of an unsecured creditor, who has none."); *In re George Ruggiere Chrysler-Plymouth, Inc.*, 727 F.2d 1017, 1019 (11th Cir. 1984). We do not mean to suggest that turnover under § 304 of property subject to a security

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of administrative expenses over secured claims was insufficient to "render turnover inconsistent with § 304(c)(4)"). The court noted, "[t]he difference in prioritization under United States and Bahamian law is particularly acute in this case because of the strong possibility that MIBL's estate will have little or no funds after payment of administrative expenses." *Id.*

181. *See id.* at 156 ("The purpose of the section is to provide a statutory mechanism through which United States courts may defer to and facilitate foreign insolvency proceedings ... [C]omity does not, as the Liquidators suggest, automatically override the other specified factors.").

182. *Id.* at 158–61. "[D]istribution of proceeds of such estate substantially in accordance with the order prescribed by this title." 11 U.S.C. § 304(c)(4) (repealed 2005).

183. *In re Treco*, 240 F.3d at 158–59.

184. *Id.* at 158; *see also* Argo Fund Ltd. v. Bd. of Dirs. of Telecom Arg., S.A. (*In re* Bd. of Dirs. of Telecom Arg., S.A.), 528 F.3d 162, 173 (2d Cir. 2008) (saying, in the context of an argument under § 1129(a)(7), that "[c]omity, however, does not require that foreign proceedings afford a creditor identical protections as under U.S. bankruptcy law ... so long as the other § 304(c) factors are satisfied, the statute does not require that the amount of a distribution in a foreign insolvency proceeding be equal to the hypothetical amount the creditor would have received in a proceeding under U.S. law").

185. *In re Treco*, 240 F.3d at 155 (noting that a "secured claim will be subordinated under Bahamian law to, among other things, the administrative expenses of liquidation"). The matter was remanded to the district court for a determination of BNY's status. *Id.* at 163.

> interest is an unconstitutional taking, a subject we discuss in part II.A, below. But our observation that security interests enjoy constitutional protection supports our conclusion that United States law affords strong protection to secured creditors and treats those protections very seriously, a conclusion that, in turn, amplifies the significance of the difference in the way secured claims are treated under Bahamian law.[186]

The court declined to directly reach the Takings Clause constitutional issue raised by BNY, saying that "if BNY's claim is secured, turnover would be barred under § 304 and we would not need to reach the constitutional issue."[187] Yet the court's comments about why the rules should be different for secured creditors are in fact *premised* on the constitutional dimensions of security interests. On the facts of the case before it, the security interest was threatened with destruction, not just infringement. The court remanded the case for consideration whether BNY in fact had a security interest, ruling in effect that, if it did, then the request for turnover, in the face of sure destruction of that interest if it were granted, would have to be denied.[188]

Although the Second Circuit in *Treco* approached the issues before it from a universalist point of view, the outcome has a territorialist feel to it. While it is easy to justify the Second Circuit's conclusion when viewed from a U.S. public policy point of view, it is much more difficult to support that view if one analogizes to the priority scheme of, say, Mexico, which might decline to release property in Mexico for distribution in a U.S. proceeding which would honor a security interest in the property, on grounds that, under Mexican law, the workers have a prior claim on those assets that have constitutional dimensions in Mexico.[189] *Treco* exemplifies how

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186. *Id.* at 159–60. The court added:

> The Liquidators cite no cases—and we are aware of none—ordering turnover of assets under § 304 from a creditor with a secured claim. To the contrary, several bankruptcy courts have refused to grant relief under § 304 where the priority of secured creditors was not recognized under the law of the foreign jurisdiction. *See In re Hourani*, 180 B.R. at 69 (denying turnover where Jordanian law failed, among other things, to distinguish between secured and unsecured claims); *In re Papeleras Reunidas, S.A.*, 92 B.R. 584, 593 (Bankr. E.D.N.Y. 1988) (denying relief under § 304 because, *inter alia*, a judgment lien creditor, a secured creditor under United States law, would be treated as an unsecured creditor under Spanish law and would therefore receive nothing in the Spanish proceeding because there were no funds in the estate for unsecured creditors); *In re Toga Mfg. Ltd.*, 28 B.R. 165, 168–70 (Bankr. E.D. Mich. 1983) (denying turnover and injunctive relief where a judgment lien creditor would be treated as an unsecured creditor under Canadian law); *cf. Koreag*, 961 F.2d at 359 (observing that the deprivation of a "valid security interest or other benefit of domestic law . . . might render a turnover unfair or otherwise improper") (dictum); *Cunard S.S. Co.*, 773 F.2d at 459 (affirming, in a non-§ 304 proceeding, vacatur of creditor's attachment of Swedish debtor's United States property on the ground of comity, in part because the creditor's claim was not secured and that there was therefore "no compelling policy reason for a general creditor . . . to receive preference over other creditors.

Id. at 160.

187. *Id.* at 161.

188. *See id.* at 160–61 ("The Bahamian rule that secured creditors do not have priority over administrative expenses threatens to destroy BNY's claim. We therefore conclude that the bankruptcy court abused its discretion by ordering turnover without first determining that in the discrete context of BNY's claim against MIBL's estate, the order of distribution under Bahamian law was 'substantially in accordance with the order prescribed by' the United States Bankruptcy Code.").

189. *Constitución Política de los Estados Unidos Mexicanos* [C.P.], art. 123(A)(XXIII) (Mex.).

modified universalism can easily fall hostage to territorialist instincts—with the ancillary court called upon to resist cooperation (or to at least condition it) when a local interest of perceived paramount importance is likely to be otherwise eviscerated. The tenor of the *Treco* decision gives strong indication that, had the same set of facts been presented to the circuit court under Chapter 15, the court might well have been tempted to ground its refusal to cooperate on § 1506 (the public policy exception), even though the Model Law expressly counsels applying this exception narrowly, consistent with international usage of the term. It is difficult, nonetheless, to miss the Second Circuit's innuendo that the foreign proceeding's treatment of the secured creditor came dangerously close to violating a fundamental policy of the United States, though it fails to fully articulate what that fundamental policy might be.[190]

B. English Decisions

Though the case did not involve the turnover of assets subject to a security interest, an English decision by Lord Leonard Hoffmann offers important insights into the interplay between ownership rights in an ancillary jurisdiction and the demands of an insolvency proceeding elsewhere, under principles of modified universalism.[191] In the late 1990s, four businessmen investing in a shipping business borrowed $300 million in the New York bond market and bought five boats.[192] They

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190. I say "dangerously close" because the court in fact stops short of premising its ruling on that basis. *In re Treco*, 240 F.3d at 157. Instead, the court claims to be simply applying the language of the statute then in effect, § 304(c), which, it will be recalled, listed multiple factors a court ought to consider when deciding whether to grant relief under § 304(b). *Id.* One factor, of course, is comity, and the foreign representative laid heavy emphasis on that factor, with its appeal to universalist principles. *Id.* The Second Circuit noted, however, that comity must be applied in light of the other factors, one of which expressly calls for the ancillary court to evaluate the treatment accorded affected creditors in the foreign proceeding, as compared with how such creditors would be treated under the U.S. insolvency regime. *Id.* Thus, the court did not need to appeal to public policy as such, having a ready "excuse" in the form of § 304(c)(4). *Id.* The court said:

> In this case, of course, § 304(c) supplants the federal common law comity analysis conducted by courts pursuant to *Hilton*. It directs courts instead to use the statutory factors to balance the reasons for and against affording comity. But the statutory factors reflect the considerations that "have historically been considered within a court's determination whether to afford comity to a proceeding in a foreign nation." In re Culmer, 25 B.R. at 629. And application of those factors requires that comity not be extended in some circumstances. *Id.* at 158.

In its later application of § 304(c)(4), the court adverts to the "special protected status that secured creditors enjoy under United States law" but adds that "[w]e do not mean to suggest that turnover under § 304 of property subject to a security interest is an unconstitutional taking, a subject we discuss in part II.A, below. But our observation that security interests enjoy constitutional protection supports our conclusion that United States law affords strong protection to secured creditors and treats those protections very seriously, a conclusion that, in turn, amplifies the significance of the difference in the way secured claims are treated under Bahamian law." *Id.* at 160. In a footnote, the court acknowledges that "[t]he status enjoyed by secured creditors under United States bankruptcy law has attracted substantial academic criticism and defense." *Id.* at 160 n.9. Thus, while the tenor of the decision is consonant with an appeal to public policy, the decision should not be read as one whose holding is premised on public policy.

191. Cambridge Gas Transp. Corp. v. The Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26, [16]–[22] [2007] 1 A.C. 508, 517–18 (appeal taken from Isle of Man) (U.K.)

192. *Id.* at [1].

were unsuccessful and at the end of 2003 filed for Chapter 11 in the United States.[193] In March 2004, the bankruptcy court confirmed a creditors' plan under which the assets were taken over by the creditors.[194] The corporate structure of the business caused problems, however. The ships were owned and managed by a group of companies in the Isle of Man.[195] Each boat was owned by a separate subsidiary of a management company and all the shares in the management company were held by a holding company, Navigator Holdings PLC.[196] In turn, Navigator was held by companies located in other offshore jurisdictions, two of which were Cambridge Gas Transportation Corporation (Cambridge) and its parent company, Vela Energy Holdings Ltd. (Vela).[197] Cambridge was a Cayman company that owned, either directly or indirectly, at least 70% of Navigator.[198]

Under the Chapter 11 plan, the interests of current shareholders of Navigator were necessarily extinguished in order to give the creditors control over Navigator and its assets (the ships).[199] The bankruptcy court sent a letter of request to the Manx court, asking for assistance in giving effect to the plan.[200] The creditors' committee did the same.[201] Cambridge asked the Manx court *not* to recognize or enforce the plan, arguing that Cambridge was a separate legal entity that had not submitted itself to the jurisdiction of the New York court, and could not therefore be stripped of its property rights over its objection.[202] The High Court of the Isle of Man agreed with Cambridge.[203]

On appeal, the Privy Council reversed and found that the plan was effective in the Isle of Man.[204] Lord Hoffmann said that the limits of assistance under the common law—as opposed to the types of assistance that a court is able to provide pursuant to statutory law—are that

> the domestic court [*i.e.*, the ancillary court] must at least be able to provide assistance by doing whatever it could have done in the case of a domestic bankruptcy. The purpose of recognition is to enable the foreign office holder or the creditors to avoid having to start parallel insolvency proceedings and to give them the remedies to which they would have been entitled if the equivalent proceedings had taken place in the domestic forum.[205]

In his analysis, Lord Hoffmann noted that bankruptcy proceedings are neither *in rem* nor *in personam* judgments, rather, they "provide a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted

193. *Id.*
194. *Id.* "The mechanism[,] which the plan used to vest the assets in the creditors was to vest the shares in Navigator in their representatives. That would enable the creditors to control the shipping companies and implement the plan." *Id.* at [5].
195. *Id.* at [2].
196. *Id.*
197. *Cambridge Gas Transp. Corp.*, [2006] UKPC 26, [3], 1 A.C. at 513.
198. *Id.*
199. *Id.* at [4].
200. *Id.* at [6].
201. *Id.* at [7].
202. *Id.*
203. *Cambridge Gas Transp. Corp.*, [2006] UKPC 26, [10], 1 A.C. at 515.
204. *Id.* at [21].
205. *Id.* at [22].

or established. The mechanism may vary in its details . . . The important point is that bankruptcy, whether personal or corporate, is a collective proceeding to enforce rights and not to establish them."[206]

The *raison d'etre* of a bankruptcy proceeding is not to establish rights vis-à-vis property of the estate as such, but to collect and distribute property of the debtor for the benefit of the creditors.[207] This axiom—the Principle of Collectivity—is one of the few that does not typically vary by country.[208]

Of course, there may be a need to establish rights during the course of a bankruptcy in order to achieve bankruptcy's collective aim with appropriate protections for those property interests. Indeed, procedures exist for the establishment of such rights.[209] For example, a debtor may object to a proof of claim or a creditor may dispute whether some item is property of the debtor.[210] However, those procedures "are incidental procedural matters and not central to the purpose of the proceedings."[211] The court explained:

> The English common law has traditionally taken the view that fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated.[212]

Lord Hoffmann then noted that traditionally (i.e., under English common law with a provenance of more than a century), recognition of a foreign proceeding carried with it "the active assistance of the court."[213] The limitations with respect to that assistance are by now familiar—prejudice to local creditors, or infringement of local law.[214] However, whatever the limits,[215] the court was certain that it could afford

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206. *Id.* at [14]–[15].

207. *Id.* at [14].

208. FLETCHER, *supra* note 9, at 9, para. 1.08; *see* LEGISLATIVE GUIDE, *supra* note 85, at 75, para. 1 (noting that "[f]undamental to insolvency proceedings is the need to identify, collect, preserve and dispose of the debtor's assets").

209. *Cambridge Gas Transp. Corp.*, [2006] UKPC 26, [15], 1 A.C. at 516.

210. *Id.*

211. *Id.*

212. *Id.* at [16]. One has to respect Lord Hoffmann's candor, as he observed that perhaps England's long-standing commitment to principles of universalism in international insolvency was owing to England's long-standing position throughout the 18th and 19th centuries as an imperial economic power.

> Not all countries took the same view. Countries less engaged in international commerce and finance did not always see it as being in their interest to allow foreign creditors to share equally with domestic creditors. But universality of bankruptcy has long been an aspiration, if not always fully achieved, of United Kingdom law. And with increasing world trade and globalisation, many other countries have come round to the same view.

Id. at [17].

213. *See id.* at [20], [22] (noting that English courts actively assist recognizing the person who is empowered under the foreign bankruptcy law to act on behalf of the insolvent company, as entitled to do in England).

214. *See Cambridge Gas Transp. Corp.*, [2006] UKPC 26, [21], 1 A.C. at 518 (noting that limitations to "active assistance" from English courts include infringement of local law and prejudice to local creditors).

assistance at least equivalent to what it could do were a full proceeding initiated under English law.[216] And in a local proceeding, the cancellation of shareholder rights in favor of the superior rights of creditors was well known in English law.[217] This was not the same as, say, a third party confiscating a shareholder's shares and awarding them to someone else, a situation much more closely analogous to the "confiscation" of a secured creditor's collateral.[218] Lord Hoffmann said: "[a]s against the outside world, that bundle of rights is an item in property, a chose in action. But as between the shareholder and the company itself, the shareholder's rights may be varied or extinguished by the mechanisms provided by the articles of association or the Companies Act."[219] It is likely that the shareholders here chose not to participate in a proceeding that could legitimately alter their rights, then hoped to claim lack of jurisdiction to prevent enforcement. The Privy Council would have none of it, and ordered that the Manx court was to grant assistance as requested by the U.S. court.[220]

The *Cambridge Gas* case, on its facts, offers less than complete guidance on the issue of handling requests for turnover of assets subject to a security interest. However, it strikes a common theme with *Treco*: when the foreign proceeding is doing little different than would the "home" proceeding in a full insolvency proceeding, there is little call not to cooperate, especially when cooperation is so important to centralized administration of worldwide insolvency proceedings consistent with principles of universalism. If the security interest would, in the process of turnover, be effectively destroyed, then turnover should not be permitted. If the security interest might be altered in significant ways that fall short of destruction, and such alterations might be expected under U.S. insolvency law, then *Cambridge Gas* suggests that a court would once again have little reason not to cooperate.

In mid-2008, the House of Lords ruled in *HIH Casualty* that, on request of Australian liquidators, assets in the control of English liquidators should be remitted to the Australian proceeding for distribution pursuant to Australian insolvency law.[221] The request was made pursuant to § 426 of the Insolvency Act 1986, but Lord Hoffmann ruled that the request would have been honored even under the common law.[222]

A brief summary of the facts is useful. On March 15, 2001, four insolvent Australian insurance companies, collectively, HIH Casualty & General Insurance (HIH), entered winding up proceedings in Australia.[223] Although the bulk of the

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215. The court thought it "doubtful whether assistance could take the form of applying provisions of the foreign insolvency law which form no part of the domestic system," *Id.* at [22]. No authority is cited for this proposition. Perhaps this is the law in England. It is not the law in the United States. *See In re* Condor Ins. Ltd., 601 F.3d 319, 327 (5th Cir. 2010) (treating the possible application of Nevis insolvency law as a question of choice of law, and not a question of public policy).

216. *Cambridge Gas Transp. Corp.*, [2006] UKPC 26, [22], 1 A.C. at 518.

217. *Id.* at [26].

218. *See In re* Condor Ins. Ltd., 601 F.3d 319, 328 (5th Cir. 2010) (discussing the objectives of UNCITRAL and the Model Law in relation to international bankruptcy law, and indicating limits on the rules that were the basis for UNCITRAL and the Model Law).

219. *Cambridge Gas Transp. Corp.*, [2006] UKPC 26, [26], 1 A.C. at 519–20.

220. *See id.* (affirming the holding in favor of the creditor).

221. McGrath v. Riddell (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21, [36], [2008] 1 W.L.R. at 863 (H. L.) (Lord Hoffmann) (appeal taken from Eng.).

222. *See id.* at [30] (stating "[t]he primary rule of private international law which seems to me applicable to this case is the principle of (modified) universalism, which has been the golden thread running through English cross-border insolvency law since the eighteenth century.").

223. *Id.* at [1].

assets were in Australia, some of HIH's assets were located in England.[224] To protect the English assets, provisional liquidators were also appointed in England.[225] Thereafter, the Australian court, pursuant to § 426(4) of the Act, sent a letter request to the English court asking that the English provisional liquidators be directed to remit assets to the Australian liquidators for distribution.[226] Australia's insolvency scheme for insurance companies requires assets to be paid out in a different priority than would be paid out in a similar English proceeding.[227] Aside from this difference in priority, however, the two schemes have a similar structure in that the assets are distributed *pari passu* among "ordinary" creditors.[228] The issue considered by the House of Lords was whether the English court could, and, if so, whether it should grant the Australian court's request that assets located in England be remitted to Australia for distribution under Australian law, despite the fact that a certain class of creditors is granted a priority in Australia.[229] The lower courts had held that the assets should not be remitted.[230] They were overruled.[231]

Although the Lords all agreed that the assets should be remitted to Australia, they each issued separate opinions, offering different rationales.[232] They fell largely into two camps: the common law camp and the § 426 camp. Lord Hoffmann relied on principles of common law,[233] and Lords Scott and Neuberger relied on § 426 of the Act.[234] We focus on Lord Hoffmann's ruling, which relied on principles described as the "golden thread running through English cross-border insolvency law since the eighteenth century."[235]

Lord Hoffmann began with a nod to universalism. As he had earlier observed in *Cambridge Gas*, he noted that a long line of English decisions, applying universalism, authorized the relief sought in this case.[236] He said it this way:

> The power to remit assets to the principal liquidation is exercised when the English court decides that there is a foreign jurisdiction more appropriate than England for the purpose of dealing with all outstanding questions in the winding up. *It is not a decision on the choice of the law to be applied to those questions. That will be a matter for the court of the principal jurisdiction to decide.* Ordinarily one would expect it to apply its own insolvency laws but in some cases its rules of the conflict of laws may point in a different direction .... the present case involves neither

224. *Id.*
225. *Id.*
226. *Id.*
227. *McGrath*, [2008] UKHL 21, [62], 1 W.L.R. at 872.
228. *Id.* at [81].
229. *Id.* at [1].
230. *Id.* at [11].
231. *Id.*
232. *Id.* at [1], [12], [14], [26].
233. *See McGrath*, [2008] UKHL 21, [37]–[44], 1 W.L.R. at 863–64 (demonstrating that Lord Phillips of Worth Matravers seemed to agree with Lord Hoffmann's analysis but his agreement was summarily stated without additional substantial analysis).
234. *Id.* at [55]–[62], [66].
235. *Id.* at [30].
236. *Id.* at [6]–[8].

> an extension of the English jurisdiction or an application by the English court of a foreign law.[237]

Lord Hoffmann continued:

> The primary rule of private international law which seems to me applicable to this case is the principle of (modified) universalism, which has been the golden thread running through English cross-border insolvency law since the eighteenth century. That principle requires that English courts should, so far as is consistent with justice and UK public policy, co-operate with the courts in the country of the principal liquidation to ensure that all the company's assets are distributed to its creditors under a single system of distribution. That is the purpose of the power to direct remittal.[238]

Ultimately, English insolvency law provides English courts with: (i) the *authority* to remit the assets to Australia, and (ii) the *discretion* to do so depending on the circumstances.[239] The key is the discretion element. In many ways, compared to the issue discussed in this article, the task for the court in *HIH* was simple. Australian law treats insurance creditors better than it treats non-insurance creditors, while under applicable English law, insurance creditors do not have priority. Thus, from the standpoint of English creditors with an interest in the assets to be remitted, sending the assets to Australia was likely to reduce their recovery, given that a priority would likely significantly reduce the assets remaining available to satisfy their claims. However, Lord Hoffmann noted that

> it seems to me that the application of Australian law to the distribution of all the assets is more likely to give effect to the expectations of creditors as a whole than the distribution of some of the assets according to English law. Policy holders and other creditors dealing with an Australian insurance company are likely, so far as they think about the matter at all to expect that in the event of insolvency their rights will be determined by Australian law. Indeed, the preference given to insurance creditors may have been seen as an advantage of a policy with an Australian company.[240]

In other words, even if the creditors in question could claim their entitlements arose under English law, their expectations regarding where an insolvency proceeding might take place pointed to Australia. That, in turn, means that they should reasonably have anticipated that, in the event of an insolvency for the debtor, their claims would be subordinated to the priority scheme of the Australian proceeding. Under principles of universalism, the remittance request should be honored.

Yet modified universalism is a doctrine of legal realism, one that recognizes that national laws embody certain national policies that are unlikely to be overcome, even

237. *Id.* at [28] (emphasis added).
238. *Id.* at [30].
239. *McGrath*, [2008] UKHL 21, [24], 1 W.L.R. at 860.
240. *Id.* at [33].

by courts committed to the principles of cooperation and centralized administration. The key is to moderate those policies, to confine them to the preservation of truly fundamental rights. In *HIH*, Lord Hoffmann said that he did not see how English public policy would be prejudiced by the application of Australian law to the distribution of English assets:

> There is no question of prejudice to English creditors as such, since it is accepted that although [the application of Australian law] gives creditors whose debts are payable in Australia a first call on Australian assets, this provision will not in practice prejudice the interests of creditors in the English assets. Furthermore, if there were to be a separate liquidation of the English assets in England, all creditors would be entitled to prove .... But UK public policy does not require them to be afforded this facility .... The fact that the assets are in England is principally the result of the companies having placed their reinsurance business in the London market. For the purposes of deciding how the assets should be distributed, that seems to me an entirely adventitious circumstance. Indeed, it may not be to the advantage of London as a reinsurance market if the distribution of the assets of insolvent foreign reinsurance companies is affected by whether they have placed their reinsurance business in London rather than somewhere else.[241]

This is a case in which a court ought:

> to give the principle of universalism full rein. There are no grounds of justice or policy which require this country to insist upon distributing an Australian company's assets according to its own system of priorities only because they happen to have been situated in this country at the time of the appointment of the provisional liquidators.[242]

The observation echoes the point made by Judge Glenn in *Atlas Shipping*, that the mere advantages of timing and location should not be sufficient to undermine the administration of a properly opened insolvency proceeding pending in the country that is properly the center of the debtor's main interests—not even when the advantage is in the nature of a security interest.[243]

Public policy will still protect rights that would be effectively destroyed by turnover, as it should. That, in fact, is the real story behind the English court's earlier decision in *In re Bank of Credit and Commerce International*.[244] In *BCCI*, monies in the hands of English ancillary liquidators were not remitted to principal liquidators in Luxembourg because Luxembourg did not recognize the rights of set-off that, under rule 4.90 of the Insolvency Rules 1986 of English law, were automatically conferred on English creditors.[245] In *BCCI*, Lord Scott said:

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241. *Id.* at [34]–[35].
242. *Id.* at [36].
243. *In re* Atlas Shipping A/S, 404 B.R. 726, 738 (Bankr. S.D.N.Y. 2009).
244. *In re* Bank of Credit and Commerce Int'l SA (No. 10), [1997] Ch 213 at 213–14.
245. *McGrath*, [2008] UKHL 21, [15]–[19], 1 W.L.R. at 858–59.

> The accumulation of judicial endorsements of the concept of ancillary liquidations have, in my judgment, produced a situation in which it has become established that in an "ancillary" liquidation the courts do have power to direct liquidators to transmit funds to the principal liquidators in order to enable a pari passu distribution to worldwide creditors to be achieved .... But the judicial authority which has established the power of the court to give, in general terms, the direction to which I have referred has certainly not established the power of the court to disapply rule 4.90 or any other substantive rule forming part of the statutory scheme under the Act and Rules of 1986. Nor, in my opinion, has this line of judicial authority established the power of the court to relieve English liquidators in an ancillary winding up of the obligation to determine whether proofs of debt submitted to them should be admitted or to see to it, so far as they are able to do so, that creditors whose claims they do admit receive the pari passu dividend to which, under the statutory insolvency scheme, they are entitled.[246]

Although Lord Scott's holding in *BCCI* could be read to mean that remittance should be denied whenever the foreign court's scheme would result in a different distribution than would be available under the ancillary court's own insolvency regime, the facts of the case belie that broad a read. *BCCI* denied remittance because Luxembourg law did not recognize setoff rights *at all*.[247] Nor could English claimants with setoff rights in England appear in Luxembourg to assert those rights in that court (as, for example the creditors in *Atlas Shipping* could).[248] In other words, it was not that the English creditor's setoff rights were lower on the priority scale under the Luxembourg proceeding that pushed Lord Scott to deny turnover; instead, it was that those rights were extinguished in their entirety.[249]

As mentioned previously, in *HIH* Lord Hoffmann agreed with Lord Scott's decision in *BCCI* to not remit assets to the Luxembourg principal liquidators because

> [t]he mutual debts which were set off against each other appear to have been entirely governed by English law, which regards set off as a matter of substantial justice between the parties ... The court of the principal winding up in Luxembourg had made it clear that it was going to apply its *lex fori* and disallow the set off, notwithstanding the close connection of the transactions with England.[250]

Lord Hoffmann noted that he too would not likely have sent the money back to Luxembourg because "[t]he mutual debts were too closely connected with England."[251] Yet he disagreed with Lord Scott's rationale in the *BCCI* decision

246. *In re* Bank of Credit and Commerce Int'l S.A. (No. 10), [1997] Ch 213 at 247–48.

247. *See id.* at 236–37 (describing Luxembourg and English law and finding that "the respective disadvantages to the net creditors and net debtors of depriving them of the benefits of rule 4.90 and applying to them the Luxembourg winding up rules is clear").

248. *See id.* at 237 (noting procedural problems preventing the Luxembourg court from reviewing the claims).

249. *See id.* at 248 (stating that the court's "conclusion...is reinforced by a consideration of the practical consequences that would follow in the present case if the court had the power to disapply rule 4.90 and purported to exercise that power.").

250. *McGrath*, [2008] UKHL 21, [17], 1 W.L.R. at 858–59.

251. *Id.*

because it was based upon the notion that "he had no jurisdiction to do otherwise because creditors in an English liquidation (principal or ancillary) cannot be deprived of their statutory rights under English law."[252] If the main proceeding will apply choice of law rules that respect the source of the claim and its entitlement to repayment, turnover to that court is easier to grant, as it is less likely to run into public policy resistance. Certainly, Lord Hoffmann is consistent in his opinion that

> the whole doctrine of ancillary winding up is based upon the premise that in such cases the English court may 'disapply' parts of the statutory scheme by authorising the English liquidator to allow actions which he is obliged by statute to perform according to English law to be performed instead by the foreign liquidator according to the foreign law (including its rules of the conflict of laws).[253]

Thus, another learning emerges—remittance is easier when made to a court that will, under its conflict of laws rules, respect the law under which the creditor's entitlement arises.

In *Rubin v. Eurofinance S.A.,* the English High Court of Justice reversed a lower court's determination that the judgment by default taken in foreign adversary proceeding was not enforceable in England against the defendant.[254] While the legal issue decided in the case is tangential to the issues at the heart of this article, the analysis used by the court relied heavily on Lord Hoffmann's decisions in *Cambridge Gas* and *HIH* and sheds additional insight into how we ought to approach our issue.

The facts are as follows. In March 2002, Eurofinance S.A. created an entity known as The Consumers Trust (TCT).[255] The law of England and Wales was to apply to TCT.[256] The "beneficiaries" of the TCT were consumers that participated in sales promotion owned and operated by the settlor of TCT.[257]

The Consumers Trust was part of an apparent scam.[258] It offered customers in the United States and Canada cashable vouchers (through certain participating merchants) that promised a 100% rebate of the purchase price of various product so long as certain, almost impossible, conditions were met, but actually counted on the high probability that very few customers would meet those conditions.[259] The merchants paid TCT 15% of the face value of each voucher, but TCT retained only 40% of that value (just 6% of the face value of the vouchers) for actual redemption costs, holding that money in a bank account in the United States.[260] The balance was paid out to a number of parties, including Eurofinance, effectively Adrian Roman, and parties involved in the management of the scheme (lawyers, accountants, etc.).[261]

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252. *Id.* at [18].
253. *Id.* at [19].
254. *Rubin v. Eurofinance S.A.*, [2010] EWCA (Civ) 895, [63]–[65], (Eng.).
255. *Id.* at [3]. The entity was a business trust that, under U.S. law, is eligible for bankruptcy relief. Such trusts are not eligible for relief in the United Kingdom, and on that basis, it was argued that the U.K. court should not grant recognition. That argument was carefully considered and rejected by both courts, but is not further discussed here because its resolution is not relevant to our analysis.
256. *Id.*
257. *Id.* at [3]–[4].
258. *Id.* at [4].
259. *Id.*
260. *Rubin v Eurofinance S.A.*, [2010] EWCA (Civ) 895, [5].
261. *Id.*

TCT attracted the unwelcome attention of states attorneys general, one of whom sued them for a violation of the state's consumer protection laws.[262] Ultimately, they settled, with TCT paying $1.65 million and $200,000 in costs, but other states attorneys general were already following suit, and TCT elected to file a Chapter 11 petition in the Southern District of New York.[263] On September 25, 2007, a joint plan of liquidation was approved, under which certain causes of action were to be prosecuted to recover funds for the estate.[264] On December 3, 2007, avoidance actions under § 548 of the Bankruptcy Code were filed in the United States against, *inter alia*, Adrian Roman, his sons Justin and Nicholas Roman, and Eurofinance S.A. (the "Respondents") to avoid and recover payments made to them.[265] On the advice of counsel, the Respondents deliberately chose not to submit to the jurisdiction of New York and not to defend.[266] As a result, on July 22, 2008, judgments (the "Judgments") were entered against them.[267]

On November 3, 2008, the appellants (with the authorization of the U.S. Bankruptcy Court) applied for recognition of the Chapter 11 case in England, under the Cross-Border Insolvency Regulations of 2006 (England's version of the Model Law).[268] They also sought enforcement of the Judgments against the Respondents.[269] The court below granted recognition but denied enforcement of the Judgments.[270] The High Court of Justice reversed the denial of enforcement.[271]

The High Court placed heavy reliance on Lord Hoffmann's opinions in *Cambridge Gas* and *HIH*.[272] The court noted that, in a later case, *Pattni v. Ali*,[273] their Lordships reiterated Lord Hoffmann's position in *Cambridge Gas* that the purpose of bankruptcy is to "simply establish a mechanism of collective execution against the property of the debtor by creditors whose rights were admitted or established."[274] The court acknowledged that the ordinary rule for enforcement of foreign judgments on these facts would have been that England would not have enforced them, because the English defendants had not submitted to the foreign court, from England's point of view.[275] These judgments, however, were not ordinary; they were avoidance actions that are deemed a part of the collective process of bankruptcy.[276] Thus, the rules for enforcement would be those applicable to granting relief to a foreign insolvency case.[277]

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262. *Id.* at [6].
263. *Id.* at [6]–[7].
264. *Id.* at [9].
265. *Id.* at [11].
266. *Rubin v. Eurofinance S.A.*, [2010] EWCA (Civ) 895, [11].
267. *Id.* at [12].
268. *Id.* at [14].
269. *Id.*
270. *Id.* at [2].
271. *See id.* at [62] (extending judicial assistance to enforcement).
272. *Rubin v. Eurofinance S.A.*, [2010] EWCA (Civ) 895, [62].
273. Pattni v. Ali [2006] UKPC 51, [2007] 2 A.C. 85 (appeal taken from the Isle of Man) (U.K.).
274. *Rubin v. Eurofinance* S.A., [2010] EWCA (Civ) 895, [45] (quoting *Pattni v. Ali* at [23]).
275. "At common law, an English court could not accede to a request by a foreign insolvency court to enforce a judgment *in personam* contrary to the rules of English private international law." *Id.* at [29] (quoting the lower court).
276. *Id.* at [50].
277. While at common law "an English court could not accede to a request by a foreign insolvency court to enforce a judgment *in personam* contrary to the rule of English private international law." *Rubin v Eurofinance S.A.*, [2009] EWHC (Ch) 2129, [59] (Eng.). "'[S]ome degree of international co-operation in corporate insolvency had been achieved by judicial practice.'" *Id.* at [61] (internal citation omitted). Moreover, Articles 25 and 26 of the UNCITRAL Model Law mandate cross-border cooperation and are

The court, in support of its conclusion that enforcement should be given to judgments of this sort, part and parcel of the collective proceeding pending in the domicile of the debtor, said:

> There should be a unitary bankruptcy proceeding in the court of the bankrupt's domicile which receives *worldwide recognition* and it should apply universally to *all the bankrupt's assets*. That is the law stated in *Cambridge Gas* and *HIH Insurance* and I would follow it. Add to that the further principle that recognition carries with it the active assistance of the court which should include assistance by doing whatever this Court *could have done in the case of domestic insolvency*.[278]

Pointedly, the court noted its concern that the Model Law's provisions regarding cooperation do not make provision for enforcement of judgments of the sort involved in this case.[279]

> What troubles me is that the specific forms of cooperation provided by Article 27 do not include enforcement. Indeed there is no mention anywhere of enforcement yet the Guidance clearly had it in mind. On the other hand cooperation "to the maximum extent possible" should surely include enforcement, especially since enforcement is available under the common law.[280]

Lord Hoffmann's articulation of the nature of bankruptcies, and the support he received in *Eurofinance*, is remarkably similar to the United States' articulation of comity vis-à-vis insolvency proceedings; to wit:

> We have repeatedly held that U.S. courts should ordinarily decline to adjudicate creditor claims that are the subject of a foreign bankruptcy proceeding. "Since 'the equitable and orderly distribution of a debtor's property requires assembling all claims against the limited assets in a single proceeding,' American courts regularly defer to such actions." In such cases, deference to the foreign court is appropriate so long as the foreign proceedings are procedurally fair and (consistent with the principles of Lord Mansfield's holding) do not contravene the laws or public policy of the United States.[281]

The similarity is unsurprising because both countries subscribe wholeheartedly to modified universalism and the principles underlying that doctrine. For that reason, the English decisions discussed in this article, and their articulation of modified universalism in practice, are worthy of our attention.

"designed to overcome the widespread problem of national laws lacking rules providing a legal basis for cooperation by local courts with foreign courts in dealing with cross-border insolvencies." *Id.* para. 174.

278. *Rubin v. Eurofinance* S.A., [2010] EWCA (Civ) 895, [62] (emphasis added).

279. *Id.* at [22].

280. *Id.* at [63].

281. JP Morgan Chase Bank v. Altos Hornos de Mex., S.A. de C.V., 412 F.3d 418, 424 (2d Cir. 2005) (citations omitted).

V. CONCLUDING THOUGHTS

What can be gleaned from the foregoing analyses, it seems, is that sacred cows can be herded, they can be put on a diet, they can be sold, or sent out to pasture, or returned to their owners. They just can't be slaughtered. The holders of secured claims will always cry foul whenever their full and complete access to their collateral, with all the leverage they thought they had an inviolate right to exercise, is somehow impinged. The story is no different when the impingement takes the form of being subjected to the insolvency rules of another country. If anything, the protests are even louder, and take on a nearly religious fervor. Yet, at the end of the day, if modified universalism is to function at all—and the author acknowledges that there are those who insist it is fated not to work—then it must of necessity permit a foreign representative to obtain some access to and control over assets subject to a security interest. Lord Hoffmann's insightful comments in both *Cambridge Gas* and *HIH* lay the conceptual groundwork for that conclusion, even if neither case involved the turnover over assets subject to a security interest. So when a court entertaining an ancillary proceeding, and committed to the principle of modified universalism, as so elegantly stated by Lord Hoffmann, is faced with a turnover request, what sort of test ought the court to employ when attempting to give content to the notion of "sufficiently protected" in § 1521(b) and § 1522(a)? At what point should that court invoke the public policy exception in § 1506? And does the court ever dare to employ § 1507 as a substitute for (or, worse, an end-around of) § 1521?

The answers to these questions are not easy, of course. In part, the author suffers under the habit of shying away from advisory rulings—principles announced outside a set of concrete facts. But the tension in this arena is quite high, as well. After all, secured creditors comfortable in their ability to resist turnover can effectively undermine or destroy the efficacy of a unified reorganization effort whenever that effort is taking place in a forum different from the forum under which their security interest arises. They can, in effect, force us into a scheme of cooperative territorialism, as Professor LoPucki predicts will occur in any event. That, in turn, compels the instigation of multiple parallel proceedings, imposing higher transaction costs on the insolvency process. True, such proceedings can be coordinated under the cooperation provisions of Articles 25 through 27 of the Model Law, but if that is the only practical course left to an insolvent debtor, then modified universalism is indeed a dead letter, and with it, much of the Model Law.

The authors optimistically believe that that is not, and should not be, the only way that an insolvency matter can be resolved. Principles already begin to emerge even from the relatively few cases that have been decided already. Here, for consideration, is a suggested listing:

Is the insolvency regime, under which the assets are to be administered, sufficiently "like" one would expect a modern insolvency regime to look like? The question, as posed, is not whether "they look like us," but rather whether they look like members of the family of modern commercial regimes, as measured by, for example, the UNCITRAL Legislative Guide on Insolvency Law.

Is the insolvency case a "main proceeding"? A system of modified universalism contemplates ancillary proceedings lending assistance to a "main" proceeding—which, in turn, ought to be located in a place that is the center of the debtor's main interests, as that term is used in the Model Law. And this should be true despite the

fact that Article 21 of the Model Law would accord the turnover remedy to the representative of a foreign non-main proceeding.

Does the insolvency regime under which the assets are to be administered, include choice of law rules that can be said to give fair consideration to the local origins of a given security interest? In other words, does the insolvency regime superimpose non-insolvency law of the forum on the treatment of creditor claims that have their origin in the ancillary forum?

Does the insolvency regime, under which the assets are to be administered, function such that the security interest would be effectively destroyed, without opportunity to defend the interest in the host forum? The test here is not one of alteration—not even significant alteration—but rather one of destruction.

Did the security interest arise within a suspect period, such that a refusal to turn over the asset would effectively frustrate the administration of the foreign insolvency regime's avoidance rules? If it did, then it is less deserving of special protections.

Is the source of law for the determination of the validity and extent of the security interest the forum of the ancillary proceeding? Given the nature of security interests, the answer to this question will, in most cases, easily be in the affirmative, because the right to enforce a security interest is typically tied to the location of the assets. Still, there may be instances in which the security interest purports to extend to assets extraterritorially.

All the foregoing summary points can find support in the concepts and authorities that have been discussed in this article. All are attempts at reconciling the potentially competing notions of cooperation with a single main proceeding and appropriate protections for the property rights that are the basis for secured creditors' claims to special protection. We do not grant special deference to these rights out of an obeisance to the sanctity of contract—contract rights are routinely altered in the collective process of insolvency. Nor do we necessarily grant special deference out of some lofty notion of the importance of secured credit in the commercial world—were there no secured credit, insolvency would be that much easier to manage. But secured credit is a fact of commercial life, and the laws of most nations accord it special protection because of the secured creditor's presumed shared interest in property of the debtor.

While it might be said, at least in the United States, that we accord special treatment to secured credit because of its constitutional underpinnings, that is a slim and unstable reed on which to premise the argument—other countries do not necessarily accord such rights constitutional protections, and we ought to be somewhat wary of elevating the rights of secured creditors, on that basis, to a level deserving of public policy protections (within the meaning of § 1506), lest we be compelled solely on that basis to grant similar treatment to rights in other countries that also enjoy constitutional protections. Indeed, we already know (from the *Ephedra* case) that, at least in this country, a constitutional entitlement will not necessarily assure that public policy will ride to the rescue. Finally, we know that not all the "sticks" that make up a secured creditor's "bundle of rights" need be preserved in the event of an insolvency proceeding. If a case is a main proceeding, then a secured creditor should not be surprised that its claim will be treated in accordance with the insolvency regime of that forum (though this observation makes it especially important that the center of a debtor's main interests be predictable in

advance—perhaps it is even important that, if a debtor attempts to change that center, the change ought to be an event of default under the security instrument).

By the same token, however, we should know that the complete destruction of a secured creditor's property rights in the event of a turnover (other than in the case of a security interest obtained within a suspect period before the filing) ought to be grounds to resist. Something less than complete destruction will of course trigger increased concern by a court (as it should) but Article 22 (§ 1522 of Chapter 15) makes provision for the granting of a security or bond, and the notion of "sufficiently protected," while not to be presumed to be the same as "adequate protection" as used in the rest of the U.S. Bankruptcy Code, gives a court enough latitude to craft the right remedy to protect the secured creditor's rights in the property that collateralizes its debt. The foreign insolvency regime may do things to a secured creditor that a U.S. proceeding would not—but that is not and should not be the test. The U.S. system permits radical alteration of the creditor's bargain. Another system's laws may do so as well, though in ways different than those in our law. That is to be expected, as Lord Hoffmann points out in *Cambridge Gas*. The fact that those alterations cause a secured creditor to howl and cry foul should be treated by a court as the expected bawling and bellowing of cattle being herded. A hurt cow or a cow in danger is not the same as a fearful cow. And none of them are sacred.

The Payment of Priority Claims in Cross-Border Insolvency Cases

ALLAN L. GROPPER*

SUMMARY

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INTRODUCTION

The premise of this symposium is, as Lord Hoffmann has stated so well, that

> fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated.[1]

Lord Hoffmann spoke of fairness between creditors. Beyond fairness, the goal of preserving the integrity of a multinational enterprise for the benefit of all

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1. Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26, [2007] 1 A.C. 508, [16] (appeal taken from Isle of Man) (U.K.).

stakeholders, by a reorganization or a sale as a going concern, is materially facilitated if there is a centralized proceeding, under the control of one administrator or one debtor in possession, rather than a multiplicity of separate, competing proceedings that usually lead to a liquidation or to a significant loss of value.

The problem, as posed by this symposium's organizers, is that each court with jurisdiction over the insolvency proceedings of a multinational enterprise

> must decide what system of priority to apply as to specific assets and creditors found in the various countries involved. Because these systems vary greatly from country to country, a court may be required to choose between its own domestic system of priorities and that of another jurisdiction. Such a choice may have great consequences for the litigants and for progress toward a system of international coordination.[2]

It is the premise of this paper that if a single court is to take control of the foreign assets of an enterprise and avoid the opening of secondary proceedings, it will ordinarily have to provide for the payment of priority claims, both domestic and foreign. In short, in a cross-border case, particularly one where there is the possibility of reorganization or sale as a going concern, priority claims will have to be paid. The further question dealt with herein is whether an adequate statutory basis exists permitting such relief in the United States, the only jurisdiction about which I am qualified to write.

I. DOMESTIC SYSTEM OF PRIORITIES

To begin the analysis, it is necessary to clarify what is meant by a "domestic system of priorities." This paper will use the term "priority" in the sense it is usually understood in the United States, that is, an unsecured claim entitled to be paid prior to other unsecured claims. Our statutory priorities are set out in § 507 of the Bankruptcy Code and include the expenses of administration of the proceeding itself; limited claims of employees; certain taxes; and such other claims that Congress has deemed sufficiently meritorious to have preferential rights to payment.[3] This paper does not include secured creditors—those creditors who have a security interest in collateral—in the following analysis because there is not a variation in the rights of secured creditors in different jurisdictions to the same degree as the treatment of priority claims. For example, virtually all insolvency regimes purport to respect the rights of secured creditors over their collateral. There are unquestionably significant differences in the procedural impact of an insolvency filing on the rights of secured creditors—some systems, such as the United States, will stay the secured creditor from realizing on its collateral for relatively long periods, while others may not interpose any stay of the right of the secured creditor to foreclose. There may also be differences in the willingness of an insolvency regime to impose certain costs on the secured creditor, such as the costs of administration of the proceeding, or to elevate certain types of claims, such as the claims of employees, over the lien of a secured creditor.

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2. *International Insolvency Symposium: The Priority Dilemma*, TEXAS INT'L LAW JOURNAL, http://www.tilj.org/insolvency/ (last visited Feb. 7, 2011).

3. *See* 11 U.S.C. § 507 (2010) (providing a list of expenses and claims with priority in bankruptcy proceedings).

These regimes nevertheless purport to grant the secured creditor the essential benefit of its bargain as to rights in collateral. In principle, it should not be difficult for a court in the United States to enforce a foreign security interest or for a foreign court to enforce a security interest created in the United States. There may be difficult choice of law issues and secured creditors may create a problem if they are entitled to take substantially all the value of an insolvency estate. However, this problem does not usually arise because of differences among jurisdictions in the recognition of the concept of secured debt.

II. TREATMENT OF PRIORITIES

By contrast, priorities receive vastly different treatment in different jurisdictions, and there is no pretense to uniformity. In the United States, for example, Congress has created a first priority, elevated even over costs of administration, for "domestic support obligations," such as child support and alimony.[4] Although these may not often apply in business cases, this priority appears to be unique. Congress has also provided a few other priorities that appear quite unusual, such as a priority for persons "engaged in the production or raising of grain,"[5] albeit only against the operators of grain storage facilities; and for U.S. fishermen, but only against those who operate a fish produce storage or processing facility.[6] The priority for fishermen is not only limited in scope but also by the citizenship of its holder, thus seemingly transgressing one of the principles enshrined in modern cross-border insolvency and in Chapter 15: all creditors should be treated equally no matter what their citizenship.[7]

Although the United States has some seemingly unusual priorities, they are at least limited in amount. For example, the priority for domestic fishermen is limited to $5,775 for each individual (as adjusted April 1, 2010).[8] Even the priority for workers for wages or salaries, severance, and vacation pay is limited in amount,

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4. *See* 11 U.S.C. § 507(a)(1)(A) (2010) (providing a list of domestic support obligations given priority in bankruptcy proceedings).

5. 11 U.S.C. § 507(a)(6)(A) (2010).

6. 11 U.S.C. § 507(a)(6)(B) (2010).

7. Our discrimination in priority between U.S. and foreign fishermen may not, however, transgress the language of Chapter 15. Section 1513 of Chapter 15, based on the Model Law on Cross-Border Insolvency, provides "[f]oreign creditors have the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors." 11 U.S.C. § 1513 (2005). It adds, nevertheless, that the foregoing principle "does not change or codify present law as to the priority of claims under sections 507 or 726, except that the claim of a foreign creditor under those sections shall not be given a lower priority than that of general unsecured claims without priority solely because the holder of such claim is a foreign creditor." *Id.* Parsing this language carefully, one could conclude that foreign fishermen can be excluded from the priority given to domestic fishermen, so long as they still get an unsecured claim. This seems to be the thrust of the commentary on the Model Law, which speaks euphemistically of "a special ranking to claims of foreign creditors." UNCITRAL, GUIDE TO ENACTMENT OF THE UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY, at 331, U.N. Sales No. E.99.v.3 (1997) [hereinafter GUIDE TO ENACTMENT]. There is also an exception in both the Model Law and Chapter 15 for foreign tax or other public law claims, recognizing that those claims may be unenforceable outside the country of origin. *See generally* Pasquantino v. U.S., 544 U.S. 349, 362 (2005) (stating suits to recover foreign tax liabilities are barred); Moore v. Mitchell, 30 F.2d 600, 602–03 (2d Cir. 1929) (explaining that the Fourteenth Amendment limits the taxing power of a state to the persons and property within its boundaries and thus, the revenue laws in one state have no potency in another state).

8. 11 U.S.C. § 507(a)(6)(B) (2010).

currently to $11,725.[9] By contrast, as is well known, wage and severance priorities under most continental European systems can be vastly higher.[10] Whereas severance pay to workers is given a very small priority in most of the United States, it is accorded a very substantial priority in other systems.[11]

As suggested above, insolvency regimes differ not only in the identity of the creditors granted priority status, but in the size and scope of priorities, particularly in the sensitive area of wages and severance. The location of an insolvency proceeding, or stated more precisely, the law governing the determination of priority claims, may make a great difference in the applicable distribution scheme.

The stakes are made even greater by virtue of two aspects of insolvency law as it exists today. First, where local proceedings are opened, an insolvency administrator is usually appointed who has a strong incentive to follow local law and practice in the distribution of the proceeds of the estate.[12] This follows from the fact that most administrators understand and follow local law and likely have little or no experience in deferring to foreign law—indeed, it is not in the nature of most insolvency administrators to defer to anyone—and for the added reason that the compensation of the administrator is almost invariably dependent on local law and may also depend on the amount of local assets.

Second, most multinational enterprises are organized in separate business units, whether as corporations or limited liability companies, in the different jurisdictions in which they operate. This structure may not owe its genesis to insolvency issues but to tax or corporate governance concerns; however, it still has important implications in the event of the failure of the enterprise. It is much easier to argue against the strict application of local priorities in distribution and for the application of a "foreign" distribution scheme if it can be said the "principal place of business" or "center of main interests" of the enterprise is in a foreign country. Where a local subsidiary is organized, and where local law requires (as it does in the United States) that the separateness of each subsidiary be respected in the event of its insolvency, it is much harder to argue that local priorities should be ignored in favor of the distribution scheme of the jurisdiction of the controlling corporation of the group.[13]

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9. 11 U.S.C. § 507(a)(4) (2010). There are additional priorities, also limited in amount, for contributions to an employee benefit plan. Although the limitation on the wage priorities may appear unduly small, at least compared to the priority for wages in other jurisdictions, it is important to note it is a crime in some states to fail to pay wages to employees, and directors and officers are sometimes made personally liable for unpaid wages. Wage claims in U.S. bankruptcy cases tend, not surprisingly, to be small and limited to the stub period just before the filing. 11 U.S.C. § 507(a)(5) (2010).

10. There are also wide differences as to priorities for taxes, consumer obligations, and tort obligations. *See* Janis Sarra, *An Investigation into Employee Wage and Pension Claims in Insolvency Proceedings Across Multiple Jurisdictions: Preliminary Observations*, 16 NORTON J. BANKR. L. & PRAC. 835, 836–62 (Oct. 2007) (outlining how a variety of other countries approach the issue of priority when an employer files for bankruptcy).

11. Allan L. Gropper, *Memorandum on the Treatment of Certain Parties in United States Bankruptcy Cases*, *in* THE CHALLENGES OF INSOLVENCY REFORM IN THE 21ST CENTURY 59, 63–64 (Henry Peter, Nicholas Jeandin & Jason Kilborn eds., 2006).

12. SAMUEL L. BUFFORD ET AL., FEDERAL JUDICIAL CENTER, INTERNATIONAL INSOLVENCY 21 (2001), *available at* http://www.fjc.gov/public/pdf.nsf/lookup/IntlInso.pdf/$file/IntlInso.pdf.

13. U.S. insolvency law permits the "substantive consolidation" of separate, related entities under narrow, limited circumstances. *In re* Owens Corning, 419 F.3d 195, 208–09 (3d Cir. 2005); *In re* Augie/Restivo Baking Co., 860 F.2d 515, 518 (2d Cir. 1988). Some other systems do not recognize the concept, even though there may be limited circumstances under which a corporate veil will be pierced. *See* Daniel Staehelin, *No Substantive Consolidation in the Insolvency of Groups of Companies*, *in* THE

Critics of the principle of "one distribution" have called attention to the unfairness of imposing a foreign distribution scheme and depriving a worker of the substantial priority claim he would have in his home jurisdiction in favor of an unanticipated leveling down.[14] Beyond fairness, it cannot be realistically expected that the authorities in a jurisdiction where assets are located will surrender those assets to a foreign court when the interests of local creditors will be adversely affected. If we are to realize the ideal of one proceeding in which all creditors are entitled and required to prove, we will have to deal carefully with local priorities, and we will ordinarily have to pay them. The remainder of this paper will examine the state of the law, first, with respect to transfers of assets out of the United States to other jurisdictions, with the possible loss of priority rights on the part of U.S. creditors; and second, whether U.S. law permits a court to protect the priority rights of foreign creditors in a case pending here.

III. TRANSFER OF ASSETS OUT OF THE UNITED STATES

Until the adoption of Chapter 15 of the Bankruptcy Code, which is the U.S. version of the Model Law on Cross-Border Insolvency, recognition of foreign insolvency cases and the potential transfer of assets abroad was governed by § 304 of the Bankruptcy Code, which was repealed when Chapter 15 was adopted.[15] Under § 304, it was theoretically possible for funds to be distributed to a foreign estate representative for distribution in a foreign proceeding, where U.S. creditors would have a smaller recovery. In determining whether to grant relief under § 304, U.S. courts were required to consider several factors, including whether there would be a "distribution of proceeds of [the foreign] estate substantially in accordance with the order prescribed by this title."[16] As long as the foreign proceeding would result in a distribution "substantially" in accordance with U.S. bankruptcy laws, differences in distribution schemes were not necessarily a bar to the grant of relief.[17] For example, in *In re García Avila*, the Bankruptcy Court stated:

CHALLENGES OF INSOLVENCY REFORM IN THE 21ST CENTURY 213, 215 (Henry Peter, Nicolas Jeandin & Jason Kilborn eds., 2006) (explaining "substantive law may provide for piercing the corporate veil," even without application of the concept of substantive consolidation).

14. *See generally* Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 700 n.11 (1999) (explaining fairness concerns suggest that a strictly universalist approach is not always best).

15. *See* 11 U.S.C. § 304(c)(4) (2005) (repealed 2005); 11 U.S.C. § 1501–1532 (2011); Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, §§ 802(d)(3), 801(a), 119 Stat. 23, 146 (2005) (repealing 11 U.S.C. § 304 and creating Chapter 15 of Title 11 respectively).

16. 11 U.S.C. § 304(c)(4) (2005) (repealed 2005).

17. *See, e.g.*, Cunard S.S. Co. v. Salen Reefer Servs. AB, 773 F.2d 452, 455 (2d Cir. 1985) (discussing factors appropriate for a court to evaluate when considering whether a foreign proceeding bars relief under U.S. law); *In re* Gee, 53 B.R. 891, 904 (Bankr. S.D.N.Y. 1985) (explaining the foreign bankruptcy code is sufficiently similar to the U.S. code to dismiss proceedings); *In re* Culmer, 25 B.R. 621, 631 (Bankr. S.D.N.Y. 1982) (explaining that, although not identical, the bankruptcy code of the Bahamas was acceptable in place of the U.S. code). The law is similar for recognizing foreign proceedings under Chapter 15. *See In re* Metcalfe & Mansfield Alt. Invs., 421 B.R. 685, 697 (Bankr. S.D.N.Y. 2010) (stating "[t]he relief granted in the foreign proceeding and the relief available in a U.S. proceeding need not be identical"). A U.S. bankruptcy court is not required to make an independent determination about the propriety of individual acts of a foreign court. *See In re* Bd. of Dirs. of Multicanal S.A., 307 B.R. 384, 391 (Bankr. S.D.N.Y. 2004) (noting neither case law nor § 304, which is the statutory predecessor to Chapter

> At bottom the [Objecting] Creditors argue that the Court should not grant comity because they may receive a smaller distribution on their unsecured claim in Mexico than they would receive on their unsecured claim under United States law. Section 304(c) does not, however, require that an unsecured creditor receive the same distribution in the foreign case and the hypothetical American bankruptcy . . . [T]he application of such a test would pose a significant obstacle to ever granting comity.[18]

In most cases under § 304, the relief provided in the U.S. proceeding was recognition of the foreign case. U.S. creditors were required to seek a recovery in the foreign proceeding rather than pursue litigation in the United States. However, there were not necessarily any material assets in the United States to which U.S. creditors might make claim. Moreover, there were relatively few cases where funds were transferred out of the United States to be distributed in the foreign case, and very few reported cases where funds were distributed to a foreign representative to the potential disadvantage of U.S. creditors. In one of the first litigated § 304 cases, *In re Culmer*, the Bankruptcy Court authorized the transfer of property for distribution in the Bahamas, but it was not clear the security interests of U.S. creditors would be adversely affected.[19] Later, in the noted *Treco* case, the Court of Appeals reversed the courts below and refused to disburse funds to liquidators in the Bahamas if the interests of the holder of a U.S. security interest would be adversely affected.[20] In another case, the same appellate court refused to disburse funds to a foreign proceeding in Switzerland before the U.S. court had determined whether the objecting U.S. creditor had a property interest in the disputed funds.[21]

In one case, funds were disbursed, over objection, to a foreign proceeding for distribution there, based in part on the premise that the objecting creditor's lien rights were void because its attachment in the United States had been obtained after the foreign proceeding had been opened.[22] In the American analogue to the English case of *McGrath v. Riddell*,[23] the Australian liquidators of HIH Insurance sought an order under § 304 to remit a relatively small amount of funds from the United States to Australia for distribution in the Australian proceeding.[24] However, by the time the

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15, require a determination that the foreign proceeding is identical to the U.S. proceeding). "The key determination required by this Court is whether the procedures used in [the foreign State] meet our fundamental standards of fairness." Cunard S.S. Co., 773 F.2d at 457; *see also In re* Atlas Shipping A/S, 404 B.R. 726, 732–33 (Bankr. S.D.N.Y. 2009) (discussing the history of § 304 and the desire for comity between foreign powers and their bankruptcy administrators).

18. *In re* García Avila, 296 B.R. 95, 112 (Bankr. S.D.N.Y. 2003).

19. *In re Culmer*, 25 B.R. at 628.

20. *In re* Treco, 240 F.3d 148, 159 (2d Cir. 2001). On the other hand, another panel of the same court remitted the holder of a U.S. security interest in assets of a Mexican company to the Mexican insolvency proceedings, and did not voice concern that it had taken years and multiple appeals before the Mexican courts were willing to accord the claim of the U.S. creditor secured status. JP Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V., 412 F.3d 418, 427 (2d Cir. 2005).

21. *In re* Koreag, Controle et Revision, S.A., 961 F.2d 341, 348–50 (2d Cir. 1992), *cert. denied*, 506 U.S. 865 (1992).

22. *In re* Milovanovic (Jik Banka), 356 B.R. 250, 256–57 (Bankr. S.D.N.Y. 2006), *aff'd*, 07 Civ. 2667 (LTS) (S.D.N.Y. 2007) (opinion unreported), *aff'd sub nom*; *In re* Agency for Deposit Ins. of Serbia, No. 08-0299-bk, 2008 U.S. App. LEXIS 24120 (2d Cir. Nov. 21, 2008).

23. McGrath v. Riddell (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21, [32], 1 W.L.R. 852 (H.L.) 863 (Lord Hoffmann) (appeal taken from Wales) (U.K.).

24. *See* Permanent Injunction Order for HIH Cas. and Gen. Ins. Ltd., *In re* Petition of Provisional Liquidators of FAI Gen. Ins. Co. Ltd. and HIH Cas. and Gen. Ins. Ltd., No. 01-B-11899 (AJG) (Bankr.

Australian liquidators sought an order remitting funds to Australia, they were apparently able to represent that the U.S. creditors would enjoy a larger distribution if they were able to file claims in the Australian proceeding and share in the pool there, rather than retain a priority in the small amount of property in the United States.[25] There were no objections to the transfer, in contrast to the result in the U.K. case, where funds were distributed to Australia to the disadvantage of U.K. creditors.[26]

The law subsequent to § 304 appears to have made it more difficult to transfer funds to a foreign estate representative to the disadvantage of U.S. creditors. Chapter 15 provides that the court may "entrust the distribution of all or part of the debtor's assets located in the United States to the foreign representative," but there is an express proviso: "provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected."[27] The first reported case involved the protection of the rights of a secured creditor,[28] the court holding that a secured creditor objecting to a Chapter 15 order would have no better rights than a secured creditor under the Bankruptcy Code.[29] More recently, a bankruptcy court expressly applied § 1521(b) in refusing to transfer property in the U.S. to a recognized proceeding in Bahrain before the foreign representative provided additional evidence that the U.S. creditors would be protected.[30]

What about the rights of creditors who would have a priority interest in the United States, but possibly lose the priority if the funds were transferred to another jurisdiction for distribution in accordance with the latter's priority scheme? In other words, could a U.S. court properly conclude, in the interest of comity, that the provision mandating protection of U.S. creditors does not require that U.S. priorities be respected?

There is little direct authority pointing to a narrow construction of the phrase, "provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected."[31] The Guide to Enactment of the UNCITRAL Model Law does not point in this direction. Paragraph 157, explaining the "turnover" of assets to a foreign representative, stresses that the "Model Law contains several safeguards designed to ensure the protection of local interests before assets are turned over to the foreign representative," including "adequate protection" of the rights of local creditors.[32] There is no express language in either the Model Law or in

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S.D.N.Y. Sept. 18, 2008) (enforcing Australian scheme in the United States); *see also* Permanent Injunction Order for World Marine and Gen. Ins. Pty., *In re* Petition of Provisional Liquidators of FAI Gen. Ins. Co. Ltd. and HIH Cas. and Gen. Ins. Ltd., No. 01-B-11899 (AJG) (Bankr. S.D.N.Y. Sept. 23, 2009) (enforcing the English Administration order).

25. *See* Permanent Injunction Order for HIH Cas. and Gen. Ins. Ltd., *In re* Petition of Provisional Liquidators of FAI Gen. Ins. Co. and HIH Cas. and Gen. Ins., No. 01-B-11899 (AJG) (Bankr. S.D.N.Y. Sept. 18, 2008) (enforcing the Australian scheme in the United States).

26. *Id.*; *McGrath*, [2008] UKHL 21, [32].

27. 11 U.S.C. § 1521(b) (2005).

28. *In re* Tri-Cont'l Exch. Ltd., 349 B.R. 627, 637–39 (Bankr. E.D. Cal. 2006).

29. *Id.* at 636.

30. *In re* Int'l Banking Corp. B.S.C., 439 B.R. 614 (Bankr. S.D.N.Y. 2010).

31. 11 U.S.C. § 1521(b) (2005).

32. The Model Law uses the phrase "adequate protection" in Article 21(2). The U.S. version changed the language to "sufficiently protected" so the concept would not be equated with "adequate protection" as described in § 361 of the Bankruptcy Code, which is the protection to which secured

the Commentary indicating the drafters did not intend the court to protect priority local creditors.

Moreover, the European Regulation on Insolvency, which served to a certain extent as a model for the UNCITRAL Model Law, points in the direction of the protection of local creditors.[33] Under the European Regulation, if there are secondary proceedings opened in one or more States of the Union in addition to the State of the "centre of main interests," assets are first distributed to creditors in the secondary proceedings in accordance with local law, and only the surplus, if any, is distributed to the administrator in the so-called main case.[34] Since the European Regulation permits and does not impede local creditors from opening local secondary proceedings in which their priorities would be respected, distributing assets to a main proceeding over the objection of dissenting local priority creditors who would be disadvantaged appears impractical.

The foregoing analysis suggests a strong statutory basis for holders of priority claims to seek "sufficient protection" of their interests before funds are transferred abroad. For holders of general unsecured claims, on the other hand, a strong argument can be made that the principle stated by Lord Hoffmann, quoted at the outset of this paper, is preserved, and similarly situated general unsecured creditors should receive the same distribution without regard to the assets available or the amount of debt located in a particular jurisdiction. As Lord Hoffmann has stated, the principle of equality among similarly situated creditors is embedded in the common law.[35] Chapter 15 and the Model Law expressly recognize this principle in at least two respects. First, § 1532 of Chapter 15, based on Article 32 of the Model Law, adopts the hotchpot rule: a creditor who has received payment

> with respect to its claim in a foreign proceeding pursuant to a law relating to insolvency may not receive a payment for the same claim in a case under any other chapter of [the Bankruptcy Code] regarding the debtor, so long as the payment to other creditors of the same class is proportionately less than the payment the creditor has already received.[36]

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creditors are entitled as compensation from any diminution in value of collateral as a result of the bankruptcy stay. *See* H.R. REP. NO. 109–031, pt. 1, at 115 (2005) (explaining the term "adequately," used in article 21 of the Model Law, has been replaced by "sufficiently" in order "to avoid confusion with a very specialized legal term in United States bankruptcy"); *see also In re* Tri-Cont'l Exch., 349 B.R. at 636 (explaining the phrase "sufficiently protected" of § 1521 is based on article 21 of the Model Law, although different "in order to avoid confusion with the Bankruptcy Code's defined term of art 'adequate protection'"). The explanatory text of the Model Law also refers to "the principle of protection of local interests in article 22, paragraph 1; the provision in article 21, paragraph 2, that the court should not authorize the turnover of assets until it is assured that the local creditors' interests are protected; and article 22, paragraph 2, according to which the court may subject the relief that it grants to conditions it considers appropriate." GUIDE TO ENACTMENT, *supra* note 7, para.157.

33. Council Regulation, 1346/2000, 2000 O.J. (L 160) 2 (EC) [hereinafter EC Regulation].

34. *Id.*

35. Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings, PLC, [2006] UKPC 26, [2007] 1 A.C. 508 (appeal taken from Isle of Man) (U.K.).

36. 11 U.S.C. § 1532 (2005). The hotchpot rule originated in England and began appearing in cases as early as 1762; one U.S. commentator has stated it is part of the U.S. common law. *See* Kurt H. Nadelmann, *Revision of Conflicts Provisions in the American Bankruptcy Act*, 1 INT'L & COMP. L.Q. 484, 487 (Oct. 1952) (footnote omitted) (explaining history of the hotchpot rule in England and its status in U.S. jurisprudence) [hereinafter Nadelmann, *Revision of Conflicts*]. In one early case, *Selkrig v. Davis*, (1814) 2 Rose 291, Lord Eldon L.C. characterized the rule by stating, "[i]t has been decided, that a Person

This preserves the principle, previously codified in § 508(a) of the Bankruptcy Code, attempting to equalize distributions to creditors in joint proceedings in more than one jurisdiction, no matter where the assets are located.[37]

A second principle of Chapter 15 and the Model Law appears to have more potential in equalizing distributions to general unsecured creditors in cases in multiple jurisdictions. This is the principle that foreign creditors have an absolute right to file a claim in a U.S. case.[38] In theory, the right of foreign creditors to file claims in a U.S. case involving the same debtor ought to equalize distributions among general unsecured creditors.[39] Professor Westbrook has written favorably about the "cross filing of claims," noting the European Insolvency Regulation contains an express provision therefor and describing the result:

> [E]very claim made in any proceeding may be asserted in all proceedings through the liquidators, and therefore every claim may share in the distribution from every proceeding. That is the system I want to call universal cross-filing, or "UCF." If there were no national priority systems, the result of UCF would approach the same equality of distribution as in a system of modified universalism, in which all distributions take place under the direction of a single national court.[40]

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cannot come in under an English Commission without bringing into the common Fund what he has received abroad. The Reason of that cannot be, merely that all the Creditors under a Commission are to be put on an equal Footing .... If a Man chuses [sic] to say, I will not bring into the common Fund that Sum which I have received, then let him retire." *Id.* at 318; Cleaver v. Delta Am. Reinsurance Co., [2001] UKPC 6, [2001] 2 W.L.R. 1202; *see also Ex parte* Wilson, (1871–1872) L.R. 7 Ch. App. 490, [492–93] (explaining hotchpot rule as characterized by *Selkrig*); Banco de Portugal v. Waddell, (1880) 5 App. Cas. 161, [167] (same).

37. Section 508 traces its history to § 65(d) of the Bankruptcy Act of 1938. *See* Bankruptcy Act of 1938, ch. 575, 52 Stat. 875 (1938) (requiring creditors residing in the United States to "be paid a dividend equal to that received" by other creditors in a foreign jurisdiction before "creditors who have received a dividend in such courts shall be paid any amounts"). Prof. Westbrook calls it "at best a first step toward an appropriate 'adjustment'" rule, but "unsophisticated and unsatisfactory." Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27, 41 (1998) [hereinafter Westbrook, *Universal Priorities*]. When § 1532 were added to the Bankruptcy Code in 2005, § 508(a) was repealed, presumably on the theory that it was superfluous and the Chapter 15 provisions relating to cross-border issues were sufficient. Unfortunately, they are not. By virtue of § 103(k), most of the provisions of Chapter 15 (including § 1532) only apply in a case under that chapter, i.e., a case in which a foreign proceeding is recognized. By the strict terms of the statute, if the provision is not deemed part of common law, the hotchpot rule would not apply in a Chapter 7 or Chapter 11 case in the United States involving a foreign debtor where there was no Chapter 15 order or proceeding. This is an apparent statutory oversight that should be remedied.

38. *See* 11 U.S.C. §§ 1513, 1514 (2005) (stating "foreign creditors have the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors").

39. In the past, it might have been assumed that the right of a foreign creditor to file a claim would be illusory, as the procedure would be too difficult. In the age of the internet, however, filing claims can be made extremely simple. Moreover, it seems to be an open issue whether a foreign representative could be permitted to file a claim on behalf of all creditors of the estate represented. There are obvious difficulties in allowing such a class proof of claim, but the requirements of Chapter 15 regarding cooperation with foreign representatives would militate in favor of such recognition. There do not appear to be any cases yet under U.S. law.

40. Westbrook, *Universal Priorities*, *supra* note 37, at 30. *But see In re* Griffin Trading Co., 270 B.R. 905 (N.D. Ill. 2001), *aff'g* 270 B.R. 883 (Bankr. N.D. Ill. 2001) (holding English liquidators lacked standing to file proof of claim in U.S. bankruptcy case on behalf of English creditors).

As Westbrook contends, the foregoing principles can be applied to equalize distribution to general unsecured creditors of estates in different jurisdictions. They definitely do not apply, however, to the equalization or leveling of priority claims. By its terms, the hotchpot provision, § 1532, equalizes payments only among "creditors of the same class."[41] Paragraph 199 of the Model Law's Guide to Enactment explains "Article 32 does not affect the ranking of claims as established by the law of the enacting State and is solely intended to establish the equal treatment of creditors of the same class."[42] Section 1513(b), precluding discrimination, similarly makes it clear the principle that foreign creditors "have the same rights regarding ... participation in, a case under this title as domestic creditors" does not change the law as to the priority of claims, "except that the claim of a foreign creditor under those sections shall not be given a lower priority than that of general unsecured claims without priority solely because the holder of such claim is a foreign creditor."[43]

There is nothing express in Chapter 15 or the Model Law to counter the presumption that priority claims in different jurisdictions should be enforced and applied, but there is much to support the proposition that the Model Law preserves and protects priorities. Moreover, it should not be forgotten that the language of Lord Hoffmann in the *Cambridge Gas* case, quoted at the outset of this paper, is "No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated."[44] Lord Hoffmann spoke about advantages based on location of assets and the presence of creditors, or the equalization of the rights of general unsecured creditors. Nothing is said, at least in that passage, as to the recognition of priority claims or what in England would be called "preferred claims."

From the foregoing, it appears that the present state of the law, and particularly the cross-border provisions now enshrined in Chapter 15, provides little support for the contention that assets can be remitted to a foreign proceeding over the objection of, and in derogation of the rights of, priority creditors in the United States. This leads to the conclusion that is the premise of this paper—in a successful cross-border proceeding, before assets are transferred out of the United States for distribution in a foreign case, priority claims will likely have to be paid or satisfied, or at least provision will have to be made for their payment in the foreign proceeding.[45]

The next question is whether a bankruptcy court sitting in the United States has an adequate statutory basis to recognize foreign priority claims.

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41. 11 U.S.C. § 1532 (2005).

42. GUIDE TO ENACTMENT, *supra* note 32, para. 199.

43. 11 U.S.C. §§ 1513(a), (b)(2) (2005). As discussed above at note 7, this language would appear to permit an enacting country to provide a priority only to domestic creditors, as the U.S. has done for fishermen, subject to the limitation that foreign creditors cannot be subordinated below general unsecured claimants. There is an exception for foreign tax claims or other foreign public law claims, which can be excluded altogether, subject to any applicable tax treaties. 11 U.S.C. § 1513(b)(2) (2005).

44. Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings, PLC, [2006] UKPC 26, [2007] 1 A.C. 508 (appeal taken from Isle of Man) (U.K.).

45. Of course, such claims would be subject to any defenses, offsets or avoidance claims. *See, e.g.*, Fogerty v. Petroquest Res. Inc. (*In re* Condor Ins. Ltd.), 601 F.3d 319, 321 (5th Cir. 2010) (holding bankruptcy courts have authority to offer avoidance relief under foreign law in a Chapter 15 proceeding).

IV. TRANSFER OF ASSETS INTO THE UNITED STATES OR CONTROL OF FOREIGN ASSETS IN A UNITED STATES PROCEEDING

It seems obvious that foreign priority claims would have to be paid if foreign creditors or foreign judges are to be convinced to permit the transfer of local property to the United States for administration there, or to allow U.S. control of property located in the foreign jurisdiction. Assuming the foreign court applies the same Model Law adopted in the United States, the foreign judge would be required, before transferring property abroad, to be at least as solicitous of the rights of local creditors as a U.S. counterpart because foreign creditors would in any event have a trump card under the Model Law. As noted above, the Model Law does not impede the right of a local creditor to commence a local plenary proceeding, notwithstanding a request for recognition by a foreign estate representative.[46]

Therefore, if foreign assets are to be successfully transferred to the United States for distribution here, it appears a U.S. court would have to have, and presumably exercise, discretion to pay or satisfy foreign priority claims that "relate to" these assets. As noted above, the stakes are high, especially if it would benefit stakeholders to reorganize the entity or sell it as a going concern. In order to preserve value and a chance at continuing the business, it is often critical to keep a group of companies together under the same form of centralized control as existed prior to the insolvency filing, and to avoid the appointment of multiple estate administrators.[47]

To answer the question whether a U.S. court could authorize payment of the claims foreign priority creditors would have in a foreign proceeding, we start with past practice, as well as the sparse legal authority on point.

V. PAST PRACTICE

U.S. debtors in Chapter 11 reorganization cases with substantial assets in their own name abroad, that seek to protect those assets, invariably try to pay in full not only foreign priority creditors but all foreign creditors, with the possible exception of foreign financial creditors (usually banks) doing business in the United States and unquestionably subject to U.S. jurisdiction. Notable examples are U.S. shipping companies and airlines, which are unique as they sail or fly their principal assets from jurisdiction to jurisdiction. It appears that all of the airlines that have filed under Chapter 11, and there have been many, obtained a "first-day" order providing for the

46. Article 20(4) of the Model Law provides that an order recognizing a foreign proceeding does not affect the right of any entity to request the commencement of a plenary case in the jurisdiction. Model Law on Cross-Border Insolvency, art. 20(4), G.A. Res. 52/158, U.N. Doc. A/RES/52/158, (Jan. 30, 1998) [hereinafter Model Law]. This principle has been codified in the United States in § 1520(c) of Chapter 15.

47. On the plus side, a reorganization rather than a liquidation may result in the continued employment of many potential priority claimants and reduce the size of the administrative claims, especially in jurisdictions where severance payments to workers are a significant burden.

payment of all foreign creditors.[48] For example, Northwest Airlines received one on the first day of its Chapter 11 case and no one protested then or later.[49]

The first successful reorganization of a U.S. shipping company under Chapter 11 was Waterman Steamship Corp., which had enough money on the date of filing to satisfy all of its foreign trade creditors.[50] Waterman obtained a first-day order providing for payment and, without this order, the company could not have had any hope of continuing to do business in foreign commerce.[51] Unfortunately, the largest U.S. flag carrier at the time, United States Lines, did not have enough cash to satisfy all of its foreign creditors when it filed its Chapter 11 petition in 1986.[52] It was able to continue its international business for a few months, by convincing its foreign creditors it would eventually pay, but once word started circulating that it might sell some of its ships, foreign creditors began to seize assets and it eventually liquidated.[53]

It may be argued that airlines and shipping companies are anomalies, as they tend to do business in many jurisdictions in one corporate form and, as noted, transfer their principal assets from jurisdiction to jurisdiction. Most U.S. multinational enterprises do business in foreign countries through subsidiaries, as also noted above. However, as a result of the difficulty of coordinating foreign insolvencies and preventing foreign creditors from seizing assets, U.S. debtors with significant foreign operations usually keep the foreign subsidiaries they wish to preserve out of a foreign case altogether.[54] The U.S. debtor ordinarily obtains

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48. *See, e.g.*, *In re* Pan Am Corp., No. 91-B-00180-87 (Bankr. S.D.N.Y. 1991); *In re* Aerovias Nacionales de Colombia, S.A. Avianca, 303 B.R. 1, 5 (Bankr. S.D.N.Y. 2003) (explaining the debtors "sought and obtained approval of several 'first-day orders'").

49. Order, *In re* Northwest Airlines Corp., No. 05-17930 (Bankr. S.D.N.Y. Sept. 15, 2005).

50. *See generally* Allan L. Gropper, *Current Developments in International Insolvency Law: A United States Perspective*, 927 PLI/Comm 867, 936 (2010) (explaining Waterman was permitted to pay foreign creditors at the time of the commencement of the U.S. proceeding in order to avoid having assets seized in a foreign jurisdiction).

51. *In re* Waterman S.S. Corp., No. 83-B-11732 (Bankr. S.D.N.Y. 1983).

52. *In re* McLean Indus. Inc., 68 B.R. 690, 691 (Bankr. S.D.N.Y. 1986).

53. There are several cases involving the attempt of U.S. Lines to reorganize and the effects of foreign seizure of its property abroad. *See, e.g.*, *In re* McLean Indus., Inc., 857 F.2d 88, 88–91 (2d Cir. 1988) (regarding proceedings in Singapore). The debtor made an effort to obtain cooperation from the U.K. courts after separate administration proceedings were opened there, resulting in a decision which refused to recognize the U.S. Chapter 11 case. *See* Felixstowe Dock & Ry. Co. v. United States Lines, Inc., [1989] Q.B. 360 (Eng.) (indicating fact of Chapter 11 proceedings were only one consideration, not a dispositive one).

54. One exception involves Canada, where the legal culture and insolvency law are very similar to those of the United States. BUFFORD, *supra* note 12, at 22. Another exception that proves the rule involved the insolvency proceedings of the Lyondell group. Chapter 11 proceedings were filed in the United States for the U.S. subsidiaries of a Dutch holding company. There were no U.S. filings by the foreign entities. Certain creditors attempted to put pressure on the U.S. debtors by taking steps to bring an involuntary proceeding in the Netherlands against the Dutch parent, which had guaranteed some of the U.S. debt, in response to which the U.S. court granted a temporary injunction staying any action by the U.S. creditors for 60 days to give the parent an opportunity to consider its options. *See* Lyondell Chem. Co. v. Centerpoint Energy Gas Servs. (*In re* Lyondell Chem. Co.), 402 B.R. 571, 595–96 (Bankr. S.D.N.Y. 2009) (granting an injunction for 60 days to allow the parties to consider their options). Although it was unable to stay out of a proceeding altogether, its preferred course, the Dutch parent filed a U.S. proceeding. Voluntary Petition of LyondellBasell Industries, *In re* Lyondell Chem. Co., No. 09-12518 (Bankr. S.D.N.Y. Apr. 24, 2009). There have also been a few cases where there has been a collective filing, in England, of the European subsidiaries of an American parent company. Even in those cases, there has been considerable conflict among the debtors and the courts with jurisdiction over the respective cases. See the *Collins & Aikman* cases discussed *infra*, notes 89–96. There are a few other examples of filings by the subsidiaries of American companies in England. *See, e.g.*, *In re* T&N Ltd., [2004] EWHC

judicial approval to continue to advance necessary funding to its foreign subsidiaries, often by maintenance of its prepetition "cash management system," and usually with creditor committee oversight.[55] The usual practice is for U.S. debtors to pay all foreign creditors, not merely priority creditors.[56]

VI. LEGAL BASIS FOR PAYMENT

How have these payments been justified as a matter of legal doctrine? The only reported case dealing specifically with the payment of foreign claims treated them as an aspect of the so-called critical vendor issue. In *In re Kmart Corp.*, the Seventh Circuit dealt with the payment of the prepetition claims of so-called critical vendors, suppliers of goods and services that, it was contended, would not continue to do business with the debtor without immediate payment, and that the debtor deemed essential to its survival in Chapter 11.[57] The Bankruptcy Court had entered an order, of a type that had become increasingly common throughout the country, providing for payment of these critical vendor claims,[58] and the Seventh Circuit reversed.[59]

Its opinion is important in any analysis of the legal justification for orders permitting the payment of foreign claims in three respects. First, it unfortunately swept into its analysis of the propriety of payments to domestic suppliers "two companion orders covering international vendors and liquor vendors," adding "[a]nalysis of all three orders is the same, so we do not mention these two further."[60] Next, it scoffed at the justification usually used to justify critical payment orders, the so-called "doctrine of necessity"—a doctrine used in railroad reorganizations prior to the adoption of the Bankruptcy Code that, the Seventh Circuit found, could not justify ignoring the express priorities and provisions codified in the Bankruptcy Code.[61]

On the other hand, the Court did not rule out the possibility that critical vendor payments could be authorized under § 363(b)(1) of the Code, which permits a debtor, after notice and a hearing, to "use, sell, or lease, other than in the ordinary course of business, property of the estate."[62] The Court implied the burden of a

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1754 (Ch.) 2361 (Eng.) (involving American subsidiaries and English companies in cross-border proceedings); Freakley v. Centra Reinsurance Int'l Co., [2004] EWHC (Ch.) 2740 (Eng.) (involving English subsidiaries of American corporation in bankruptcy proceedings); *see In re* Federal-Mogul Global, Inc. 300 F.3d 368 (3d Cir. 2002) (involving English subsidiaries of Federal Mogul Corp.). In the *Federal-Mogul* case, the U.S.-U.K. conflict was resolve in a U.K. Global Settlement Agreement, pursuant to which the U.S. debtors agreed to fund company voluntary arrangements in the U.K. that were approved there and incorporated into a U.S. plan of reorganization. *See In re* Federal-Mogul Inc., 2007 WL 4180545, at *17 (Bankr. D. Del. 2007).

55. *See In re* Charter Co., 778 F.2d 617, 621–22 (11th Cir. 1985) (indicating use of "cash management system" to facilitate advancement of funds to foreign subsidiaries).

56. BUFFORD, *supra* note 12, at 22.

57. *In re* Kmart Corp., 359 F.3d 866, 868–9 (7th Cir. 2004), *cert. denied*, 543 U.S. 986 (2004).

58. *Id.* at 868; 2 COLLIER ON BANKRUPTCY para. 105.02(4)(a) (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).

59. *See In re Kmart*, 359 F.3d at 871–2, 874 (holding §§ 105(a), 364(b), and 503 do not authorize payment of critical vendor orders, but leaving unresolved the question of whether such power could be found in § 363(b)(1)).

60. *Id.* at 869.

61. *Id.* at 871.

62. *Id.* at 872; 11 U.S.C. § 363(b)(1) (2010).

proponent would be high to establish that the priorities set by statute should be rearranged, particularly in light of Supreme Court authority cautioning against such action.[63] It found the *Kmart* order was not supported by any evidence of record that the vendors were in fact critical to the survival of the debtor, and it also found there was inadequate notice of the proposed order.[64] But it did not bar critical vendor orders under all circumstances, and the Court's decision leaves open the possibility that notice and specific findings under § 363(b) of the Bankruptcy Code would justify such an order.[65]

Where does *Kmart* leave us? Perhaps the Court acted much too hastily by treating the order regarding international vendors as identical to the order governing domestic vendors. Although Kmart might not have owned any property abroad in its own name, and might have had no risk that its property would be seized by unpaid foreign creditors, the issues raised by an order seeking authority to pay foreign creditors are very different from those in the typical domestic critical vendor order. On the other hand, even though the Seventh Circuit did not rule out the possibility of an appropriate order providing for payment to critical vendors, it arrays all of the authority that must be overcome in order to justify any order providing for payment of creditor claims in derogation of the rules of distribution set out in the U.S. Bankruptcy Code.

Can that authority be overcome, and is there adequate legal justification for the payment of the prepetition claims of foreign creditors in U.S. cases, particularly those cases where there is a need to protect foreign assets or repatriate them? The following principles indicate we can prefer foreign claims, or at least foreign priority claims, without utilizing the doctrine of necessity.

First, the courts have not failed to recognize that domestic judicial power is limited and foreign creditors may have the ability to flout our bankruptcy principles if they are not dealt with in a preferential fashion. In principle, a U.S. bankruptcy estate extends to property of the debtor, "wherever located,"[66] but courts have not ignored the reality that foreign property and foreign creditors may not be subject to control.[67]

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63. *In re Kmart*, 359 F.3d at 872. The Court cited *United States v. Noland*, 517 U.S. 535, 538 (1996) and *United States v. Reorg. CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 228–29 (1996). *See also In re* Oxford Mgmt., Inc., 4 F.3d 1329, 1334 (5th Cir. 1993) (refusing to "allow the payment of post-petition funds to satisfy pre-petition claims"); Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299, 302 (4th Cir. 1987) ("The Bankruptcy Code does not permit a distribution to unsecured creditors in a Chapter 11 proceeding except under and pursuant to a plan of reorganization that has been properly presented and approved.").

64. *In re Kmart*, 359 F.3d at 868.

65. There are more recent decisions that have approved critical-vendor motions but on a heightened evidentiary standard. *See In re* Tropical Sportswear Int'l Corp., 320 B.R. 15, 17 (Bankr. M.D. Fla. 2005) (holding §§ 105 and 363(b)(1) authorize the court to issue critical vendor orders but requiring the parties to satisfy a heightened evidentiary standard in spite of delay in the case); *In re* CoServ, L.L.C., 273 B.R. 487, 490, 498–502 (Bankr. N.D. Tex. 2002) (requiring the parties meet a heightened evidentiary standard for a critical vendor order even though the motions were unopposed, resulting in the court denying five of seven requests); *In re* Just for Feet, 242 B.R. 821, 826 (Bankr. D. Del. 1999) (holding only a showing "that payment of the pre-petition claims is 'critical to the debtor's reorganization'" would justify the authorization of the payments under § 105(a) (internal citations omitted)).

66. 11 U.S.C. § 541(a).

67. *See* Shaw Group, Inc. v. Triplefine Int'l Corp., 322 F.3d 115, 120 (2d Cir. 2003) (recognizing limitations on judicial power); Fotochrome, Inc. v. Copal Co., Ltd., 517 F.2d 512, 516 (2d Cir. 1975) (noting the court lacked personal jurisdiction over the foreign creditor); *In re* Peregrine Sys., Inc., 2005 WL

A more specific justification for the payment of foreign priority claims may be found in a provision of the Model Law that expressly deals with the claims of foreign creditors. Section 1513, entitled "Access of foreign creditors to a case under this title," provides in subsection (a) that "[f]oreign creditors have the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors."[68] Subsection (b) then provides an exception to this general rule of non-discrimination for priority claims, but it does not merely carve out priority claims from the rule.[69] Subsection (b)(1) provides "[s]ubsection (a) does not change or codify present law as to the priority of claims under section 507 or 726."[70] It is not difficult to understand what is meant when this clause states the rule of non-discrimination does not "change" present law—as noted above, U.S. creditors can be preferred.[71] However, the drafters also provided the rule of non-discrimination does not "'codify' present law as to the priority of claims."[72] This language clearly suggests the priority of foreign claims, if not codified in §§ 507 and 726, can be dealt with outside of those provisions. Judges must apply every word of a statute, and use of the word "codify" indicates foreign priority claims are entitled to "uncodified treatment."[73]

The Guide to Enactment has similar language. There it is explained that "[p]aragraph 2 [codified in Chapter 15 as subsection (b) § 1513] makes it clear that the principle of non-discrimination embodied in paragraph 1 leaves intact the provisions on the ranking of claims in insolvency proceedings, including any provisions that might assign a *special ranking* to the claims of foreign creditors."[74] The concept of "special ranking" would include better treatment for a foreign priority claim than the treatment provided to a similar creditor under the local law of the forum, the treatment this paper proposes for foreign priority claims.

A third basis for providing preferential treatment to foreign priority claims, and thereby in effect modifying our distributional scheme, is based on a choice of law analysis. Professor Westbrook has suggested we can use choice of law analysis for this purpose, in effect conceptualizing separate pools of assets based on their location at the time of the insolvency filing.[75] If non-domestic assets are acquired by the U.S. debtor or controlled in the U.S. case, those assets are considered to be impressed by

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2401955, *4 (D. Del. Sept. 29, 2005) (recognizing the bankruptcy court's limited jurisdiction); *see also In re* Atlas Shipping A/S, 404 B.R. 726, 736 (Bankr. S.D.N.Y. 2009) (explaining the decision in *Fotochrome* as a result of the court's lack of personal jurisdiction). As Lord Hoffmann once stated, with respect to one U.S. cross-border case, "As a matter of U.S. law, the automatic stay operated worldwide. But that was no reason why an English court should give it effect." Leonard Hoffmann, *Cross-Border Insolvency: A British Perspective*, 64 FORD. L. REV. 2507, 2513 (1996).

68. 11 U.S.C. § 1513(a) (2010).

69. 11 U.S.C. § 1513(b) (2010).

70. 11 U.S.C. § 1513(b)(1) (2010). As noted above, there is an exception in that the claim of a foreign creditor cannot be subordinated below the claims of general unsecured creditors without priority "solely because the holder of such a claim is a foreign creditor." *Id.* There is also an exception to the rule of non-discrimination altogether for foreign tax and public law claims. 11 U.S.C. § 1513(b)(2) (2010).

71. *See* discussion *supra* note 7.

72. 11 U.S.C. § 1513(b)(1) (2010).

73. The potential importance of § 1513 is underscored by the fact that it applies in any case commenced under the Bankruptcy Code, not just cases under Chapter 15. *See* 11 U.S.C. § 103(k) (indicating Chapter 15 is applicable in proceedings commenced under the Bankruptcy Code).

74. *Guide to Enactment*, *supra* note 32, para. 104 (emphasis added).

75. Westbrook, *Universal Priorities*, *supra* note 37, at 38–42.

the priorities of their situs on the petition date, and must be used first to satisfy creditors located at the situs. In his words, "we have found a substantial justification for a rule of priority based on the situs of the property at the time of bankruptcy."[76] Although he goes on to state "this type of rule is not a happy result because situs rules are notoriously difficult and arbitrary in application," the principle has the advantage of linking a benefit to a class of foreign creditor to a direct benefit to the U.S. estate—acquisition or control over property situated in a foreign jurisdiction and not subject to the jurisdiction of our courts without foreign cooperation.[77]

The referenced article does not contain citation of authority as support for the analysis but support can be found in one of the most successful cross-border insolvency cases to date, *Maxwell Communications Corp. PLC*, in which Lord Hoffmann played an essential role.[78] A critical factor in the success of the case was the ability of the Joint U.S.-U.K. Plan to pay priority claims in both the United States and the United Kingdom. The inability to pay all such claims would likely have had a fatal impact on the Joint Plan that provided a uniform distribution to general unsecured creditors in the United Kingdom and the United States.

More relevant to the issue at hand, the Court applied what was essentially a choice of law analysis in determining the avoidance proceeding in the United States should be dismissed. Much of the appellate court's reasoning was based on the issue of comity, or deference to the pending English case, but the grant of deference was premised on an analysis of the transaction at issue as fundamentally an English transaction.[79] On this basis, the Court rejected the contention that insolvency schemes are uniform, litigants cannot pick and choose among different parts of an insolvency system, and U.S. avoidance law was necessarily applicable in a U.S. insolvency case.[80] The U.S. examiner in particular had, in the words of the Court of Appeals, warned that "dire consequences would result from a failure to enforce the Code's avoidance provision."[81]

The Court rejected the proposition that all Bankruptcy Code provisions had to be "applied in all Chapter 11 proceedings," stating:

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76. *Id.*

77. *Id.*

78. The final decision in the case was that of the United States Court of Appeals for the Second Circuit in *Maxwell Commc'n Corp. PLC v. Societe Generale (In re Maxwell Commc'n Corp. PLC)*, 93 F.3d 1036 (2d Cir. 1996). The issue was whether the U.S. debtor could bring an avoidance proceeding under U.S. law against three banks located in England. There were plenary bankruptcy cases pending in respect of the debtor in both the U.S. and U.K.; both cases were controlled by English administrators appointed in the English case. The Court of Appeals affirmed, on somewhat different grounds, extensive opinions of the bankruptcy court and the district court. *In re Maxwell Commc'n Corp. PLC*, 170 B.R. 800 (Bankr. S.D.N.Y. 1994); 186 B.R. 807 (S.D.N.Y. 1995) (on intermediate appeal). All three courts held that the U.S. avoidance case could not be pursued based on U.S. law. The involvement of then-Justice Hoffmann was in connection with his denial of an application by Barclays Bank, one of the three banks that were the prospective defendants in the U.S. case, to enjoin the English administrators from proceeding under U.S. law. Justice Hoffmann held that it was up to the U.S. courts to determine whether to exercise jurisdiction in the case and that an injunction would improperly interfere with the U.S. court's authority. *Re* Maxwell Commc'n. Corp. (Barclays Bank PLC v. Homan), [1992] B.C.C 757 (Ch.), *aff'd*, [1992] B.C.C 767 (C.A.).

79. *In re Maxwell Commc'n Corp.*, 93 F.3d at 1048–55.

80. *Id.* at 1049, 1052.

81. *Id.* at 1052.

> Although the non-application of these or other Bankruptcy Code provisions certainly might detract from the Code's policies in other cases, here the negative effects are insubstantial.[82]

Admittedly, the Court's decision went on to stress the fact that a parallel insolvency proceeding was "taking place in another country," and it stated "a different result might be warranted were there no parallel proceeding in England—and, hence, no alternative mechanism for voiding preferences."[83]

Nevertheless, the Court accepted the proposition that provisions of the U.S. Bankruptcy Code would not be applied in a U.S. bankruptcy case, and it chose the application of English avoidance law rather than U.S. avoidance principles based on familiar choice of law principles.[84] Indeed, in the same part of its opinion in which the Court said a different result might be warranted if there were no foreign proceeding pending, the Court made a pure conflicts analysis, stating:

> [W]e cannot say the United States has a significant interest in applying its avoidance law .... Because of the strong British connection to the present dispute, it follows that England has a stronger interest than the United States in applying its own avoidance law to these actions .... [W]e agree with the lower courts that English law could have been expected to apply.[85]

This analysis would be directly relevant to the application of foreign law in connection with the distribution of estate property in a U.S. insolvency case.

Finally, in attempting to support preferential payment to foreign priority creditors based on foreign laws, we might look to the decisions of the English courts, which have been struggling with these same issues. Indeed, in Europe the issues appear more pressing. As noted above, creditors can enforce a right to local priority in the treatment of their claims simply by filing a secondary proceeding in their jurisdiction.[86] Moreover, a decision of the European Court of Justice makes it difficult to argue a joint proceeding of all of the affiliates of an enterprise can be commenced at the center of main interests of the controlling company, rather than at the place of registration of each subsidiary.[87] In order to vest control of the

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82. *Id.* The argument is also flatly rejected in Jay Lawrence Westbrook, *The Lessons of Maxwell Communications*, 64 FORD. L. REV. 2531, 2538 (1996).

83. *In re Maxwell Commc'n Corp. PLC*, 93 F.3d at 1052.

84. *Id.* at 1051–52.

85. *Id.* at 1052. The Court of Appeals cited the district court opinion, 186 B.R. at 823; the bankruptcy court opinion, 170 B.R. at 818; and *Canada S. Ry. Co. v. Gebhard*, 109 U.S. 527, 538, 3 S. Ct. 363, 370 (1883) (holding domestic creditors of foreign bankrupts are "presumed to have contracted with a view to . . . laws of th[e] [foreign] government"). *In re Maxwell Commc'n Corp.* PLC, 93 F.3d at 1052.

86. Westbrook, *Universal Priorities*, *supra* note 37, at 41.

87. Case C-341/04, *In re* Eurofood IFSC Ltd., 2006 E.C.R. I-3813; Samuel Bufford, *International Insolvency Case Venue in the European Union: The Parmalat and Daisytek Controversies*, 12 COLUM. J. EUR. L. 426, 438 (2006). Notwithstanding the language of the *Eurofood* decision, several post-*Eurofood* decisions continue to locate the center of main interests of a subsidiary at the location of the controlling parent of the group, based on the language of the Virgos-Schmit Report, an antecedent of the European Regulation, which states that the place of a debtor's registered office "normally corresponds to the debtor's head office." Report on the Convention of Insolvency Proceedings, E.U. Council Report No. 6500/96, para. 75 (May 1996) (prepared by Etienne Schmit & Miguel Virgos); Gabriel Moss and Tom

subsidiaries in the trustee or administrator in the main case, and to avoid the opening of secondary proceedings, the creditors of the subsidiaries are frequently provided the treatment they would have received in a local insolvency case, even if it is better than the treatment they would receive in the jurisdiction of the main proceeding. There is literature advocating this type of procedure and giving it a name—virtual contractual secondary proceedings.[88]

The proceedings involving Collins & Aikman are a notable example. The enterprise, headquartered in the United States, had 23,000 employees in 17 countries, including 24 facilities in Europe employing 4,500 people.[89] It filed insolvency proceedings in the United States, Canada, and the U.K.[90] It did not attempt to sustain the proposition that its center of main interests was in the United States, but it did contend the center of main interests of its European operations was in London, and it filed all of its European subsidiaries there.[91] After creditors in Spain and Germany threatened to open local cases because they would obtain better treatment in secondary proceedings there, the U.K. administrators managed to avoid the costs and potentially ruinous complications of separate proceedings by promising those creditors better treatment than they would receive under U.K. law.[92] This clearly raised serious issues under English law and under the European Regulation, which appears to require the application of English law and English law priorities.[93] The problem was in effect the reverse of *McGrath v. Riddell.*

The administrators were nevertheless able to convince the British court to authorize a distribution violating English priorities. As counsel for the administrators has stated in an article extolling English pragmatism, "we were able to find no less than three grounds, accepted by the judge, for justifying the giving of assurances."[94] The three grounds were: (i) the express powers of the English legislation; (ii) the inherent jurisdiction of the English court over the joint administrators; and (iii) the principle "based on morality" that "if an officer of the court is under an obligation of conscience, then the Court will direct the officer to fulfil that obligation."[95] The third principle was based on the theory that the administrators had made a promise to the Spanish and German creditors and were morally bound to make good on their promise.

Smith, *Commentary on Council Regulation 1346/2000 on Insolvency Proceedings*, *in* THE EC REGULATION ON INSOLVENCY PROCEEDINGS: A COMMENTARY AND ANNOTATED GUIDE, 8.39 (Gabriel Moss, I.F. Fletcher & S. Isaacs eds., 2002).

88. Michael Menjucq & Reinhard Dammann, *Regulation No. 1346/2000 on Insolvency Proceedings: Facing the Companies Group Phenomenon*, 9 BUS. L. INTL. 145, 145–58 (May 2008).

89. *Re* Collins & Aikman Corp. Group, [2005] EWCH 1754 (Ch) at [2].

90. *Id.* at [4, 10].

91. These cases were commenced before the *Eurofood* decision, and the English court sustained the filing of all of the subsidiaries in England on the premise that England was the center of main interest of each of them. *Id.* at [29].

92. The goal, in the words of counsel for the administrators, was "a very good sale of the group business (with some exceptions) without the opening of secondaries (again with some exceptions) . . . achieving a considerably higher return than had been forecast." Gabriel Moss, *Group Insolvency—Choice of Forum and Law: The European Experience under the Influence of English Pragmatism*, 32 BROOK. J. INT'L. L. 1005, 1018 (2007).

93. *Id.* at 1018 (citing EC Regulation, art. 4).

94. *Id.*

95. *Re* Collins & Aikman Corp. Group, [2006] EWHC 1343 (Ch) at [15].

Could any of these principles be imported in the United States? Certainly, U.S. debtors may also be morally bound to make good on their promises, but it may be questioned how often this principle could be used in subsequent cases, whether in the United States or the United Kingdom, if the appellate courts ultimately found the payments were unlawful. The English Court also relied on an express provision in the English legislation providing an administrator may make a payment not otherwise provided for "if he thinks it likely to assist the achievement of the purpose of administration."[96] There is nothing in the U.S. Bankruptcy Code as broad as this, but § 363 does provide that a trustee may use, sell, or lease property other than in the ordinary course of business with notice and opportunity for a hearing. As suggested in the *Kmart* case, § 363(b) may provide an adequate basis for payments to parties who might be called "critical foreign entities." Without the ability to authorize such payments, the U.S. courts would lack the ability to preserve value and avoid the dismemberment of salvageable enterprises. It is suggested that such authority would benefit all parties in interest.

96. *Id.* at [22] (quoting Insolvency Act, 1986, c. 45, sch. B1, para. 66) (schedule effective Sept. 15, 2003)).

A New Role for Secondary Proceedings in International Bankruptcies

JOHN A. E. POTTOW*

SUMMARY

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Secondary proceedings—the ugly stepsisters to main proceedings—get short shrift in international bankruptcy scholarship.[1] This article seeks to remedy that

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1. Negative propositions are difficult to support. For example, one article with the subject right in its title was only three pages long. *See* Adam Al-Attar, *Using and Losing Secondary Proceedings*, 22(5) INSOLV. INTELL. 76–78 (2009). Secondary proceedings do, of course, receive passing analysis in more lengthy scholarly work. *See, e.g.*, Jay L. Westbrook, *The Lessons of Maxwell Communication*, 64 FORDHAM L. REV. 2531, 2533 (1997) (claiming secondary proceedings are preferable to territorialism, but are a "less-bold advance" than modified universalism).

deficiency. First, it describes what it argues are the traditional conceptions—both stated and implicit—of secondary proceedings in international bankruptcies. Second, it offers a revised way of thinking about secondary proceedings, proposing to restrict their scope through the use of "synthetic" hearings. Third, it addresses some problems with the proposed new role of secondary proceedings and sketches a possible solution involving the creation of an international priorities registry.

I. THE SECONDARY PROCEEDING AS TRADITIONALLY UNDERSTOOD

The Europeans get the principal credit with popularizing the secondary proceeding.[2] True, "ancillary," "parallel," and other related proceedings existed all along, stitched together ad hoc in the haphazard comity-based precedent book of cross-border bankruptcy,[3] but the concept of the "secondary proceeding" did not really take off until the EU Insolvency Regulation.[4] The purpose of a secondary proceeding is to allow local creditors of a foreign debtor the opportunity to open a bankruptcy case in their native country, chiefly to enjoy the benefit of local bankruptcy law.[5] They exist only in contrast to a main proceeding, which is a plenary bankruptcy case opened in the country housing the debtor's center of main interests (COMI).[6] Thus, secondary proceedings serve as a form of definitional residuum: proceedings that are not main proceedings.[7] (One preliminary point of lexical air must be cleared, however, at the outset of this discussion. Secondary proceedings are not, strictly speaking, a true residuum class, because there can be proceedings so remote to the debtor that they are neither COMI-based main proceedings nor the lesser class of secondary proceedings (which require, under the EU Insolvency Regulation and U.S. chapter 15 an "establishment").[8] As such, there can be non-main, non-secondary proceedings. These tangential affairs have yet to find a good

2. *See* Council Regulation 1346/2000, art. 12, 2000 O.J. (L 160) 1 (EC) [also referred to throughout the article as EU Insolvency Regulation]. This Regulation became effective in May 2002 for all members except Denmark; *see also* Model Law on Cross-Border Insolvency, G.A. Res. 52/158, U.N. Doc. A/Res/52/158, art. 21 (Jan. 30, 1998) (model law based largely on EU Insolvency Regulation) [hereinafter Model Law].

3. *See generally* 11 U.S.C. § 304 (repealed by Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005)) (allowing for cases ancillary to foreign proceedings to have been opened in U.S. bankruptcy courts); *In re* Maxwell Communication Corp. PLC 93 F.3d 1036 (2d Cir. 1996) (parallel bankruptcy proceedings of reorganization/administration in United States and United Kingdom).

4. *See, e.g.*, Bob Wessels, *The European Union Insolvency Regulation: An Overview with Trans-Atlantic Elaborations*, *in* ANNUAL SURVEY OF BANKRUPTCY LAW 494 (William L. Norton, Jr. ed., 2003) (describing the provisions and limitations of the EU Insolvency Regulation, including use of secondary proceedings). The U.S. version of secondary proceedings finds outlet in 11 U.S.C. § 1528.

5. Council Regulation 1346/2000, art. 27; *see, e.g.*, Jay L. Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles, and The EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1, 11 (2002) (explaining how secondary proceedings function alongside main proceedings).

6. *See* Council Regulation 1346/2000, art. 3(1); *see also* 11 U.S.C. § 1502(4), 1520 (adopting Model Law approach in U.S. law).

7. *See* Westbrook, *supra* note 5, at 11; *see also* 11 U.S.C. § 1502(5) (defining "foreign non-main proceeding").

8. *See* 11 U.S.C. §§ 1502(2) (defining "establishment"), 1502(5) (defining "foreign non-main proceeding" as requiring a debtor "establishment"); Council Regulation 1346/2000, 12th Recital.

name.[9] Others have explored these oddities,[10] but they are beyond the scope of this enquiry.)

Why allow secondary proceedings? The traditional justification is to respect the sovereignty of local courts that have direct jurisdictional power over locally situated assets, as well as to accord local creditors their rights under domestic bankruptcy law.[11] In other words, secondary proceedings are needed to counteract a perceived "over-relinquishment" of sovereignty in a cross-border insolvency to the main proceeding.[12] The tension flows from the extra-territorial application of the main proceeding's substantive bankruptcy law under a universalist international insolvency regime. (On the off-chance anyone reading this article is unfamiliar with this debate, "universalism" refers to the theory that advocates resolving cross-border insolvencies to the maximal extent possible by one substantive bankruptcy law.[13] Its doctrinally promulgated version is "pluralist," i.e., the substantive bankruptcy law is chosen from among various jurisdictions for export from the one housing the debtor's COMI.[14] It is contrasted with "territorialism," which advocates strict territorial application of bankruptcy laws to those assets—and only those assets—within a country's physical borders.[15])

Universalism challenges states that are sensitive about the rotating subjugation of sovereignty a universalist system inherently requires.[16] This concern spawned the secondary proceeding as a compromise to these territorialists.[17] While in a pure universalist system, the deferring state might open an "ancillary" or "auxiliary" proceeding to marshal assets, exercise jurisdiction, and otherwise compel performance of bankruptcy actors to assist the COMI state's proceedings,[18] a true

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9. One insightful author proposes "non-qualifying proceedings" as the best term. Alesia Ranney-Marinelli, *Overview of Chapter 15 Ancillary and Other Cross-Border Cases*, 82 AM. BANKR. L.J. 269, 298–300 (2008).

10. *See, e.g., id.*

11. Council Regulation 1346/2000, 12th Recital ("To protect the diversity of interests, this Regulation permits secondary proceedings to be opened to run in parallel with the main proceedings."), 19th Recital (contending that secondary proceedings "protect local interests"); *see also, e.g.*, Frederick Tung, *Fear of Commitment in International Bankruptcy*, 33 GEO. WASH. INT'L L. REV. 555, 566–68, 576–77 (discussing theoretical underpinnings).

12. *See* John A. E. Pottow, *Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to "Local Interests,"* 104 MICH. L. REV. 1899, 1915 (2006); *see also* Council Regulation 1346/2000, 19th Recital ("Cases may arise . . . where differences in the legal systems concerned are so great that difficulties may arise from the extension of effects deriving from the law of the State of the opening to the other States where the assets are located.").

13. *See, e.g.*, Jay L. Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2277 (2000).

14. *See* John A. E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy,* 45 VA. J. INT'L L. 935, 948 (2005).

15. *See, e.g.*, Lynn LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216 (2000). For a discussion of the tension between these paradigms, *see* Pottow, *supra* note 14, at 945–951.

16. *See* Frederick Tung, *Fear of Commitment in International Bankruptcy*, 33 GEO. WASH. INT'L L. REV. 555, 576 ("Universalism effectively requires a state's precommitment to wholesale deferral to other states' various prescriptions for financial distress.").

17. *See* Pottow, *supra* note 12, at 1915 (describing why states might want their own laws enforced).

18. *See, e.g.*, Pottow, *supra* note 12, at 1904–05 (discussing operation of universalist system's true ancillary proceedings).

"secondary" proceeding accords the putative deferring state the opportunity to entertain a full-fledged parallel action.[19] And the rub comes in choice of law: while an ancillary proceeding would presumably defer to COMI bankruptcy law (operationalized by transferring jurisdiction of assets to the main proceeding or perhaps liquidating and sending proceeds for disbursement to the main proceeding),[20] a secondary proceeding distributes the local assets under local substantive bankruptcy law, not the bankruptcy law of the COMI jurisdiction.[21]

Viewed thus—which should not be a contentious characterization—secondary proceedings are driven by a choice of law compromise. International bankruptcy conventions like the EU Insolvency Regulation are presumptively universalist, but territorialists are accorded a veto power by permitting local creditors the opportunity to open a secondary proceeding and bask in the comforting familiarity of local bankruptcy law.[22] Whence the choice of law anxiety? Among other things, it comes from priority rules: those pesky normative distributional differences that the cynical cast as rent-seeking outputs of domestic lobbying efforts and the naïve see as the culmination of a thousand flowers of important socio-cultural differences blooming.[23] In other words, secondary proceedings owe their existence in large part to the persistence of the territorialism-fomenting priority differences between domestic bankruptcy systems.[24]

Accordingly, what might be considered the "doctrinal" basis for secondary proceedings is the vindication of domestic bankruptcy priority rules,[25] and what might be considered the "theoretical" basis is the inchoate adoption of universalism as the dominant paradigm of cross-border insolvency resolution in the face of lingering

19. Council Regulation 1346/2000, art. 27, 2000 O.J. (L 160) 1 (EC). This choice of law discussion somewhat conflates secondary proceedings with plenary proceedings, an intentional sacrifice of precision for exposition. Nothing of import to this analysis turns on it.

20. *See, e.g.*, 11 U.S.C. § 1521(a)(5) (turnover of U.S. assets to foreign bankruptcy representative). Local proceedings in cross-border insolvencies may either be "ancillary" (assisting a primary jurisdiction) or "plenary" (rivaling a primary jurisdiction by insisting on parallel actions). Ancillary proceedings in the U.S. Code would fall under chapter 15 and plenary ones would be under chapters 11 or 7.

21. *See* Council Regulation 1346/2000, art. 28; *see also* 11 U.S.C. § 1528, 1529(1)(B); *see generally* John A. E. Pottow, *The Maxwell Case*, *in* BANKRUPTCY LAW STORIES 222, 232 (R. Rasmussen ed., 2007) (discussing choice of law issues); Jay L. Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT'L L. 499, 516 (1991) (same); Jay L. Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 487 (1991) (same).

22. *See* Council Regulation 1346/2000, art. 28 ("Save as otherwise provided in this Regulation, the law applicable to secondary proceedings shall be that of the Member State within the territory of which the secondary proceedings are opened.").

23. *Compare, e.g.*, Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT'L L. 31, 55 (2001) (describing priorities as the spoils of "domestic rent seeking contests") *with, e.g.*, Antwerp Bulkcarriers, N.V. v. Holt Cargo Sys., [2001] 3 S.C.R. 951, 964 (Can.) ("National bankruptcy laws express the policies and priorities of their enacting countries."); *see also* Jay L. Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27, 30 (1998) (analyzing problems with different priorities); Pottow, *supra* note 14, at 941 (describing priority laws as "prickly" and "highly normative").

24. *See* Pottow, *supra* note 12, at 1011–12; *see also* Bob Wessels & Ian Fletcher, Global Principles for Cooperation in International Insolvency Cases 151 (International Insolvency Institute 2010). These of course are not the only issues driving secondary proceedings. For example, actions to quiet title of real property likely require the exercise of judicial power by the situs jurisdiction. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 223, 226, 228, 234–36, 239, 241 (1971).

25. *See* Westbrook, *supra* note 23, at 30 (noting the difficulties presented by national variations in insolvency priorities).

vitality to territorialism.[26] (These bases are closely related: one of the main territorialist sticking points is the concern over the subjugation of normative policy preferences expressed through the adoption of bankruptcy priority rules.)[27] But there is also a more "hidden" reason, again related, but analytically distinct, lurking beneath the surface. The concern is that universalism will lead to jurisdiction fights, because the stakes are larger.[28] After all, the COMI jurisdiction gets to export its bankruptcy law worldwide in a transnational insolvency. "Universalism is an all-or-nothing system. A single court gets the case, and runs it worldwide."[29] The concern, therefore, is that even if we were all good universalists on paper, we might fight over who gets to be the COMI in any given bankruptcy.[30] Secondary proceedings are a way to blunt this competitive impulse by lowering the stakes.[31]

The preceding characterization might lead one to conclude that secondary proceedings, if and when opened, are co-equal legal affairs to the main proceedings afoot in the debtor's COMI. Yes and no. True, secondary proceedings under local law are available to local creditors "as of right," so to speak, when the debtor has an establishment and assets in a non-COMI jurisdiction,[32] but there are deliberate jurisdictional hierarchies designed to subordinate the secondary proceedings and make them, aptly, secondary. For example, the jurisdictional scope of the secondary proceeding is expressly limited to assets within the physical territory of the secondary country.[33] In contrast to many bankruptcy laws that exert extraterritorial scope (the United States being the paradigmatic example),[34] the secondary proceedings are

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26. *See* Pottow, *supra* note 14, at 947 ("Accordingly, the dominant theory of an ideal international insolvency regime, 'universalism,' advocates one law to control a bankrupt's worldwide assets, regardless of their location.").

27. *See* Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 709, 711 (1999) ("[I]n a universalist system, the priority of Mexican workers' employment claims against a U.S. firm operating in Mexico would be determined by U.S. priority rules of priority—much to the disappointment of the affected Mexican workers.").

28. *See* Lynn M. LoPucki, *Universalism Unravels*, 79 AM. BANKR. L.J. 143, 151 (2005) ("When courts compete for cases internationally, the stakes are higher than when courts compete domestically.").

29. *Id.* at 148.

30. *See id.* (discussing the discomfort that arises when selecting which country's court and laws will control); *see also* John A. E. Pottow, *The Myth and Realities of Forum Shopping in Transnational Insolvency*, 32 BROOK. J. INT'L L. 785, 812 (2007) (challenging this concern and discussing cases where it may be unfounded).

31. *See* Pottow, *supra* note 14, at 995–96 (discussing importance of stakes-lowering in bankruptcy reform). For a recent case suggesting this concern is overstated, *see In re* Metcalfe & Mansfield Alternative Invs., 421 B.R. 685 (Bankr. S.D.N.Y. 2010) (enforcing Canadian bankruptcy plan's release of third-party debtors in chapter 15 ancillary proceeding that would arguably have been impermissible under U.S. law).

32. *See* 11 U.S.C. §§ 1528, 1529 (2005).

33. *See* 11 U.S.C. § 1528 ("The effects of such case shall be restricted to asset of the debtor that are within the territorial jurisdiction of the United States."); Council Regulation 1346/2000, art. 27, 2000 O.J. (L 160) 1 (EC).

34. *See* 11 U.S.C. § 541(a) (asserting in rem jurisdiction over assets worldwide); 28 U.S.C. § 1334(e)(1) (assigning exclusive subject-matter jurisdiction to federal courts of same). *Compare* Council Regulation 1346/2000, 12th Recital ("This Regulation enables the main insolvency proceedings to be opened in the Member State where the debtor has the centre of his main interests. These proceedings have universal scope and aim at encompassing all the debtor's assets.").

expressly constrained.[35] Similarly, there are other more indirect restrictions on the scope of a secondary proceeding's jurisdictional reach, such as the lack of an automatic stay that a COMI proceeding enjoys.[36]

In sum, the most accurate understanding (from the normative perspective of a universalist) of secondary proceedings is that they are a necessary evil. They are required to dampen territorialist and competitive impulses—perhaps tolerated due to the idiosyncrasies of local property law—but sit as an otherwise theoretical thorn in the side of universalists confronting a divergent array of priority rules. This begrudging tolerance explains why they are cut down through explicit scope restriction in universalist-animated legal documents like the UNCITRAL Model Law, chapter 15, and so forth. The corollary observation to this characterization is that if one of the anchoring sticking points—divergence in priority rules—can be resolved, then secondary proceedings (at least in their current, stronger form) may no longer be needed.[37]

II. LEGAL INNOVATION: THE "SYNTHETIC" SECONDARY PROCEEDING

The preceding analysis envisions priority law differences and secondary proceedings going hand-in-hand: a priority fight among creditors in a multinational bankruptcy will likely result in a secondary proceeding being opened, and a cross-border insolvency that raises no meaningful priority squabbles will not. That may be too quick an assessment. Consider the landmark U.K. experience with the Collins and Aikman (C&A) bankruptcy.[38] (This is extrapolation from a sample size of one, but at the cutting edge of international commercial practice, such inference is often required.)[39] There, administration proceedings were opened in the United Kingdom, which was the COMI of certain European operations that spanned several jurisdictions within the Union. (As such, under the EU Insolvency Regulation "main" proceedings were opened in the U.K.) One of the problems that arose involved the treatment of certain Spanish trade creditors and, as often happens in such disputes, objection by those creditors that they would not be accorded the favorable treatment for their claims that they would otherwise receive under Spanish bankruptcy law if the C&A distribution were conducted under U.K. rules. Unsurprisingly, and consistent with the contention of this article that secondary proceedings are driven by priority fights, a secondary proceeding was "threatened" by the Spaniards.[40] This was perceived as a real problem to the expeditious and unified resolution of the C&A estate sought by the Brits.[41]

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35. *See* 11 U.S.C. § 1528; Council Regulation 1346/2000, art. 27.

36. *See* 15 U.S.C. §§ 1519, 1521; Council Regulation 1346/2000, art. 33. There are also important doctrinal constraints, such as that secondary proceedings are restricted to liquidation. *See id.* art. 3(3) ("Where insolvency proceedings have been opened under paragraph 1, any proceedings opened subsequently under paragraph 2 shall be secondary proceedings. These latter proceedings must be winding-up proceedings.").

37. They may of course persist in their weaker, universalist incarnation of the ancillary or auxiliary proceeding.

38. *In re* Collins & Aikman Eur. S.A., [2006] EWHC (Ch) 1343 (Eng.).

39. Although *C&A* is by no means an outlier. *See, e.g.*, Eurotunnel Finance Ltd., No. 200647559 (Tribunal de Commerce de Paris (Commercial Court of Paris), Aug. 2, 2006) (achieving effect similar to synthetic secondary proceeding).

40. *See* Gabriel Moss, *Group Insolvency—Choice of Forum and Law: The European Experience*

A creative solution, however, emerged. Cynically, one might describe it as buying off the Spaniards, but a more elegant label is warranted. The debtor constructed what might be considered a "synthetic" secondary proceeding. How was this done? C&A carved out a special claim category for the Spanish creditors to entitle them to identical distribution they would receive under Spanish law, all within the main U.K. bankruptcy distribution.[42] The losers fought this synthetic secondary proceeding as essentially "un-British," lodging objections to the court's jurisdiction to sanction such an innovation. C&A nevertheless prevailed and the Spanish creditors went home happy (or, more precisely, as happy as creditors of a bankrupt foreign company can be).[43] The treatment of the claims was therefore the same economically as if a secondary proceeding had been opened, i.e., they were synthetically resolved.[44] Yet there were two important distinctions: first, considerable cost was saved (likely to the pleasure of C&A creditors and disappointment of the Spanish insolvency bar); and second, control was preserved by the British decision-makers (the lawyers, principals, and judge), without risk of having a Spanish court inject unpredictability into the matter.[45]

Under the Influence of English Pragmatism, 32 BROOK. J. INT'L L. 1005, 1018 (2007) (discussing threatened Spanish proceedings).

41. *See id.* (discussing how administrators sought assurance from local creditors that they would not open secondary proceedings). This concern was wholly apart from the liquidation posture that would have attached to a secondary proceeding. *See* Council Regulation 1346/2000, art. 3(3).

42. *See In re* Collins & Aikman, [2006] EWHC (Ch) 1343, [41] (Eng.) (concluding that the joint administrators could permissibly implement the synthetic secondary proceedings):

> By April 2006, then, the joint administrators had a problem before them. They had given assurances which they wished to honour, assurances given not only with a view to the benefit of creditors generally but assurances which had conduced to achievement of that benefit. Those assurances had included performance by the joint administrators of differing provisions, country by country, as to local law as to, for example, the preferences to be given to particular classes of creditors and the subordination or not of inter-company indebtedness, provisions which were different from the applicable provisions of English law, the law of the main proceedings.

43. *Id.* at [8] ("With only minor exceptions creditors did not seek to open secondary proceedings or take other divisive steps but rather supported the broad strategy which the joint administrators had proposed."). While the court ultimately authorized the synthetic secondary proceeding, the actual basis of its holding admits of some ambiguity. For example, as quoted in the previous footnote, the court's opinion underscores strong estoppel considerations, emphasizing the fact that the administrators promised the Spanish creditors their priority treatment would be vindicated if they supported the administration; the outcome-determinative relevance of this reliance, however, is never made explicit.

44. Ted Janger proposes the term "virtual territoriality" to cover situations just like this one. *See* Edward Janger, *Virtual Territoriality*, 48 COLUM. J. TRANSNAT'L L. 401 (2010); *see also* Michael Menjucq & Reinhard Dammann, *Regulation No. 1346/2000 on Insolvency Proceedings: Facing the Companies Group Phenomenon*, 9 BUS. L. INT'L. 145, 154 (2008) (using the phrase "virtual contractual secondary proceedings" to describe the practice of providing creditors the same treatment as if secondary proceedings had been opened).

45. Beyond the scope of this article—because it requires greater treatment—is Jay Westbrook's important recognition of the role control plays in restructuring proceedings. *See* Jay L. Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795 (2004). Although *C&A* (and the proposals of this article) synthetically achieve "the same" outcome regarding treatment of priority claims as secondary proceedings, they do so under the control of a different judicial actor (the COMI judge). While the universalist likely applauds this unified control, the territorialist is apt to feel either conscious or

The success of the C&A synthetic secondary proceeding invites re-examination of the traditional role of the regular secondary proceeding. On the one hand, it seems that the divergence of local creditor priorities did not require (only "threatened") the opening of a secondary proceeding, suggesting that the priority dispute-secondary proceeding linkage implied earlier is overstated. On the other hand, the only way this outcome was possible was through complete capitulation on the priority difference: the Brits had to swallow their own priority rule to allow ad hoc accession to the Spanish one—directly contrary to the universalist injunction that Spanish law should have ceded to British. (Practice once again slighted theory.) Does one thus score this as a victory for uncoupling priority fights from the need to open secondary proceedings, or is it merely confirmation that priority fights will cause secondary proceedings, with the grim corollary that forfeiting those fights will not?[46] The former, more positive interpretation is preferable: priority fights risk secondary proceedings, but they do not assure them, as workarounds can be achieved. In other words, the synthetic secondary proceeding is a positive outcome reflecting a glass half-full: better than the whole headache and expense of a real secondary proceeding.[47] To be sure, this may not assuage the pure theoretician, who doubtless chafes at the holdout power accorded the local creditor under the secondary proceeding model, but it should at least count as a victory for those wishing to maximize efficiency within the given negotiating endowment of the local law veto that exists under the EU Insolvency Regulation regime.[48]

III. THE SECONDARY PROCEEDING RE-ENVISIONED

A. *The Proposed New Scope: (Chiefly) Non-monetary Relief*

C&A suggests that a priority fight does not necessitate the opening of a secondary proceeding, because one can always be synthetically created as a sidebar within the main proceeding in the debtor's COMI. Can we generalize to the death of the secondary proceeding? That is, if priority fights are what in large part drive secondary proceedings, does their resolution through synthetic means sound secondaries' death knell? No. This is because there are priority differences in bankruptcy laws, and there are "Priority" differences in bankruptcy laws. This distinction can be understood several ways, but the most helpful is probably a loose comparison to the Anglo-American division between law and equity.[49] Under this legal tradition, there is an historical distinction that survives in several forms today between legal and equitable claims and, more significantly, relief. The classic example is in the law of remedies, where, for example, claims for a breach of contract

unconscious angst. Note too the doctrinal constraint that a true secondary proceeding would had to have been a winding-up procedure. Council Regulation 1346/2000, art. 3(3), 2000 O.J. (L 160) 1 (EC).

46. *Cf.* 11 U.S.C. § 1129(a)(9) (requiring payment in full of many priority claims upon confirmation).

47. A synthetic secondary proceeding is much better given the doctrinal requirement that a secondary proceeding would had to have been a liquidation one. *See* Council Regulation 1346/2000, art. 3(3).

48. Wessels & Fletcher, *supra* note 24, at 151 (reminding in a nod to Voltaire that "the best should not be allowed to become the enemy of the good").

49. *See, e.g.*, Christopher Langdell, *A Brief Survey of Equity Jurisdiction*, 1 HARV. L. REV. 111 (1887).

are reduced to monetary damages, with specific performance only rarely available.[50] This distinction can arguably map onto some of the priority differences in bankruptcy laws. Consider, for example, the important priority of employee wage claims (at the heart of many cross-border priority fights). Under U.S. law, employees are entitled to preferential claims up to around $10,000 going back a few months for unpaid wages.[51] Other systems are different.[52] But while there are variations around the contours of the priority, these sorts of jurisdictions envision monetization of the employee relationship: the damages translate into claims.[53]

By contrast, other bankruptcy systems reflect stronger socialist sensibilities. This is not just the unlimited wage priority of some,[54] or even the security-trumping priority of others.[55] There are some systems that parachute state judicial actors into the employment termination context by, for example, requiring judicial assent to lay-offs.[56] Indeed, some expressly rank the preservation of employment as equal or

50. *See, e.g.*, E. Allen Farnsworth, CONTRACTS § 12.5 (4th ed. 2004); *see also* Douglas Laycock, *The Death of the Irreparable Injury Rule*, 103 HARV. L. REV. 687, 689 (1990).

51. 11 U.S.C. § 507(a)(4) (2010).

52. *See, e.g.*, R.S.C., c. 47, s. 1 (2009) (Can.) (guaranteeing employees payment up to maximum of $2,000 but surcharging the estate for government subrogation claim to these guarantees).

53. *See* Janis Sarra, *An Investigation into Employee Wage and Pension Claims in Insolvency Proceedings Across Multiple Jurisdictions: Preliminary Observations*, 16 J. BANKR. L. & PRAC. 835, 836 (2007) (surveying multiple jurisdictions to find widespread prioritization of employee claims).

54. *See, e.g., id.* at 8 ("France grants a priority based on a particular timeframe, granting super-priority for wages not paid 60 days prior to insolvency, over secured claims but not those with retention of title, and general preference over personal property and real estate for unpaid wages up to six months prior to insolvency.").

55. *See, e.g., id.* at 2. In fact, many countries give wage claims some priority over secured creditors. *See* INTERNATIONAL LABOUR OFFICE, THE PROTECTION OF WORKERS' CLAIMS IN THE EVENT OF THE EMPLOYER'S INSOLVENCY 30 (Edward Yemin & Arturo S. Bronstein eds., 1991) (naming France, Spain, Brazil, Ecuador, Mexico, Peru, Benin, Chad, Cote d'Ivoire, Gabon, Guinea, Algeria, Tunisia, and Philippines as countries that prioritize employee claims over secured debt); *see also* Sarra, *supra* note 53, at 838 (describing Mexico's absolute priority system for employee wage claims). Some countries have backed off this super-priority. For example, Brazil's reforms capped wage claims for the first time. *See* Christopher Andrew Jarvinen et al., *The International Scene: Bankruptcy Reform Coming to Brazil*, AM. BANKR. INST. J. 32, 69 (Dec.–Jan. 2005).

56. For example, Dutch law requires court approval to dismiss employees. *See* International Insolvency Institute Fifth Annual International Insolvency Conference at Fordham Law School (June 6–7, 2005) (presentation on file with author). French law apparently involves the public prosecutor in the event of mass layoffs. *See* Paul J. Omar, *The Internationalisation of Insolvency Law: An Anglo-French Comparison*, 39 INT'L LAW. 107, 119 (2005) ("[T]he chief features of the French system are that the courts are interventionists providing close supervision at all stages of the insolvency process."); *see also* Isabelle Didier, *The Reform of Insolvency Proceedings in France—A Professional's Point of View*, 15 J. BANKR. L. & PRAC. 5, art. 4 (2006) (noting French law requires dismissals by a company in bankruptcy to be approved by the bankruptcy judge); Sarra, *supra* note 53, at 860–61 ("[I]nsolvency law is aimed at protecting companies while labour law is favorable to the employees, sometimes even at the expense of the companies, and that it is clear under French law that the employees cannot be treated as mere assets of the companies and have the right to a certain degree of protection."). French law also of course offers wage claim priority. *See* Sarra, *supra* note 53, at 844 (citing section L.143-7 of the French Labor Code (providing that wages are guaranteed by the general preference that exists in the French Civil Code (section 2331-4 and section 2375-2, créances privilégiées)) and section L.143-10 (providing that créance super-privilégiée wages are "guaranteed by a super-priority, which supersedes any other preferential debt")).

superior to the maximization of creditor value as an aim of bankruptcy law.[57] It is these latter types of jurisdictions that can be likened to having "equitable" authority to vindicate what is, in essence, a bankruptcy law priority. (One can quibble over this characterization. Some might say it is a non-bankruptcy employment law "priority" that is protected or respected in bankruptcy proceedings, but likely the better characterization is that it reflects a bankruptcy policy or "priority" of deference to non-bankruptcy legal entitlements.)[58] Thus, some jurisdictions say that employees get not just a priority claim when reduced to a monetary judgment, but "priority" in a stronger policy sense—absolute employment protection requiring judicial oversight even in the insolvency context.[59]

The implication of this distinction for secondary proceedings is straightforward. If the employees hold certain employment rights that require judicial sign-off before alteration, then they cannot be effectively addressed in a synthetic secondary proceeding. Why? The answer treads on incommensurability.[60] These jurisdictions essentially say that it is not just about money when employees are discharged and, relatedly, that the state ought to be involved. If the jurisdiction's policy preferences are strong enough to require state intervention, then it is unlikely that the jurisdiction will accord comity to a foreign state's remote exercise of that authority regarding local workers (or expect a foreign state to accord its judicial actors comity regarding foreign employees). This should not surprise those versed in the norms of cross-border litigation. Consider, for example, the hoary distinction between recognition of foreign monetary judgments and foreign injunction orders. (Generally, the former yes, and the latter no.)[61] Comity's diminished solicitude for non-monetizable claims is thus well established.[62]

Accordingly, territorialism's heightened persistence in the subset of bankruptcy decisions that require "equitable" judicial involvement assures that secondary proceedings will be around for quite some time. Recognizing this reality, the proposal of this article is to accept, but then cabin, their role. The new role of secondary proceedings should be constrained in line with this distinction, limited to

57. *See* Andre J. Berends, *The UNCITRAL Model Law on Cross-Border Insolvency: A Comprehensive Overview*, 6 TUL. J. INT'L & COMP. L. 309, 323–24 (1998) (discussing Dutch notion of "social interests").

58. This aesthetic fight finds roots in Butler v. Goreley, 146 U.S. 303, 304 (1892). Nothing at present turns on it; I flag only for the curious.

59. Consider in this regard the German labor requirement of one-third union representation on a corporate board of directors. *See* Works Constitution Act, Div. V, § 76 (1) ("Representation of employees on advisory boards.").

60. *See, e.g.,* Margaret Jane Radin, *On the Domain of Market Rhetoric*, 15 HARV. J.L. & PUB. POL'Y 711, 723–34 (1992) (distinguishing compensable and non-compensable losses).

61. *Compare* Uniform Foreign Money-Judgments Recognition Act (U.L.A.) § 4 (enacted by at least eleven U.S. states) (recognizing foreign monetary awards) *with* Medellin v. Texas, 552 U.S. 491, 520–22 (2008) (reminding that in the United States "judgments of foreign courts awarding injunctive relief, even as to private parties, let alone sovereign states, are not generally entitled to enforcement") (internal quotation marks omitted) (citing RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 481 cmt.b at 595).

62. Of course, in the bankruptcy context, injunctive relief by way of enforcing a confirmed bankruptcy plan under comity doctrines is well established, going all the way back to *Hilton v. Guyot*, 159 U.S. 113 (1895). For a recent example under chapter 15 enforcing a foreign injunction as part of a confirmed foreign reorganization plan, see *In re* Metcalfe & Mansfield Alternative Invs., 421 B.R. 685, 700 (Barkr. S.D.N.Y. 2010) (enforcing Canadian release of and injunction protecting non-debtor third parties as part of confirmed Canadian reorganization plan).

two specific circumstances: first, cases involving real property, as this historical distinction is too old to fight;[63] and second, cases in which the creditors or debtor need to avail themselves to non-monetary relief in the local jurisdiction, which would operationalize the division between a mere bankruptcy priority divergence amenable to synthetic resolution and a big-P "Priority" divergence reflecting some higher policy interest of incommensurability. (Doctrinally, of course, there could be a third category: an escape clause residuum, covering, e.g., "any other circumstances necessary to vindicate fundamental policies of the local jurisdiction or fundamental rights of the local creditors," to give wiggle room to the unforeseen case as well as to tantalize the skeptical by offering a ready defection route.)[64]

B. Problems with the New Scope

This proposed new scope of secondary proceedings will not make priority fights go away; it will just shift their venue. In other words, all that is advocated is a centripedal push of the activity of putative secondary proceedings to resolution in the COMI, without necessary change in actual outcome. Still, even such an incrementalist universalism advance is likely to face objection, both doctrinal and theoretical.

1. Doctrinal Challenge: Jurisdictional Authority

On the doctrinal front, it is possible to envision some jurisdictions as initially paralyzed by the prospect of "applying" foreign bankruptcy priority law to a subset of creditors within their purview. A clear example of this angst can be seen in the first rounds of the *HIH* case,[65] where the challenging creditors successfully cast the frame that according Australian preferred creditors priority in the U.K. court would

63. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 230 ("(1) Whether a lien creates an interest in land and the nature of the interest created are determined by the law that would be applied by the courts of the situs. (2) These courts would usually apply their own local law in determining such questions."). Of course real estate on its own is not a sufficient basis to open secondary proceedings. *Cf.* Council Regulation, 1346/2000, 12th Recital, O.J. (L 160) 1 (EC) (stating in preamble requirements for opening secondary proceedings):

> The line can be drawn at real property. Consider that the revision to Article 9 of the Uniform Commercial Code in the United States largely abolished a conflicts rule based on the location of immoveable personal property in favor of a location of the debtor approach, *see* UCC 9-301, and the world, on information and belief, did not stop spinning.

64. This would be analogous to the standard escape clause in conflicts rules. *See, e.g.*, 11 U.S.C. § 1506 (2011); Symeon C. Symeonides, *Exception Clauses in American Conflicts Law*, 42 AM. J. COMP. L. 813, 819–25, 864–65 (Supp. 1994) (discussing escape clauses' prevalence). Note another approach would be to allow recognition of liens that vindicate normative priority preferences. *See* 11 U.S.C. § 545 (2011) (respecting some but not all state law liens in federal bankruptcy proceedings); Pottow, *supra* note 12, at 1934–35 (discussing translation of priority preferences into liens).

65. McMahon v. McGrath (*In re* HIH Cas. & Gen. Ins. Ltd.), [2005] EWHC (Ch) 2125 (Eng.).

lead to the "disapplication" of U.K. law.[66] Disapplication? The very term smacks of renegade judicial activism. But as the ultimate resolution of the case revealed (even through its fractured-reasoning prism), "disapplication" simply begs the question whether such deference is imminent in the system already. (Compare, for example, the torturous renvoi doctrine.)[67] Synthetic secondary proceedings, therefore, need to be properly framed. For example, preambles to a new model law or best practices guide should "remind" adopting jurisdictions that the power to conduct synthetic secondary proceedings may well already exist within their own doctrines of comity, co-operation, and so forth.[68] That said, it is also surely the case that there are some jurisdictions (likely civilian in origin) that will require more explicit textual conferral of authority.[69] There is not much that can be done about that other than to recommend the adoption of the specific legislative power that would accord such flexibility. (Such is the prerogative of the normative commentator simply to recommend what states should do; execution is left to those more expert in such matters.)

2. Theoretical Challenge: Priority Divergence and Outcome Differences

There is, however, a looming theoretical problem to the viability of synthetic secondary proceedings. The recommendation of shifting most of the action of a secondary proceeding into synthetic resolution within the COMI bankruptcy case presupposes the main jurisdiction's amenability to enforce those foreign priorities. This may not be the case, as was revealed in the long, tortured history of former

66. *Id.* para. 73. ("But the judicial authority which has established the power of the court to give, in general terms, the direction to which I have referred has certainly not established the power of the court to disapply rule 4.90 or any other substantive rule forming part of the statutory scheme under the Act and Rules of 1986.").

67. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 8 (1971) (describing renvoi, or the applicability of another state's choice of law rules in a choice of law analysis).

68. McGrath v. Riddell (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21, [6], 1 W.L.R. 852 (H.L.) (Lord Hoffmann) (appeal taken from Eng.):

> Despite the absence of statutory provision, some degree of international co-operation in corporate insolvency had been achieved by judicial practice. This was based upon what English judges have for many years regarded as a general principle of private international law, namely that bankruptcy (whether personal or corporate) should be unitary and universal. There should be a unitary bankruptcy proceeding in the court of the bankrupt's domicile which receives world-wide recognition and it should apply universally to all the bankrupt's assets.

69. *See, e.g.*, A.L.I., TRANSNATIONAL INSOLVENCY: COOPERATION AMONG NAFTA COUNTRIES, INTERNATIONAL STATEMENT OF UNITED STATES BANKRUPTCY LAW, General Principles Volume at 5 n.6 (2003) (discussing restriction on Mexican judicial discretion), *cited in* Jay L. Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles, and The EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1, 41 n.109 (2002). Indeed, even in the United Kingdom, dictum from the Privy Council suggests some hesitance at reading into the common law a judicial power to permit synthetic secondary proceedings. *See* Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26 [22], [2007] 1 AC 508, (Isle of Man) ("At common law, their Lordships think it is doubtful whether assistance could take the form of applying provisions of the foreign insolvency law which form no part of the domestic system. But the domestic court must at least be able to provide assistance by doing whatever it could have done in the case of a domestic insolvency.") (dictum) (undermined by contravening dictum of Lords Hoffman and Walker in *HIH*, discussed *infra* at text accompanying notes 82 to 87).

section 304 of the U.S. Code (and analogous case-by-case adjudication of other countries' approaches) when considering whether to cooperate or otherwise assist a foreign bankruptcy court trying to vindicate a foreign priority.[70] What if the main proceeding simply does not want to conduct a synthetic secondary?

Stepping back a bit, recall that the animation of secondary proceedings is a compromise to territorialist impulses that in turn are driven largely by fierce protection of local priority rules.[71] A secondary proceeding is thus required in part because states will not accept the wholesale subjugation of their domestic priority rules when they are in the ancillary position that full-fledged universalism dictates.[72] A synthetic secondary proceeding, however, pushes the priority subjugation the other way: the main proceeding must recognize the foreign priority rule for the protected creditors—in essence, carving out a portion of its estate for foreign resolution and thus subjugating a portion of its own bankruptcy law.[73] If one cannot anticipate this willing deference in the traditional universalist model by the ancillary jurisdiction, why would one be more sanguine the other way around simply because the courtroom has changed?

The question is a fair one. The positions, however, while similar, are not identical, which may help find the path to a solution. First, the main jurisdiction controls all the action of the bankruptcy; asking for a synthetic secondary to vindicate a foreign priority rule requires only a partial subjugation of what may be a small carve-out.[74] By contrast, under strict universalism the ancillary proceeding's sole purpose is to open a bankruptcy case exclusively designed to implement foreign priority rules, an arguably more galling task.[75] Second, the main proceeding court may be swayed by indirect considerations. For example, in *C&A* the preservation of

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70. *See, e.g.*, Todd Kraft & Allison Aranson, *Transnational Bankruptcies: Section 304 and Beyond*, 1993 COLUM. BUS. L. REV. 329 (1993) (discussing the shortcomings of former section 304); Daniel M. Glosband & Christopher T. Katucki, *Claims and Priorities in Ancillary Proceedings Under Section 304*, 17 BROOK. J. INT'L L. 477, 481 (1991) (noting problems with territoriality under same). One of the best recent analyses of former section 304 from a rigorous conflicts perspective remains Hannah L. Buxbaum, *Rethinking International Insolvency: The Neglected Role of Choice-of-Law Rules and Theory*, 36 STAN. J. INT'L L. 20 (2000).

71. *See* Pottow, *supra* note 12, at 1915–19 (discussing aggressive enforcement of regulatory sovereignty).

72. *See* text accompanying notes 11–16 in Part I of this article (describing the traditional understandings of secondary proceedings). This theoretical concern may actually be blunted in practice. *See, e.g.*, *In re* Metcalfe and Mansfield Alternative Invs., 421 B.R. 685 (Bankr. S.D.N.Y. 2010) (enforcing Canadian third-party release in U.S. ancillary proceeding under chapter 15 that arguably would have been impermissible under U.S. bankruptcy law).

73. This clearly rubbed the trial judge the wrong way in *HIH*. *See* McMahon v. McGrath (*In re* HIH Cas. and Gen. Ins. Ltd.), [2005] EWHC (Ch) 2125, [155] (Eng.) ("[I]n the event of a winding-up order being made against the Companies the English Court would not direct or authorise the English liquidators to remit the assets collected by them to the Australian liquidators, having regard to section 562A of the [Australian] Corporation Act 2001 and section 116 of the [Australian] Insurance Act 1973, unless some means could be found of ensuring that those assets could be distributed as if in an English liquidation.").

74. *Cf.* 11 U.S.C. § 1129(a)(9) (2010) (requiring settlement of many priority claims upon confirmation of reorganization plan).

75. *See* Pottow, *supra* note 12, at 1904–05 (describing universalist approach). *See, e.g.*, *In re* Metcalfe & Mansfield Alternative Inv., 421 B.R. 685, 700 (Bankr. S.D.N.Y. 2010) (enforcing Canadian third-party release in U.S. ancillary proceeding under chapter 15 that arguably would have been impermissible under U.S. bankruptcy law).

time and expense, as well as the increase in certainty, was emphasized in advocating resolution of the Spanish claims through a synthetic secondary in England—the "threat" of the Spanish secondary was real enough to make those costs seem undesirable.[76] Thus, there are reasons to believe the main proceeding's resistance may not be as robust as the non-main proceeding's to the application of foreign insolvency law.[77]

That said, those considerations are realistically marginal tweaks around a theoretical edge: there surely must be some priority differences so vast that they have outcome-determinative effects on the distribution of the estate. Consider *Treco*, for example, where administrative claims threatened to devour even the secured creditor's collateral.[78] One of the reasons the local Spanish creditors could be paid off in full in *C&A* likely was because doing so did not substantially imperil the U.K. estate—it was a distributional hiccough at worst.[79] The evil, Treconian doppelganger to *C&A*, however, still lurks out there in the dark—a case where the priority fight would be much more distributionally disruptive.[80]

IV. A POSSIBLE SOLUTION: INTERNATIONAL CERTIFICATION

The theoretical concern that priority fights will scuttle the attempt to constrict the scope of secondary proceedings can only be addressed by forcing main states to accept some bankruptcy outcome differences.[81] *HIH* shows that this can happen.[82] The real question then, as it has always been, is how much is too much? One possible answer takes a lead from the pagebook of *HIH* itself, but takes that page very carefully.

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76. *In re* Collins & Aikman Eur. SA, [2006] EWHC (Ch) 1343, [8] (Eng.) ("[T]he opening of such secondary proceedings and the appointment of local officeholders would have been likely to have impeded the achievement of the purposes of the administration by making it difficult to continue to trade the businesses, fund the administrations and conduct sales processes on a group-wide basis.").

77. *Cf.* Pottow, *supra* note 12, at 1941–42 (discussing ancillary court's imposition when deferring to main court).

78. *In re* Treco, 240 F.3d 148, 159 (2d Cir. 2001) ("The difference in prioritization under U.S. and Bahamian law is particularly acute in this case because of the strong possibility that MIBL's estate will have little or no funds after payment of administrative expenses.").

79. The *Collins & Aikman* court analyzed foreign priority distribution and concluded that it would only meaningfully affect one of twenty-four foreign subsidiaries not already in secondary proceedings. *Collins & Aikman*, [2006] EWHC (Ch) 1343, [9] ("By April 2006 the realisations were virtually complete and the joint administrators held over $125m for distribution to the creditors of the European companies.").

80. Consider the *Yukos* tax priorities, for example, discussed *infra* at text accompanying notes 112 to 114.

81. This is one of the main theoretical challenges of universalism. *See* Westbrook, *Theory and Pragmatism*, *supra* note 21, at 458 (discussing "acceptance of outcome differences" as a requirement of universalism); Pottow, *supra* note 14, at 952 (characterizing that requirement as "the commitment of rationally selfish states—which generally prefer to see their own substantive bankruptcy laws govern—to cede sovereignty when another state has been chosen to control an international bankruptcy").

82. McGrath v. Riddell (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21, [36], 1 W.L.R. 825 at 863 (H.L.) (Lord Hoffmann) (appeal taken from Eng.) (turning over assets from U.K. insolvency proceeding to Australian main proceeding in to be distributed under (different) Australian priority rules).

A. *What and Why?*

Recall that in *HIH*, the court split on the role of certification.[83] That is, U.K. bankruptcy law has a certification provision,[84] indicating that jurisdictions falling on the certifying schedule may be accorded cooperation in a cross-border bankruptcy by way of turnover or other remedies (effectively permitting the application of foreign priority rules and laying the basis for a possible synthetic secondary proceeding). Their Lordships divided on its import. One group thought that certification was the exclusive answer to the question whether foreign bankruptcy law could be recognized in U.K. proceedings (i.e., whether a synthetic secondary was possible).[85] The other group thought certification was only one possible avenue for permitting the application of foreign insolvency law, mindful of such alternatives as international comity and the inherent power of common law courts.[86] The deciding vote demurred from answering that question as unnecessary to resolve the appeal because certification was present.[87] Thus, the lesson from *HIH* is that certification can galvanize consensus: certification spells out answers clearly and cleanly in black and white. Australia was "in the club" of certification and so enjoyed deference to its insolvency laws (technically, enjoyed eligibility to have discretion exercised in favor of applying its insolvency laws through turnover).

One must tread carefully here. The lesson from *HIH* to deploy in designing a path forward on resolving priority disputes (and hence viably restricting the scope of secondary proceedings) is limited to the general attraction that "lists" and "schedules" have in providing judicial actors clarity in the uncertain world of cross-border insolvency.[88] One should not embrace the narrower holding of the opinion advocating certification as the only permissible basis on which to apply foreign insolvency law; on the contrary, the flexible common law addendum upon that certification power is important.[89] Rather, the more modest point to appreciate is that certification drives consensus. The operationalization of this insight in service of this article's proposal, then, requires assembling something that looks like a Good

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83. *Compare id.* at [66] (Lords Scott and Neuburger) (requiring certification of Australia under section 426(5) of the Insolvency Act in order to cooperate with Australian bankruptcy main proceeding through turnover of assets), *with id.* at [36, 44] (Lords Hoffmann and Walker) (permitting turnover of such assets even without certification for Australia under section 426(5)).

84. Insolvency Act, 1986, c. 45, § 426 (Eng.).

85. *See HIH*, [2008] UKHL 21 [62], [77], 1 W.L.R. at 873–4 (Lords Scott and Neuberger).

86. *Id.* at [36], [63], 1 W.L.R. 873 (Lords Hoffmann and Walker).

87. *See id.* at [44], 1 W.L.R. 864 (Lord Phillips). Note that *HIH* may be functionally revisited soon. As this article goes to press, the new U.K. Supreme Court has granted leave to appeal in *Rubin v. Eurofinance*, [2010] E.W.C.A. (Civ.) 895, [2010] All E.R. (D) 358 (C.A.). The unanimous Court of Appeal opinion in *Eurofinance* quotes extensively and approvingly from Lord Hoffman's prior opinions endorsing universalist positions, ultimately affirming a lower court's recognition of a U.S. bankruptcy court order that arguably would have been void for lack of jurisdiction under U.K. law—all in the name of universalist bankruptcy cooperation. It will be interesting to see whether the U.K. Supreme Court follows this lead.

88. One stark example of this is the schedule to the EU Insolvency Regulation itself, which certifies certain procedures in foreign courts that will count as candidates for deference. *See* Council Regulation 1346/2000, Annex A, 2000 O.J. (L 160) 1 (EC) (listing foreign court insolvency proceedings).

89. In this regard, universalist that I am, I align myself normatively with Lord Hoffman's resolution of the appeal.

Housekeeping Seal of Approval[90] for insolvency priority rules—a "Registry of Recognized Insolvency Priorities."[91]

B. Who?

Priorities seem to be the third rail of insolvency reform. No one wants to touch them, and even voluminous reform projects, such as the UNCITRAL Legislative Guide, fall into conspicuous silence and vagary on just what the priority rules should be.[92] This augurs ill for finding candidates to take up the reformist torch. Academics—especially tenured academics—are of course happy to strike out on such foolishness (coming up with, for example, such bizarre ideas as carving out portions of secondary proceedings for adjudication under different substantive bankruptcy laws).[93] The problem with academics, however, is they have only limited impact on their own; if there is "hard" law and "soft" law, scholarly proposals are downright gelatinous.

This sounds too cynical. There are reform-minded institutions, and they can get stuff done. For instance, UNCITRAL, notwithstanding the gentle ribbing above, performed brilliantly with the Model Law on Cross-Border Insolvencies.[94] The

90. *See The Good Housekeeping Seal,* GOOD HOUSEKEEPING, http://www.goodhousekeeping.com/product-testing/history/welcome-gh-seal (last visited Apr. 7, 2011) (providing the consumer protectionist history of the Good Housekeeping Seal).

91. Guidance for a registry system could come from the A.L.I.'s Proposed Foreign Judgments Recognition Act, which envisions certification by the Secretary of State of countries whose judgments would be recognized by U.S. courts. *See* RECOGNITION AND ENFORCEMENT OF FOREIGN JUDGMENTS: ANALYSIS AND PROPOSED FEDERAL STATUTE § 7(e) (Proposed Final Draft 2005) ("The Secretary of State is authorized to negotiate agreements with foreign states or groups of states setting forth reciprocal practices concerning recognition and enforcement of judgments rendered in the United States."). Interestingly, the A.L.I. proposes excluding bankruptcy judgments from this certification procedure, explaining that the "definition of final judgment and the limitations on enforcement of injunctions in this Act do not fit easily into bankruptcy practice, and cooperation among courts of different states is subject to separate formal and informal agreements." RECOGNITION AND ENFORCEMENT OF FOREIGN JUDGMENTS: ANALYSIS AND PROPOSED FEDERAL STATUTE § 1 cmt. n.1(C)(2) (Proposed Final Draft 2005). For a discussion of the third draft of the full A.L.I. proposal, see Susan L. Stevens, *Commanding International Judicial Respect: Reciprocity and the Recognition and Enforcement of Foreign Judgments,* 26 HASTINGS INT'L & COMP. L. REV. 115, 129–35 (2002). For a discussion of the final draft of the proposal, see Melinda Luthin, *U.S. Enforcement of Foreign Money Judgments and the Need for Reform,* 14 U.C. DAVIS J. INT'L L. & POL'Y 111, 139 (2007); *see also* Montré D. Carodine, *Political Judging: When Due Process Goes International,* 48 WM. & MARY L. REV. 1159, 1217 (2007) (discussing the project and related due process concerns). Another example of a registry list could be the "grey list" that the Organization for Economic Cooperation and Development ("OECD") kept of countries whose tax policies it considered to meet tax haven criteria. The OECD has subsequently abandoned this system in favor of maintaining progress reports on problematic countries. *See Fighting Tax Evasion,* OECD, http://www.oecd.org/document/ 21/0,3746,en_2649_37427_42344853_1_1_1_37427,00.html (last visited Apr. 7, 2011).

92. *See* U.N. COMM. ON INT'L TRADE LAW, UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW 67 (2004). The Guide tepidly bemoans that "[t]he provision of priority rights has the potential to foster unproductive debate on the assessment of which creditors should be afforded priority and the justifications for doing so," but does not actually propose any priority rules for inclusion. *Id.* at 270. This timidity sits in striking contrast with the Guide's forcefulness in prescribing, for example, optimal voting rules for reorganization proceedings. *Id.* at 274.

93. *See* Pottow, *supra* note 12, at 1939.

94. Legislation based on the Model Law has now been adopted in the following jurisdictions: Australia (2008), British Virgin Islands (2003), Canada (2009), Colombia (2006), Eritrea (1998), Great Britain (2006), Japan (2000), Mauritius (2009), Mexico (2000), Montenegro (2002), New Zealand (2006),

International Insolvency Institute (III) too seems productive, especially as it comes fresh off the heels of its Global Principles project.[95] In fact, the III might be the perfect party to step up to this plate, not just because of its increasingly recognized and respected status, but because of the legitimacy it likely enjoys from having such a diverse representation base.[96] The downside, of course, with having the III generate this registry is that the III is extra-judicial (indeed, extra-governmental).[97] Perhaps all the attraction of certification inferred from the *HIH* case above dissolves when instead of coming from Parliament it emanates from a bunch of bankruptcy lawyers who like to have nice dinners. Indeed, one senses a conservatism in the *HIH* narrow holding, bristling at the purported "activism" of "disapplying" British law in favor of some foreign rule.[98] Certification of parliamentary provenance would prove a balm for those judges, who doubtless fear the rebuke of activism. Such comfort may be absent if it is simply the soft—considerably soft—pronouncements of the III upon which they were to rely.

Yet therein, exquisitely, lies the strength of having a group such as the III generate this international certification of priorities. Precisely because it can only offer soft law—recommending but not compelling judicial action—its voice can be heard but it cannot threaten. Sovereignty persists, reigning supreme and unbullied by internationally drafted recommendations, but the wonkish experts get to have their say.[99] Their creation of a tangible list of internationally studied and mulled priorities could have traction and give the cooperatively inclined judge cover to

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Poland (2003), Republic of Korea (2006), Romania (2003), Serbia (2004), Slovenia (2007), South Africa (2000), and the United States (2005). Press Release, UNCITRAL Secretariat, Greece Adopts Legislation Based on UNCITRAL Model Law on Cross-Border Insolvency, U.N. Press Release UNIS/L/138 (June 25, 2010), http://www.unis. unvienna.org/unis/pressrels/2010/unisl138.html.

95. *See* Fletcher and Wessels, *supra* note 24 (International Insolvency Institute's Global Principles for Cooperation in International Insolvency Cases).

96. *See* INTERNATIONAL INSOLVENCY INSTITUTE, BOARD OF DIRECTORS, http://www.iiiglobal.org/board-of-directors (last visited Feb. 8, 2011) (showing wide-ranging diversity of the III's Board of Directors). This diversity should not be overstated. The III is still quite Western-dominated, so perhaps a better candidate might be UNCITRAL. This sort of legitimacy analysis is beyond the scope of this article but rigorously explored in Terence C. Halliday, *Legitimacy, Technology, and Leverage: The Building Blocks of Insolvency Architecture in the Decade Past and the Decade Ahead*, 32 BROOK. J. INT'L L. 1081 (2007) (demonstrating the legitimacy of banking regimes, including UNCITRAL) and Susan Block-Lieb & Terence C. Halliday, *Incrementalisms in Global Lawmaking*, 32 BROOK. J. INT'L L. 851 (2007) (demonstrating how UNCITRAL derives legitimacy from incrementalism). The III could supplement in areas where it lacks representativeness through reports from the World Bank's insolvency law ROSCs (Reports on Standards and Codes).

97. *See* INTERNATIONAL INSOLVENCY INSTITUTE, BOARD OF DIRECTORS, http://www.iiiglobal.org/about (last visited Feb. 8, 2011) (explaining III's membership includes academics and financial industry professionals in addition to legal practitioners and judges).

98. *See* McGrath v. Riddell (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21, [69], 1 W.L.R. 852 (H.L.), 873–4 (Lords Scott and Neuberger) (appeal taken from Eng.) (acknowledging ultimate control of Australian law).

99. A tangential comparison might be to the Canadian Constitution's so-called "Notwithstanding Clause." *See* Canadian Charter of Rights and Freedoms, Part 1, § 33 of the Constitution Act, 1982, *being* Schedule B to the Canada Act, 1982, c. 11 (U.K.) (allowing Parliament to override a Supreme Court finding of unconstitutionality). That parliamentary supremacy is protected in the document that formalizes judicial review does not mean that the courts are toothless in their adjudications of unconstitutionality. Quite to the contrary: this power has never been invoked to date by the Canadian Parliament.

justify a decision to defer to foreign law. To be sure, it will not be as much cover as statutory law would give, but an international registry of approved priorities will provide something to show that an exercise of discretion has been sound. Again, clarification is in order: the suggestion is not that cooperation in international bankruptcy cases is unprincipled or that judges exercising discretion are not already performing careful analyses; that would imply a comity-based system is lawless, which it is not. Rather, the virtue of an international registry is to provide a structural support for the bankruptcy judge who will face a battle in issuing a priority deference decision (someone will always be on the losing end and hence want to fight),[100] because the loser will have to impugn both the judge's exercise of sound decision-making and the III's decision to include/exclude a given priority in its registry.[101]

C. *How?*

Just exactly how would the III (or other entity) go about determining the content of this registry? There are a few possibilities. First, it could adopt a positivist procedural approach, something like a Hartian rule of recognition.[102] Under this approach, the list of "acceptable" priorities could be generated not by looking at the content of the priority rule itself but only at the body or jurisdiction generating it. So, for example, the approval would not be for priority to insurance company claimants but rather to Australia's priority rules generally.[103] The advantage of such an approach would be to stay out of the muck of passing on the substantive content of specific insolvency rules, and there is much to be said for that.[104] Certainly, such a process would spark the least opposition ex ante by states who may be embarrassed by one or two nakedly protectionist boondoggles in their priority rules but otherwise have a logically cohesive system that they could present for review with heads held high.[105] (Note that this approach would find some

100. The citations for this proposition beyond cases already discussed in this article could be infinite. *See, e.g.*, Stonington Partners, Inc. v. Learnout & Hauspie Speech Prods. N.V., 310 F.3d 118 (3d Cir. 2002) (demonstrating tenacious priority fight); *see also* Antwerp Bulkcarriers N.V. v. Holt Cargo Sys., Inc., [2001] S.C.R. 951 (Can.) (litigating priority case all the way to country's highest court). Indeed, this proposition is generalizable beyond priority fights to any choice of law fight in a cross-border bankruptcy with enough at stake. *Compare* Lehman Bros. Special Fin. Inc. v. BNY Corporate Tr. Servs. (*In re* Lehman Bros. Holdings Inc.), 422 B.R. 407 (Bankr. S.D.N.Y. 2010) (noting bankruptcy law divergence between U.S. and U.K. law), *with* Perpetual Trustee Comp. Ltd. v. BNY Corp. Trustee Servs. Ltd. & another, [2009] EWCA (Civ) 1160, (Eng.) (announcing U.K. rule in same cross-border dispute). The *Perpetual/Lehman Bros.* dispute settled pending appeal, and so the choice of law divergence, while identified, was never resolved.

101. Lest I be accused of unfounded optimism regarding the power of registries, let me be the first to point out the unusual situation of South Africa, whose "adoption" of the UNCITRAL Model Law contains a requirement that its Minister of Justice must first designate each country with law that "justifies the application of this Act to foreign proceedings in such State" before deference can be accorded in an insolvency proceeding. Cross-Border Insolvency Act 42 of 2000 § 2 (S. Afr.). To the best of my knowledge, no such country has been designated to date!

102. *See generally* H.L.A. HART, THE CONCEPT OF LAW (2d. ed. 1994).

103. *See* McGrath v. Riddell (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21, [55], 1 W.L.R. 852 (H.L.), 868 (Lord Scott) (appeal taken from Eng.) ("Australia was designated a 'relevant country' for the purposes of section 426.").

104. Some of it is said in Pottow, *supra* note 12, at 1929–34.

105. *Cf.* 11 U.S.C. § 507(a)(6)(B) (2006) (prioritizing claims for certain United States fishermen).

pedigree with the broadest approach taken to former section 304(c)(4) of the U.S. Code.)[106]

The problem with such a purely proceduralist approach would be the danger of exploitation. Once a state got the green light, it could then modify rules ex post to nefarious end. True, secondary rules could be established to dampen this temptation (perhaps re-certification requirements), but the difficulty remains that there would be wiggle room for states inclined to promote "excessive" priorities.[107] Consequently, the alternative approach of actually rolling up one's sleeves and conducting a substantive analysis of different states' priority rules must be considered.[108] Yes, it is a political minefield, but is it possible? The answer is a resounding maybe. The goal would be to employ some metric of "plausibility" to the priority rules of an insolvency law, perhaps self-referentially defining that plausibility in part by an empirical canvassing of other jurisdictions.[109] Thus, one can imagine an employee priority rule being so commonplace as not to engender serious controversy.[110] The question for such an uncontentious category would be what limits (if any) to impose. This question in a sense is a second-order recursion of the earlier rule-of-recognition issue: will the simple fact that the priority under review is for an agreeable category ("workers") be sufficient to conclude the enquiry and secure a place on the registry, or will the analysis of content be even more demanding?

Taking the hard case for further scrutiny, the anchoring question will be quantitative: will there be a cap on the amount of properly classified claims or can they be unlimited?[111] The better path is to endorse caps, because every bankruptcy lawyer knows tales of unlimited priorities that swallow a case.[112] Then again, the requirement of caps need not be universal. For example, maybe certain priority

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106. *See generally* Buxbaum, *supra* note 70, at 31 (discussing former section 304(c) case law).

107. The problem would be similar to the pre-specification of reorganization law explored by "contractualist" bankruptcy scholars. *See, e.g.,* Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy,* 71 TEX. L. REV. 51 (1992).

108. *See* Pottow, *supra* note 12, at 1928 (underscoring the difficulty of comparing utility between state policies).

109. Further discussion exploring this issue is in Pottow, *supra* note 12, at 1929–34. Note that the III has conducted an analysis of the priority rules in other jurisdictions, *see* SOCIAL CLAIMS COMMITTEE OF THE INTERNATIONAL INSOLVENCY INSTITUTE, DRAFT REPORT ON EMPLOYEE, PENSION AND RELATED SOCIAL CLAIMS IN INSOLVENCY (Jun. 9, 2009), http://www.iiiglobal.org/component/jdownloads/?task=view.download&cid=1828. Other scholars have done so in specific domains, such as workers' priority rules. *See* Sarra, *supra* note 53 (surveying multiple jurisdictions and finding widespread prioritization of employee claims).

110. Sarra, *supra* note 53, at 836 (noting prevalence of employee priorities).

111. As discussed previously, many countries have an uncapped employee claim priority. *See* Yemin & Bronstein, *supra* note 55, at 30 (listing countries). Indeed, uncapped protections, at least in consumer exemptions, are not foreign to the United States. *See, e.g.,* TEX. CONST. Art. XVI, § 50 (2010) (unlimited homestead exemption); 31 OKLA. STAT. tit.1 § 1 (2009) (same).

112. *See, e.g., In re* Yukos Oil Co., Fed. Sec. L. Rep. (CCH) para. 94, 115 (S.D.N.Y. 2006) (tax claim, likely bogus in origin, drowning and requiring liquidation of viable business); *In re* Treco, 240 F.3d. 148 (2d Cir. 2001) (administrative claim eclipsing secured creditors' claims); *cf.* Leif M. Clark & Karen Goldstein, *Sacred Cows: How to Care for Secured Creditors' Rights in Cross-Border Bankruptcies,* 46 TEX. INT'L L. J. 513, 521 (2011) ("Notably, as of February 2010, the U.S. receiver had collected approximately $145 million and spent 40% of that recovery—almost $58 million—in fees and costs for operating expenses, receivership costs, and fees.") (discussing *In re* Stanford International Bank, Ltd., No. 3:09-CV-0721-N (N.D. Tex. Dec. 17, 2009)).

claims would be more politically feasible without caps. Staying with the example of wage priorities, for instance, what would be the problem with an unlimited priority for backwages?[113] After all, how large can the backwages get of a company seeking to reorganize? Surely after a point the employees will walk out. Contrast this to tax claims, which can be unbounded by a sufficiently creative and motivated government.[114] As such, notwithstanding the theoretical resistance to unlimited priorities—for the reason that priorities are in general problematic for universalism—pragmatism should prevail. The field of international bankruptcy is rife with compromise,[115] and the most politically salient priorities might well be the ones requiring the lightest touch. (On the other hand, if it were decided that caps were desirable to certify a priority as internationally compliant, those caps could perhaps be calculated by references to an index of existing priority caps, an approach consonant with a new provision of the U.S. Bankruptcy Code policing excessive compensation.)[116]

The toughest issue will be the treatment of secured claims. This is because some countries consider secured creditors not even meaningfully "in" the bankruptcy system (e.g., immune from moratorium rules) and so the idea of ranking a bankruptcy priority ahead of a security pledge may be too much to swallow.[117] Indeed, many of these jurisdictions envision secured claims as property rights and hence of an altogether different legal species as "mere" contractual bankruptcy claims, such that the discussion of their subordination would be almost unthinkable.[118] This issue is tough, and the right answer is uncertain. Choice of law rules that have tried to wrestle this beast in the past have given up, concluding simply that main proceedings must respect the rights in rem of secured creditors.[119] Thus, the trend to date has been "security wins."[120] If this is so, then maybe discretion is the better part of valor, especially for incremental change, and so reformers should strike a conciliatory stance.[121] Still, even the United Kingdom has flirted with a carve-out

113. *See* Sarra, *supra* note 53, at 845 (noting that workers in France are entitled to unlimited priority for wage claims dating six months prior to bankruptcy).

114. *See Yukos*, *supra* note 112.

115. *See* Ian Fletcher, *Evolving Approaches to the Treatment of Security Rights in Cross-Border Insolvency*, 46 TEX. INT'L L. J. 489, 497–98 (2011) ("Some degree of compromise seems inevitable if the perceived advantages of an internally standardized approach are not to be marred due to an unduly-strict adherence to a 'pure' form of the universality principle—a further example of how the best can become the enemy of the good.").

116. *See* 11 U.S.C. § 503(c)(1)(C)(i) (2005) (capping maximum executive compensation for retention agreement at ten-times mean worker retention payment).

117. *See, e.g.*, Corporate Law Reform Act 1992, § 441A (exempting from stay secured creditors with substantially all of a debtor's property under a lien), 441B (exempting from stay secured creditors who have acted to enforce their claims before the appointment of an administrator), 441C (exempting from stay secured creditors who have a lien on perishable property) (Austl.).

118. An example of this approach is implicit in the choice of law rules under the EU Insolvency Regulation, where the property rights "in rem" of secured creditors must be protected. *See* Council Regulation 1346/2000, art. 5, 2000 O.J. (L 160) 1 (EC). This conceptualization of the secured creditor's lien as an inviolable property right necessarily presupposes the wrongfulness of its subordination to other contractual rights.

119. *See id.*; *id.* at 25th Recital.

120. *See, e.g.*, *In re* Treco, 240 F.3d. 148 (2d Cir. 2001) (secured creditors securing refusal to cooperate with Bahamian proceedings); *cf.* Council Regulation 1346/2000, 25th Recital (describing validity and extent of in rem rights).

121. *See generally* Pottow, *supra* note 14 (advocating incremental reform in international insolvency).

for unsecured creditors,[122] so perhaps the answer might be some form of carve-out: security generally wins, but in jurisdictions where security is subordinated to certain protected claims, those super-priorities should be certified as acceptable—notwithstanding the purported infringement on in rem rights—provided they stay within a small threshold of the encumbered collateral's value.[123] Finding a middle path here is a fine needle to thread, but it may be possible.

V. CONCLUSION

The proposal presented in this article is to re-envision—and drastically reduce the scope of—the secondary proceeding, a necessary evil (at least to the universalists) in international bankruptcy. To do so, ongoing reform efforts should explicitly limit the scope of these proceedings to: (1) real property disputes; (2) disputes where local judicial authority is needed to exercise equitable or other non-monetary bankruptcy-related relief; and (3) other extraordinary circumstances pursuant to some safety valve escape clause. Conspicuously absent from this list is disputes involving a divergence in priority rules between the main and secondary jurisdiction. This redesign effectively requires shifting priority recognition up to the main proceeding—including priorities unrecognized by the main proceeding's own bankruptcy laws. While the true universalist consequence of this move would be to subjugate those priorities as unrecognized by the COMI laws, this article suggests relaxing that purity and embracing "synthetic secondary proceedings" within the confines of the main proceedings as a way to vindicate these foreign local priorities.

Permitting synthetic secondary proceedings within the main proceeding will require the COMI jurisdiction to subjugate its own conflicting priority rules in favor of the foreign jurisdiction's. Rather than rely upon doctrines of comity alone to encourage this deference by the COMI jurisdiction—which surely would suffice in some but not all circumstances—this article also recommends the creation of an international registry of "approved" bankruptcy priorities by a respected non-state actor (e.g., the III). The adoption of that registry should be by express statutory provision in jurisdictions where such authorization is required or by judges in the exercise of their discretion in places where it is not. These suggestions for incremental reform are designed to hobble—but not yet kill—the secondary proceeding. They may reflect wishful thinking, and they may have problems with implementation, but they are earnest attempts to deal with the most difficult bankruptcy issue—priority—that has so far stubbornly refused meaningful reform.

122. *See* Enterprise Act 2002, c. 40, § 252, § 176A (2) (U.K.) (setting aside property for the satisfaction of unsecured claims).

123. *Cf.* Yemin & Bronstein, *supra* note 55, at 30 (listing Brazil, Ecuador, and Peru as the only countries that place caps on neither the lookback period nor amount of employee priority claims (though Brazil has since capped claims, *see* Jarvinen et al., *supra* note 55, at 69)).

Breaking Away: Local Priorities and Global Assets

JAY LAWRENCE WESTBROOK*

"There are no grounds of justice or policy which require this country to insist upon distributing an Australian company's assets according to [English] priorities only because they happen to have been situated in this country at the time of the appointment of the provisional liquidators."[1]

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1. McGrath v. Riddell (*In re* HIH Cas.& Gen. Ins., Ltd.), [2008] UKHL 21, [36], 1 W.L.R. 852 (H.L.) 863 (Lord Hoffmann) (appeal taken from Eng.).

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I. INTRODUCTION

Like an adolescent struggling with clothes that no longer fit, the growing field of international insolvency has not so far put aside the old notion that local priorities must always be applied in distributing local assets. Yet the great variation in the distribution rules from one nation to another means that application of local priorities creates a serious obstacle to multinational cooperation, puts both maximization and fairness at risk, and exacerbates the likelihood of forum stashing.

The problem of conflicting distribution rules is part of the larger discourse pitting territorialism against universalism in the insolvency proceedings of multinational corporations.[2] That aspect of territorialism that would apply local priority rules to locally seized assets may be called "localism." If fully realized, localism would create a separate pool of the assets seized in each jurisdiction and distribute its value under local priority rules, while universalism would create a single global asset pool and distribute its value worldwide under a single set of rules. Some of the authors in this symposium believe localism is the inevitable rule, while others incline toward universalism.[3] Professor Edward Janger has advocated a form of localism that would mitigate its more glaring defects through a choice of law rule that would permit some less parochial results.[4] I share his sense that any general rule we might adopt requires exceptions, but I think there are compelling arguments against adopting a territorial rule as the general rule in multinational cases. I would propose a universalist rule with some exceptions that recognize legitimate local expectations. But an approach from such a different beginning has a quite different ending as well. That is, to start with a central rule and make exceptions produces results different from a regime that has no central rule at all.

Two crucial points underlie the argument. First, localism does not favor local creditors per se, but rather privileges the application of local rules that might often benefit foreign multinationals as much or more than the local contractor. Thus

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2. *See* A.L.I., PRINCIPLES OF COOPERATION AMONG THE NAFTA COUNTRIES 8 (2003) [hereinafter PRINCIPLES] (explaining the traditional dichotomy between the distribution rules of territorialism versus universalism).

3. Lord Hoffmann has described universalism as a "golden thread running through English cross-border insolvency law since the eighteenth century." *McGrath*, [2008] UKHL 21,[30] 1 W.L.R. at 861. He would not claim, any more than I would, that the common law of England or the law of any other jurisdiction has adopted universalism in its purest form. Leonard Hoffmann, Baron, Keynote Address at the University of Texas School of Law International Insolvency Symposium: The Priority Dilemma (May 11, 2010).

4. *See* Edward J. Janger, *Virtual Territoriality*, 48 COLUM. J. TRANSNAT'L L. 401, 422–40 (2010) (advocating decentralized priority rules through a system of "universal proceduralism"). His contribution to this symposium seems to emphasize a choice of law rule focusing on the territory where a claim arose. *See generally* Edward J. Janger, *Reciprocal Comity*, 46 TEX. INT'L L.J. 441 (2011) [hereinafter Janger, *Reciprocal Comity*].

localism cannot be justified by protection of local creditors, leaving aside the difficulty of defining that category in a globalizing world.

The second point is that localism would apply local rules to all locally controlled assets whether or not those assets bear any significant relationship to the claims given priority under local law. Absent such a relationship, a creditor has no legitimate expectation that these assets will be distributed under local rules. It follows that the application of local rules to those assets is often adventitious and unprincipled, because it is not related to legitimate expectations. For these reasons, the proper general rule is universalist, with local rules to be applied only where there is a substantial connection to specific assets and therefore arguably a legitimate reliance on local rules. These instances are not necessarily rare. They would include workers' reliance on the assets associated with their workplace and customers' reliance on funds required by regulators to be maintained in local accounts. Certain taxes and secured claims might also be exceptions for similar reasons, although this article does not work through those two important categories of claims. Thus there is room in a universalist regime for a choice of law rule based on the existence of such expectations, permitting local assets to be distributed under local rules where appropriate.

Given its difficulties, why does localism survive? The primary overt justification seems to be a claim that it satisfies commercial expectations, although that claim is unproven and highly questionable. An underlying proposition that may be more important is that localism is unavoidable politically and is supported by a commitment to special local values. I will suggest that except for the three Great Priorities which are found nearly everywhere—wages, security, and taxes[5]—it seems unlikely that either politics or widely shared national values strongly support most of the remaining grants of priority. Taking all in all, neither legislators nor judges are apt to be deeply committed to their vindication. If the Great Priorities could be managed, the rest would be of limited concern.

These policy arguments admittedly leave unaddressed the argument that all local priorities—and for that matter the very principle of *pari passu* distribution—are imposed by the terms of statutes[6] and therefore must be enforced absent an international treaty. I divide possible solutions of the difficulty into two parts. First, a choice of law approach applies the law of the main proceeding as the law with the most significant connection to the distribution overall, but identifies some claims as so associated with particular assets as to justify application of local distribution rules. The second approach uses choice of forum as a method of centralizing choice of law, subject once again to exceptions for certain kinds of claims. I offer the United States and the United Kingdom as examples of the use of this approach.

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5. I ignore a fourth priority that may be even more universal, the priority for administrative expenses of the proceeding. In the United States, for example, that would be found in section 507(a)(2) of the Bankruptcy Code. 11 U.S.C. § 507(a)(2) (2006), *amended by* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, § 1101(b), 124 Stat. 1376, 2115 (2010). That priority must be granted in each jurisdiction where local official action is needed, along the lines suggested by the old adage that someone in the circus parade has to clean up after the elephants.

6. *See, e.g.*, Alan L. Gropper, *The Payment of Priority Claims in Cross-Border Insolvency Cases*, 46 TEX. INT'L L. J. 559, 560–61 (2011) (describing the system of priorities imposed by Section 507 of the U.S. Bankruptcy Code).

II. THE CASE FOR LOCALISM

Given all its flaws, why do observers still cling to localism, often reluctantly?[7] Although others in this symposium present various arguments for favoring a local rule for local assets, I think it is fair to say that there are three grounds typically advanced in defense of localism. The first is that this rule is the traditional approach and current law in many jurisdictions. The second is that nationalism compels localism. The third is that local expectations and values should be vindicated. The first two arguments are importantly wrong. The last is valid, but only to a limited extent.

As to the fact that localism is the traditional rule, "[I]t is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV."[8] If the rule of localized distribution—a legacy of territorialism or "the grab rule"—has no justification except its existence, it should not detain us long except insofar as it may bind local judges despite their appreciation for its defects, a point addressed below.

The second argument for local distribution is one of *realpolitik*. It has two branches: refusal and resistance. The first branch is the claim that local judges will never be willing to permit local assets to slip away when local creditors would benefit from a local rule. We know that is wrong, because there are too many contrary examples.[9] Whether parochialism might prevail more often than not remains to be

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7. To a significant extent, the arguments for localism overlap those supporting territorialism and opposing universalism. *See generally* Benjamin J. Christenson, *Best Let Sleeping Presumptions Lie: Interpretation of "Center of Main Interest" Under Chapter 15 of the Bankruptcy Code and an Appeal for Additional Judicial Complacency*, 2010 U. ILL. L. REV. 1565 (arguing that U.S. courts under universalism have too much discretion in locating the single appropriate forum); John J. Chung, *The New Chapter 15 of The Bankruptcy Code: A Step Toward Erosion of National Sovereignty*, 27 NW. J. INT'L L. & BUS. 89 (2006) (proposing that universalism threatens national sovereignty and incentivizes forum shopping, with only theoretical economic benefits); Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696 (1999) [hereinafter LoPucki, *Post-Universalist Approach*] (arguing that territoriality lays the best foundation for international cooperation while universalism leads to unpredictable results); Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216 (2000) [hereinafter LoPucki, *Cooperative Territoriality*] (outlining the inherent weaknesses in attempting to define "home country" under a universalist approach); Frederick Tung, *Fear of Commitment in International Bankruptcy*, 33 GEO. WASH. INT'L L. REV. 555 (2001) (listing various factors that make states reluctant to adopt universalism); Symposium, *Bankruptcy in the Global Village: The Second Decade*, 32 BROOK. J. INT'L L. 753 (2007) (exploring the complexity of substantive coordination of cross-border insolvency cases); Edward S. Adams & Jason Fincke, *Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism*, 15 COLUM. J. EUR. L. 43 (2008) (suggesting that territorialist aspects of the Model Law protect domestic interests of creditors and stakeholders while universalism does not); Nigel John Howcroft, *Universal vs. Territorial Models for Cross-Border Insolvency: The Theory, the Practice, and the Reality that Universalism Prevails*, 8 U.C. DAVIS BUS. L.J. 366 (2008) (summarizing localist models, including territoriality and cooperative territoriality).

8. Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 469 (1897).

9. *See, e.g.*, McGrath v. Riddell (*In re* HIH Cas.& Gen. Ins., Ltd.), [2008] UKHL 21, 1 W.L.R.852 (H.L.) (appeal taken from Eng.) (applying Australian bankruptcy law in the United Kingdom despite negative effects on local creditors); *see also* Maxwell Commc'n Corp. v. Soc'y Gen. (*In re* Maxwell Commc'n Corp.), 93 F.3d 1036 (1996) (applying English avoidance rules in Chapter 11 and accepting a worldwide plan); JP Morgan Chase Bank v. Altos Hornos de Mex., S.A. de C.V., 412 F.3d 418 (2d Cir. 2005) (deferring to Mexican bankruptcy court in proceedings brought by lending bank against foreign borrower regarding funds in the bank's possession); *In re* Compañía de Alimentos Fargo, S.A., 376 B.R. 427 (Bankr. S.D.N.Y. 2007) (dismissing an involuntary Chapter 11 case in discretion where no good reason

fully tested, but the tide is flowing toward cooperation and universalism, and every jurisdiction responding positively is an addition to the community of coordination, so there seems every reason to press on.[10] Defenders of the localist position counter with the second branch of this argument, which is that insistence on global distribution will prevent cooperation while the embrace of nationalism will encourage it. In fact, the opposite is likely to be true.[11]

Another argument for localism is based on a concern to protect localized expectations, an assertion that is unsupported and doubtful.[12] An underlying proposition is that localism is politically unavoidable because it is supported by a commitment to special local values.[13] I have suggested that after the three Great Priorities which are found nearly everywhere—wages, security, and taxes—it seems unlikely that either politics or widely shared national values strongly support most of the remaining grants of priority.

Having said that, the argument for local rules of priority does have some validity, as to certain sorts of rules under certain circumstances, a point addressed in section IV.

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existed for a United States proceeding and the insolvency should be resolved in Argentina); *In re* Bd. of Dirs. of Telecom Arg. S.A., 2005 WL 3098934 (S.D.N.Y. 2005) (deferring to bankruptcy court decision that claimants' rights were sufficiently similar to United States provisions to justify deference); *In re* Bd. of Dirs. of Multicanal S.A., 307 B.R. 384 (Bankr. S.D.N.Y. 2004) (dismissing claim that the Trust Indenture Act prohibited impairment of company members' rights by recognition of foreign insolvency proceedings in the United States); *In re* Condor Ins. Ltd., 601 F.3d 319 (5th Cir. 2010) (applying foreign avoidance law in Chapter 15 proceeding). *But see In re* Globo Comunicacoes e Participacoes, S.A., 317 B.R. 235 (S.D.N.Y. 2004) (stating that an involuntary petition in the United States should not be dismissed in deference to Brazilian main proceeding unless dismissal benefits both creditors and debtor).

10. Leonard Hoffmann, Baron, Keynote Address at the University of Texas School of Law International Insolvency Symposium: The Priority Dilemma (May 11, 2010) ("[H]istory shows that it may be necessary to cast one's bread upon the waters, even though it is many days before one can find the reward in the form of enactments like the Model Law.").

11. *See infra* Part III.C.

12. *See* Adams & Fincke, *supra* note 7, at 57–58 (noting that protection of creditor expectations is one of the four main advantages that proponents of territorialism claim); LoPucki, *Post-Universalist Approach*, *supra* note 7, at 747 (arguing that a territorialist regime will better match unsophisticated creditors' expectations); *cf.* LoPucki, *Cooperative Territoriality*, *supra* note 7, at 2223 ("[T]he workers in a Chrysler plant in Detroit do not expect to have to claim their wages and benefits in a German bankruptcy court . . . .").

13. *See* Adams &Fincke, *supra* note 7, at 71–72 (arguing that it is unrealistic to expect judges to resist domestic political pressure in bankruptcies, especially high-profile cases). Professor Tung described how various political pressures acting on local politicians work to defeat universalism:

> In general, a state's preference for its own bankruptcy law and reluctance to recognize foreign bankruptcy proceedings may arise from the desire of domestic political actors to defend the policies implicit in their domestic laws. This may include the preservation of any perquisites that redound to particular groups under those laws. The complexities of a state's bankruptcy regime reflect myriad policy decisions and political trade-offs. These trade-offs might enhance the public interest or merely the interests of the victors in domestic rent seeking contests. Regardless of which, political actors will wish to preserve the balance struck in their domestic bankruptcy rules. They will generally resist recognition of foreign bankruptcy proceedings that would upset this careful balance.

Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT'L L. 31, 55 (2001) (footnotes omitted).

III. THE TROUBLE WITH LOCALISM

The reason that localism is so subversive of the benefits of universalism is that distribution of value is a core function of bankruptcy proceedings. To adopt a territorial approach to distribution is to attempt to carve out the central idea of territorialism—the claim that creditors have vested interests in local assets based on local law—and then graft that idea upon universalism. The result is something like Professor LoPucki's cooperative territorialism, but not much like universalism, even in its pragmatic, modified version.[14] Choosing priority law on a territorial basis makes this fundamental mistake and there remains only the struggle to ameliorate its inevitable anomalies and inefficiencies in a global economy.

Localism has five primary defects. The first is that its effects are arbitrary and unprincipled, normatively and economically, and therefore little related to its goals because it does not rest upon any relevant connection to particular local assets and cannot be used to benefit local creditors over others. The second is that there is little evidence for the assumption that locally claiming creditors legitimately expect to be paid from local assets. The third is that localism is harmful to the prospects for any international cooperation. The fourth is that it will encourage forum stashing, the transfer of assets for the purpose of exploiting local rules that favor a debtor's purposes rather than the rights of creditors and other stakeholders. The fifth, addressed in Section IV, is that it is far too broad a response to local expectations and local values. In those instances where the case for applying local rules to local assets is persuasive, that result can be achieved by a nuanced choice of law rule within a global regime.

A. The Lack of Connection Between Claimants and Assets

Localism does not protect local interests because there is no necessary connection between the assets captured by the local courts and the creditors who will be benefited by a local distribution. Thus, there is no principled connection between the claimants and the local assets on which to rest a preference. For example, applying local insolvency law may grant a priority to local civil contractors in the distribution of the proceeds of a company airplane that happened to be landing at the airport at the moment of filing or in the proceeds of sale of a local patent on a product unrelated to any local activity.[15] The proceeds of inventory seized locally might be distributed to local employees although the inventory was produced and marketed by employees in another country and is destined for sale elsewhere.

The lottery flavor of localism is especially great in the case of intangibles. In the Lehman case we learned of the infamous $8 billion that was transferred through its cash management system from London to New York over the weekend before

14. *See generally* LoPucki, *Cooperative Territoriality*, *supra* note 6 (advocating application of principles of sovereignty-territoriality in cross-border bankruptcy cases).

15. This difficulty is the one that Professor Janger attempts to meet with his choice of local law rules, an approach that I applaud, although we disagree about where to start and how to proceed. *See* Janger, *Reciprocal Comity*, *supra* note 4, at 449. For the difficulty of harmonizing choice of law rules, *see* Hannah L. Buxbaum, *Rethinking International Insolvency: The Neglected Role of Choice-of-Law Rules and Theory*, 36STAN. J. INT'L L. 23, 54–55 (2000).

Lehman filed insolvency proceedings in both jurisdictions.[16] There has been no suggestion that employees, pensioners, or lenders on Wall Street or the Upper West Side had any greater relationship to this wandering treasure than their counterparts in the City or the East End. Similar cash management systems in thousands of large corporations loft huge sums from continent to continent every night. As to bank accounts generally, the answer to the question "where is a bank account located for legal purposes?" is "it depends."[17]

The lack of a connection between claimants and assets is found at both ends of localism, because it does not actually serve local creditors. Built into many discussions of localism is the implicit notion that it favors locals. I believe that this unstated assumption causes many judges and lawyers to assert that it is unthinkable that local judges would transfer assets without first satisfying local priorities, because the implication is that local creditors (and voters) would be favored.[18] Yet nowadays, in virtually all jurisdictions with substantial economies, there is no statutory discrimination against foreign creditors.[19] If Colossal Transnational Construction Company is owed millions of dollars by the debtor, it will claim in a local bankruptcy right alongside the local contractors and the electric utility and will share proportionately in any distribution of the value of the seized assets.[20] So, under a

16. Landon Thomas, Jr., *Funds Try to Lose Ties to Lehman*, N.Y. TIMES, Oct. 1, 2008, *available at* http://www.nytimes.com/2008/10/02/business/02lehman.html.

17. *See, e.g.*, Citibank, N.A. v. Wells Fargo Asia Ltd., 495 U.S. 660 (1990) (reflecting the ambiguity surrounding the question of account location). A recent case in France illustrates the possibilities. There the creditor sought and obtained attachment of a bank account opened and maintained in Monaco by an action against the bank's French branch. Gilles Cunniberti, *International Reach of French Attachments*, CONFLICT OF LAWS .NET (Mar. 2, 2008), http://conflictoflaws.net/2008/international-reach-of-french-attachments.

18. This mental block is found even among the outstanding expert participants in this symposium. José M. Garrido, *No Two Snowflakes the Same: The Distributional Question in International Bankruptcies*, 46 TEX. INT'L. L. J. 459, 479 (2011) (quoting an inartful reference in the Guide to the Model Law concerning "local" creditors); *id.* at 485 (protecting local creditors over foreigners); John A.E. Pottow, *A New Role for Secondary Proceedings in International Bankruptcies*, 46 TEX. INT'L L. J. 579, 580 (2011) ("[t]he purpose of a secondary proceeding is to allow *local creditors* of a foreign debtor the opportunity to open a bankruptcy case in *their native country*, chiefly to enjoy the benefit of *local bankruptcy law*") (emphasis added); Gropper, *supra* note 6, at 563 (arguing that it is unfair to "impos[e] a foreign distribution scheme and depriv[e] a worker of the substantial priority claim be would have in *his home jurisdiction*," and that "it cannot be realistically expected that the authorities in a jurisdiction where assets are located will surrender those assets to a foreign court when the interests of *local creditors* will be adversely affected") (emphasis added). Even Professor Fletcher is ambiguous in this regard. Ian Fletcher, "L'enfer, c'est les autres": *Evolving Approaches to the Treatment of Security Rights in Cross-Border Insolvency*, 46 TEX. INT'L L. J. 489, 491 (2011) ("This [public policy choice concerning priority rules] becomes a factor that is likely to color the approach by the courts of that country when reviewing any request to authorize the transmission of assets from their own jurisdiction to that of a different state under whose insolvency law the said assets will be subject to a different order of distribution.").

19. *See* Jay Lawrence Westbrook, *Universal Participation in Transnational Bankruptcies*, *in* MAKING COMMERCIAL LAW: ESSAYS IN HONOUR OF ROY GOODE 419, 436–37 (Ross Cranston ed., 1997) [hereinafter *Universal Participation*] (arguing that the assumption that local priorities benefit local creditors has not been enshrined in local statutes); Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27, 31 (1998) [hereinafter *Universal Priorities*]; *see also* Model Law on Cross-Border Insolvency, G.A. Res. 52/158, U.N. Doc. A/RES/52/158, art.13, para.2 (Jan. 30, 1998) [hereinafter Model Law] (prohibiting discrimination against foreign creditors). Of course, local creditors have the usual "home team" advantage, as is true in all international litigation.

20. Concerning their right to share in local priorities that come ahead of general unsecured creditors, *see infra* Part V.A.

localist approach, the local contractor will share in the proceeds of a locally registered patent sold as part of a worldwide auction of intellectual property (if lack of cooperation does not prevent the sale), while the international construction colossus will share in the proceeds of sale of the local accounts receivable. Each will benefit preferentially from the sale of assets with which it has no meaningful connection or right to preferred treatment and the benefit will often be adventitious and unpredictable.[21]

The situation is only somewhat less clear in the case of priority claims. If the local court would treat foreign creditors without discrimination in a *pari passu* distribution to general unsecured creditors, would it also permit foreign creditors to share in a priority distribution if a domestic creditor would enjoy priority in the same circumstances? The situation in the United States may be illustrative. Consider the position of foreign claimants in a regular corporate bankruptcy case, typically a Chapter 11. How will the United States priority rules apply to foreign claimants? I have discussed this problem at some length in earlier work,[22] so I offer only a summary here.

Take as an example the bankruptcy of a Miami condominium project. A Minnesotan has put down a substantial deposit to buy apartment 6005 and a Mexican has deposited a similar amount against purchase of apartment 6006. There is nothing in section 507 or 726 of our Bankruptcy Code to limit the "deposit" priority of section 507(a)(7) to citizens or residents of the United States. On the face of our priorities, they apply to any creditor whose claim fits the stated requirements. Beyond the language of the statute, to grant the Minnesotan person a priority under section 507(a)(7) of the Bankruptcy Code while denying it to the Mexican would not only defy ordinary notions of fairness but would violate our treaty obligations with Mexico.[23] In addition to the WTO treaty,[24] the United States is party to hundreds of commercial treaties that require that each party give "national treatment" to the citizens of the other state party, which means that the foreign citizen must be treated in the same way legally as a United States citizen. These are commercial treaties and therefore have special cogency in commercial matters like bankruptcy. Given that there is nothing in the language of the Bankruptcy Code to suggest that the priority system should discriminate against foreigners and the case law is not an obstacle, it seems inconceivable that the United States would deny equal, national treatment to the Mexican claimant.[25] This analysis has several important implications,[26] but the

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21. Professor Janger focuses not on the asset or the claim but the "transaction." Janger, *Reciprocal Comity*, *supra* note 4, at 449 ("I envision a narrow role for *lex forum concursus*, and a much broader role for *lex situs*. My focus is not limited to assets . . . .."). It seems to me to locate a transaction that typically involves several countries is even harder than applying a territorial approach to an asset or a claim.

22. *See Universal Participation*, *supra* note 19, at 425–27. *See generally*, *Universal Priorities*, *supra* note 19 (describing the effects of cross-border priorities).

23. *See, e.g.*, North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993) [hereinafter NAFTA] (granting "national treatment" to numerous aspects of transactions between citizens of the United States, Mexico, and Canada). The American Law Institute Transnational Insolvency Project has recommended that such "cross priority" be granted. PRINCIPLES, *supra* note 2, at 95. *See also infra* note 79 and accompanying text.

24. General Agreement on Tariffs and Trade: Multilateral Trade Negotiations Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, Annex 1B, art. XVII § 1, 33 I.L.M. 1125 (1994) [hereinafter WTO Treaty]; see *infra* note 64.

25. *See Universal Participation*, *supra* note 19, at 427 (stating that nothing in the U.S. Bankruptcy

first one is that localism cannot target its benefits to local citizens and residents of the United States. Much the same analysis would apply in a number of other countries that would likely apply national treatment for priority claimants as well as for general unsecured creditors.

B. Creditor Expectations

It is often assumed that creditors have expectations based upon one or another sort of local contact.[27] In particular, the argument for localism turns in large part on the idea that local creditors have relied on the presence of local assets in extending credit.[28] Yet there are no reported data, hard or soft, to support that assertion. Experience suggests that creditor reliance is a very complicated question and may vary greatly from case to case, especially when the debtor is a multinational corporation. Does the local supplier rely on the presence of local assets or instead rely on a brand name associated with a multinational corporation of which the local operation is a part? In a certain supplier's jurisdiction, do the credit reports break out the local assets in rating Wal-Mart? Do creditors in a particular credit culture have available reliable credit reports and what is their focus and effect, especially in terms of reporting assets, asset locations, and group identities? Is credit in that culture instead based on cash flow or prior payment record?[29] Did the investor who

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Code discriminates against foreign creditors); *see also* PRINCIPLES, *supra* note 2, at 29–31, 95 (stating the general principle of national treatment among the NAFTA countries, but noting that there is little or no positive law on this subject); A.L.I., INTERNATIONAL STATEMENT OF UNITED STATES BANKRUPTCY LAW 77 (2003) (describing national treatment of foreign claims under U.S. Bankruptcy law). There may be an exception as to taxes and other public-law claims. *See* Jonathon M. Weiss, *Tax Claims in Transnational Insolvencies: A "Revenue Rule" Approach*, 30 VA. TAX REV. 261, 299–304, 315–16 (2010) (describing how foreign tax claims have traditionally been unenforceable in foreign countries); PRINCIPLES, *supra* note 2, at 95–96; *Universal Participation*, *supra* note 19, at 427–28; *Universal Priorities*, *supra* note 19, at 36. But this exception is based on the traditional rule (the "revenue rule") against recognizing foreign public-law judgments, a quite different problem.

26. *See infra* Part V.A.

27. *See* Case C-341/04, *In re* Eurofood IFSC Ltd.,2006 E.C.R. I-3813, para. 37 ("[W]here a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different Member States, the presumption laid down in the second sentence of Article 3(1) of the Regulation, whereby the centre of main interests of that subsidiary is situated in the Member State where its registered office is situated, can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect."). It seems especially unlikely that many creditors other than a lender would rely on the rules of the state of incorporation, without reference to assets or operations, yet the *Eurofood* court transformed a convenient procedural presumption into a set of presumed expectations to be overcome only by empirical evidence to the contrary. *See* Jay Lawrence Westbrook, *Locating the Eye of the Financial Storm*, 32 BROOK. J. INT'L L. 1019, 1028 (2007). Most lenders, I am reliably informed by lawyers in the trade, now put the COMI location right into the loan documents, making any change subject to notice and perhaps making the change an event of default. Of course, the fact that the court's analysis in *Eurofood* is rather weak does not mean its conclusion about reliance in that case was wrong. It is difficult to judge the merits in that regard based on the reports of the case, but it involved a limited purpose financing entity, so perhaps the only relevant perspective was that of the lenders and they expected the law of incorporation to control.

28. *See* Tung, *supra* note 7, at 572–73; LoPucki, *Cooperation in International Bankruptcy*, *supra* note 7, at 701–02; LoPucki, *Case for Cooperative Territoriality*, *supra* note 7, at 2218–19; *see also* Janger, *Reciprocal Comity*, *supra* note 4, at 449 (arguing that the location of assets and the location of claims are both important under universal proceduralism).

29. United States credit reports suggest that prior payment records are by far the most important

bought $10,000 worth of Wal-Mart bonds from a New York underwriting house rely on the presence of a local Wal-Mart in the investor's country? The answers to these questions are largely unknown or at least unstudied. The creditors' expectations argument is neither supported by evidence nor compelled by ordinary experience. It may represent an effort to make twenty-first century global rules based on nineteenth century mental pictures of commerce in small towns.

Many of these points are illustrated by the facts in the *HIH* case in the United Kingdom, discussed in other articles in this symposium.[30] The assets "in" England were reinsurance agreements. HIH might as readily have entered into such contracts with the same reinsurers in any money-center jurisdiction in the world where these reinsurers had a place of business. English creditors could hardly have relied on English priority rules for these assets, while policyholders in many countries may have relied on Australian law to protect them against failure of this Australian insurance company and to prefer them if it failed nonetheless.[31] The absence of any reasonable expectation that English law would be applied to these assets is closely related to the lack of a meaningful relationship between these creditors and those assets.[32]

Another dispute in the Lehman matter permits us to see the interaction of procedure and forum with the anomalies of localism. In the *Perpetual* cases,[33] there have been inconsistent decisions in New York and London as to the legality of contractual priority clauses in a trust held by the Bank of New York that served as the vehicle for a complex derivative transaction between a Lehman entity and a group of investors. The effect of the clauses would be to "flip" priority positions in the trust assets—that is, to reverse them—in the event the Lehman party bankrupted. The United States and English courts both purported to apply rules designed to protect the debtor's creditors from bankruptcy-termination clauses. The American court held that the United States rules against permitting a bankruptcy filing to serve as a default meant the flip in contractual priority was unenforceable. The English court held that a somewhat similar common law principle was not implicated and therefore the contractual flip should be given effect.[34] The English

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factor in the credit decision.

30. McGrath v. Riddell (*In re* HIH Cas.& Gen. Ins., Ltd.), [2008] UKHL 21, 1 W.L.R. 852 (H.L.) (appeal taken from Eng.).

31. This point was suggested by the judgment of Lord Hoffmann in the case. *Id.* at [35]. The insurance laws in some jurisdictions require maintenance of a pool of local assets to protect local policyholders and perhaps other creditors, but there is no suggestion that any such provision of English law applied in *HIH*.

32. I have been told by knowledgeable people that the trust beneficiaries in *Perpetual* are primarily from Australia and New Zealand.

33. *In re* Lehman Bros. Holdings Inc., 422 B.R. 407 (Bankr. S.D.N.Y. 2010); Perpetual Tr. Co. Ltd. v. BNY Corporate Tr. Servs. Ltd., [2009] EWCA (Civ) 1160.

34. Of course, I oversimplify greatly a complex case and two complex decisions. The United States rules bar so-called ipso facto clauses, 11 U.S.C. §§ 365(b)(2), 365(f), 541(c)(1) (2009), while the English common law "anti-deprivation" principle is that "there cannot be a valid contract that a man's property shall remain his until bankruptcy, and on the happening of that event go over to someone else, and be taken away from his creditors." Perpetual Tr. Co. Ltd. v. BNY Corporate Tr. Servs., [2009] EWHC (Ch) 1912, [26] (quoting Money Mkts. Int'l Stockbrokers Ltd. v. London Stock Exch. Ltd., [2002] 1 W.L.R. 1150 [87]). *See* Look Chan Ho, *The Principle Against Divestiture and the* Pari Passu *Fallacy*, BUTTERWORTHS J. OF INT'L BANKING AND FIN. L., Jan. 2010, at 3 (discussing the flawed interpretation of the anti-deprivation principle in *Perpetual* that allowed priority-reversal provisions).

court specifically noted it was not deciding if United States bankruptcy law should apply, and the American court was careful not to enter judgment and thus left some room for a satisfactory accommodation of different views, if possible.[35]

To see how this analysis applies to distribution rules, we have to alter the facts a bit. Suppose that the difference in distribution of the trust assets arose from a difference in the priority rules in the two countries rather than from a contract.[36] Assume, as is apparently true in *Perpetual*, that the creditors to be benefited or disadvantaged come from many countries and not primarily from the United States or England.[37] If both the United States and England had localist choice of law rules for distributions, would the English court feel free to defer to the United States bankruptcy court? If not, how would the dispute between them be resolved, if both felt required to ensure that the assets would be distributed under their local rules? Would the location of the assets matter,[38] the outcome turning on whether the assets were securities issued by Japanese corporations or real estate in Tanzania?[39] Would both courts order the Bank of New York to surrender the assets to their respective liquidators under threat of sanctions if it did not comply with the conflicting orders? Would the "winning" court have somehow served its national interest by following its priority rules in distributing the value of the assets to persons who were probably resident elsewhere for the most part and who had not relied in any meaningful way on the chance of benefiting from application of the winning court's rules?

A single rule of distribution will not solve all such problems. But a global distribution rule based on the priority rules of the main proceeding would seem to reduce the chances of such confrontations and to avoid the anomalies that arise from the lack of connection between claimants and the assets that are captured locally.

C. *The Effect on Cooperation*

One major consequence of localism is that courts otherwise willing to cooperate may feel bound to the letter of their local statutory priorities, which they may read as

35. Subsequently, however, the district court ordered that judgment be entered, so as to permit an appeal. *See* Decision and Order Granting BNY Corporate Tr. Servs. Ltd.'s Motion for Leave to Appeal, Lehman Brothers Holdings Inc., No. 08-13555, Lehman Bros. Special Fin. Inc. v. BNY Corporate Tr. Servs. Ltd., No. 09-11242 (S.D.N.Y. Sept. 21, 2010) (stating McMahon's opinion that the decision warranted immediate review because of its "potentially game-changing effect on the structured finance business."). *See also* Grant McKool, *Judge Allows "Game-Changing" Lehman Case Appeal*, REUTERS, Sep. 21, 2010, *available at* http://www.reuters.com/article/idUSTRE68K5CH20100921.

36. Similar conflicts in legal priorities arise fairly often. For example, the United States has a rule subordinating victims of fraudulent sales of stock to general creditors, while many other countries treat their fraud claimants as general unsecured creditors. 11 U.S.C. §510(b) (2006). *See* Stonington Partners, Inc. v. Lernout & Hauspie Speech Prods. N.V., 310 F.3d 118 (3d Cir. 2002) (describing United States subordination of defrauded shareholders versus Belgian rule of nonsubordination). I understand that in the United Kingdom such a rule applies to some equity holders but not others, creating a potential conflict between jurisdictions. *See* Soden v. British and Commonwealth Holdings PLC, [1998] A.C. 298 (H.L.) (Lord Browne-Wilkinson) (appeal taken from Eng.) (establishing that shareholder claims of misrepresentation resulting in purchase of shares are not subject to subordination to creditor claims based on the "character of a member").

37. *See supra* note 32.

38. In their decisions on the flip provision, neither court seemed to care where the trust and its assets were "located."

39. We steadfastly ignore what the Japanese or Tanzanian courts might have done.

requiring that the value of the assets they can seize be distributed according to the local scheme. Such a result may in turn reduce or eliminate cooperation across the board. For example, if the local court requires that locally seized value be distributed under the local rules, then it may refuse to cooperate in the sale of a multijurisdictional division of the debtor company because of the difficulty in agreeing on the allocation of the proceeds of the sale to each local component of the division.[40] Instead, it may insist that each component be sold separately even if that reduces realization overall. That is, the requirement of local distribution may impede multinational realization. That result is even more likely if the local component can be sold quickly and cheaply (perhaps to a competitor who is quite happy to liquidate the operation) and will produce more for favored local creditors while leaving the other jurisdictions with components worth far less.

Note that the pressure here arises not necessarily from a beggar-thy-neighbor impulse in the local court, but from the assumption that localism means that the court must favor distribution to those entitled under local law by maximizing the realization of local assets regardless of the effect elsewhere. That is, the court may believe that the territorial approach means not merely that local realization must be distributed under local rules, but also that the maximum local realization must be the goal of the proceeding. Localism may or may not compel that further step, but is highly likely to produce it. As a result, the common claim that universalism threatens cooperation[41] may be more than counterbalanced by the potential for noncooperation arising from a broad view of localism.

D. Forum Stashing

Finally, localism encourages forum stashing, which seems to me a much greater risk than the much-discussed forum shopping, because moving assets is generally much easier than relocating the seat of the enterprise.[42] Debtors, for their own purposes or to propitiate an aggressive creditor, will be tempted to find jurisdictions where the local rules will give advantages to those whom the debtors wish to prefer. Inevitably, this will give rise to a competition among jurisdictions to provide such rules, a consequence inexplicably applauded in some academic circles. A single distribution rule would nullify the effects of stashing in those jurisdictions that adopt

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40. Nortel has attempted a solution to this problem by selling assets worldwide and then dividing the proceeds, but called in a mediator to resolve disagreements. *Nortel Turns To Mediator To Help Divide $3.2B Sale Proceeds*, GLOBAL INSOLVENCY (October 8, 2010), http://global.abi.org/headlines/nortel-turns-mediator-help-divide-32b-sale-proceeds. It remains to be seen if this approach works or merely reminds local courts of the difficulty of after-the-fact division of proceeds in a territorial distribution, so they will be less willing to cooperate in a multinational realization scheme.

41. *See, e.g.*, Janger, *Reciprocal Comity*, *supra* note 4, at 443 ("Westbrook's view that priority should be determined by the rules of the main jurisdiction is likely to make such coordinated governance more, rather than less, difficult."); Pottow, *supra* note 18, at 581 ("Universalism challenges states that are sensitive about the rotating subjugation of sovereignty a universalist system inherently requires."); *id.* at591 ("[S]tates will not accept the wholesale subjugation of their domestic priority rules when there are in the ancillary position that full-fledged universalism dictates.").

42. In one exemplary case, the debtor transferred more than $20 million from the United States to the Cayman Islands shortly before filing bankruptcy in that sun-kissed jurisdiction. Hoffmann v. Bullmore (*In re* Nat'l Warranty Ins. Risk Retention Grp.), 306 B.R. 614, 618 (B.A.P. 8th Cir.), *aff'd* 384 F.3d 959 (8th Cir. 2004). I should confess I was an advocate for a claimant in that case who objected to the transfer.

it, because most realizations would be distributed globally. While a single distribution rule would not prevent stashing in those jurisdictions that do not adhere to it, such a rule would at least avoid legitimatizing it and might provide a judicial tool for refusing cooperation to jurisdictions that permit it as well as injunctions requiring a return of assets.[43]

IV. HOW TO ACHIEVE A UNIVERSALIST BALANCE

A. *The Choice of Law Solution*

The general rule for distribution of value in a multinational insolvency case should be a single law applied worldwide. Such a rule permits the maximization of value through the application of a single distribution plan and avoidance of the barriers to cooperation discussed earlier. That single rule should be taken from the "main" or home-country jurisdiction, the center of main interests of the debtor, which is also the chosen forum under the Model Law.[44] Of all the plausible jurisdictions, it is the most predictable for creditors who in some meaningful way rely on insolvency rules to protect them and might actually price their credits to some extent in light of those rules. Lenders may write the current home-country designation into their contracts and make any change a default. A single, generally accepted set of rules will make such a designation more useful, yet also make it harder for lenders to manipulate the rules to the disadvantage of other creditors. Beyond actual reliance, a home-country rule may also reflect a general creditor's expectation that the financial distress of a company based in England or Germany, for example, will probably be governed by a reasonable set of rules for protecting and ranking creditors.

As we discussed earlier, some courts may be concerned that the local statute requires by implication that local assets be distributed in accordance with local priorities. I know of no statute that actually says that. If the jurisdiction has traditionally applied the grab rule by judicial interpretation, that traditional rule may be considered overturned by a more recent adoption of a statute that provides for cooperation with and some deference to a main proceeding, whether under the provisions of the Model Law or otherwise.[45] In that case, the requirement of cooperation and deference necessarily modifies the local insolvency priority rules in cases where the local proceeding is not the main one, because a slavish and detailed insistence on local priority rules would make the mandated cooperation impossible. As Professor Ziegel has said, referring to the Canadian priority system for secured parties,

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43. *See* X v. Schenkius (Receiver For Y), Court of Appeal of 'S-Hertogenbosch, 6 July 1993 KG 1993, 406; NIPR 1993 No. 469; NJ 1994, 250 reported in 42 NETH. INT'L L. REV. 121 (1995) (providing an example of Netherland's departure from territorialism toward a rule that allows claims to overseas property).

44. Model Law, *supra* note 19, art. 2(b),.

45. Judge Gropper points out that the *Maxwell* case is powerful United States authority for the nonapplicability of provisions of the Bankruptcy Code in appropriate cases, using a choice of law approach. *See* Gropper, *supra* note 6, at 574–75 (citing Maxwell Commc'n Corp. v. Soc'y Gen. (*In re* Maxwell Commc'n Corp.), 93 F.3d 1036, 1052 (2d Cir. 1996)).

> If we require the law of the home jurisdiction to mirror the Canadian characterization and ranking rules faithfully then it is unlikely a Canadian court will ever agree to release assets subject to a security interest or where the claimants have preferred status under Canadian law. If we agree, on the other hand, on the need for elasticity in applying our concept of fairness in the international context then we must also accept the consequence that Canadian creditors may not fare as well abroad as they would at home if the assets were retained and administered in Canada.[46]

Thus a legislature's mandate of cooperation and deference lacks any substance unless the legislature intended also to permit some flexibility in regard to local priorities. On the required assumption that the legislature was rational, the necessary flexibility is best found in appropriately employing choice of law rules to choose the law properly applicable to fixing the priority of a particular claim. On that basis, the analysis would start with the general choice of law rule: priority should be governed by the priority rules of the main proceeding, as argued above.

But there are likely to be some important exceptions to application of the home-country rule in the form of choices of local law to govern the distribution of local assets for the benefit of certain classes of claims. The three Great Priorities, found in most countries, are likely to be among these exceptions. The Great Priorities are for wages, taxes, and secured claims.[47] My only example among these three in this article will be wages, but the analysis might be extended, with modifications, to taxes and secured claims as well.[48]

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46. Jacob S. Ziegel, *Ships at Sea, International Insolvencies, and Divided Courts*, 28 CAN. BUS. L. J. 417, 432 (1998).

47. *E.g.*, Council Regulation1346/2000, arts. 5, 10, 2000 O.J. (L160) 1(EC) (establishing regulations for security rights and employment). The Council Regulation has a system somewhat like the one I propose, with a central rule and stated exceptions, but the central rule has far less bite because of the latitude to open secondary proceedings. That latitude seems to give the trump to local priorities for local assets, although the choice of law results are not clear. *See* Donald T. Trautman, Jay Lawrence Westbrook & Emmanuel Gaillard, *Four Models for International Bankruptcy*, 41 AM. J. COMP. L. 573, 586, 589–91, 595 (1994) [hereinafter *Four Models*] (discussing the structure of earlier draft conventions leading up to the Council Regulation). The exceptions seem to be based on some political compromises rather than any consistent principle. *See* Fletcher, *supra* note 18, at 498 (describing compromises in conventions dating back to the 1960s as well as the Council Regulation); *see also Four Models*, *supra*, at 580–81, 595–97, 603–04 (noting compromises in the draft conventions predating the Council Regulation). One reason for the thinness of the Council Regulation's provisions is the fact that it dates back to a draft convention from the 1980's when all of us knew a lot less about cross-border insolvency. *See* Fletcher, *supra*, note 18, at 500; *see also* Council Regulation 1346/2000, *supra*, art. 44 § 1(k) (explicitly superseding the prior convention). *See generally* Bob Wessels, *Unilateral Regimes Concerning International Insolvency in Modern Europe*, 6 INT'L CORP. RESCUE 90 (2009) (noting the failed attempts to establish regulations for cross-border insolvency law). For an overall view of priorities, see Janis Sarra, EMPLOYEE AND PENSION CLAIMS DURING COMPANY INSOLVENCY: A COMPARATIVE STUDY OF 62 JURISDICTIONS (2008).

48. Judge Gropper makes some salient points about the effects of corporate groups on priority decisions. *See* Gropper, *supra* note 6, at 562. That problem is very complex, not least because of overlapping assets and liabilities within a corporate group among affiliates incorporated in several countries, and because of the consolidation practice in the United States. *See generally* UNCITRAL, Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency (pre-release July 21, 2010), http://www.uncitral.org/pdf/english/texts/insolven/pre-leg-guide-part-three.pdf (providing guidance on the treatment of domestic and cross-border insolvency proceedings of enterprise groups).

The challenge is to identify the instances where a local law should be chosen. The answer begins with looking back to the earlier discussion about the fundamental defect of localism, which is the failure to connect particular types of claims with particular assets. The correct inquiry for applying local law appropriately is to determine if a claimant can assert a legitimate expectation of payment from local assets because of some connection between those assets and the claim. The most common instance where that connection might be successfully asserted is a claim for wages as against the local assets that constitute the workplace. Office equipment, the office building, local receivables arising from local activity, a local-office bank account—all of these might be found to be closely connected with the wage claim, giving rise to a worker's legitimate expectation that these, at least, would be available to pay the claim. At the other extreme, a court might be more skeptical of a supposed connection with a deposit at a local bank that was made by the multinational's global cash management system because of a spike in local interest rates and was caught there by the accident of the timing of the insolvency proceeding. The receivables might be distributed locally, but the deposit account might not.[49]

Choice of local law may not be limited to one of the Great Priorities. For example, suppose a local branch that sells insurance or brokerage services is required to maintain certain funds locally to which customers would have preferential access in case of default. In that common situation, the claim and the local funds have a strong connection and the claimant's expectation of priority in those funds is amply justified, so choosing local law is the obviously correct result in most such cases.

The facts in *Perpetual* and *HIH*, discussed earlier in this article, illustrate the opposite circumstance, where it is clear the general rule ought to be applied. The earlier discussion of *Perpetual* considered the hypothetical situation where the priority rule was a matter of law rather than provided in a contract. It seems obvious that there would be no apparent connection between the assets at issue and any particular local law and no discernable reason for a legitimate expectation that any insolvency law would apply other than the bankruptcy law of the United States, Lehman's home country. In *HIH*, Lord Hoffmann noted that the assets in question—reinsurance contracts—had no substantial connection with England that would have given rise to legitimate expectations that English priority law would apply, a position not seriously challenged by any of the other judges in that case. Absent such a connection, the applicable priority rule should be that of the main proceeding.

B. The Choice of Forum Solution

Notwithstanding the appeal of the choice of law solution just described, some courts may feel that the filing of a local insolvency proceeding commits them to applying local priority rules to local assets, even though nothing in the local statute commands that result. In courts like those in the United States and the United Kingdom, the availability of ancillary proceedings, which do not invoke the priority

49. This example might be an instance where Professor's Janger's "local transaction" rule would overlap with my approach, but I am not sure what that rule means and whether it would lead to the same result as I suggest.

provisions of their insolvency codes, may permit them to avoid this problem. However, in any jurisdiction, creditors or a debtor may open a "full" local insolvency proceeding of the same sort that would be opened for a purely domestic enterprise. That sort of proceeding in a nonmain jurisdiction may be called a parallel proceeding or, in a jurisdiction that takes international cooperation seriously, a secondary proceeding. Thus, the courts in any country may confront priority provisions that are believed to be controlling because a full proceeding has been opened, even in the face of the choice of law analysis presented above.

1. Choice of Forum Generally

It should be possible to adopt a single-distribution rule by judicial interpretation in many jurisdictions by applying a choice of law rule through a choice of forum procedure, as explained below.

When a court elects to transfer assets for distribution to the main proceeding, it may be effectively making a choice of law ruling, at least as to the general rule to be applied. That is, the court is deciding to adopt the distribution result that will be applied in the main jurisdiction's courts.[50] Traditionally, the main jurisdiction will apply its own rules to all claimants, producing a single global scheme of distribution. The ideal will be when the main jurisdiction is also willing to adopt certain exceptions along the lines suggested by this article and mirrored to some extent by Professor Janger. This de facto choice of a single law with exceptions is much less difficult than application of home-country law in the local courts. First, it avoids the usual problem where court A attempts to understand and apply in contentious cases the law of court B, especially when B's laws are in another language and derive from a different legal culture. Second, it responds in forum-choosing terms to the unity of bankruptcy law, a very traditional notion, without having to engage the details of choice of law analysis. Given the vagueness of some choice of law rules, this result will be welcomed by all. Third, and closely related, it permits a number of jurisdictions effectively to choose the same law and produce coherent, consistent results.

Interestingly, the choice of forum approach was followed by the universalist judges in *HIH*,[51] but was rejected by at least one of the judges who relied on the special relationship between England and Australia under section 426 of the Insolvency Act.[52] Lord Neuberger thought that the effect of section 426 was to choose Australian law, which then generated the authority to transfer the assets to the Australian court.[53] With respect, this analysis seems to put the engine on top of the rocket. If choice of law was the point, the English courts should simply apply Australian law, which they evidently understood very well. It is not obvious how turnover could be logically compelled by choice of law.[54]

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50. McGrath v. Riddell (*In re* HIH Cas.& Gen. Ins., Ltd.), [2008] UKHL 21, [28] 1 W.L.R. 852 (H.L.) 863 (Lord Hoffmann) (appeal taken from Eng.).

51. Professor Janger suggests that the choice of forum choice was not a choice of law. Janger, *Reciprocal Comity*, *supra* note 4, at 452–53. However, it was such a choice in the functional sense for which I am arguing: the judges knew the Australian court would apply its own distribution rules.

52. *McGrath*, [2008] UKHL 21, [64–83] 1 W.L.R. at 873–78.

53. *Id.*

54. On the other hand, the choice of law decision might be a factor in the decision whether to

The choice of forum approach to choice of law would also permit consideration of the local exceptions discussed above. For example, assume that the assets of General Universal, Inc. in Country A were the stock of a brokerage office and some passive real estate investments. Its main insolvency proceeding is pending in Country B. Employees and customers assert claims in Country A relating to the regulated brokerage business. Others file claims unrelated to the local operation. The local court might order turnover of the real estate assets to the main proceeding and send the claimants with unrelated claims to the main proceeding for validation and distribution.[55] The local claims and assets might be retained locally. Note that some of the claimants asserting local brokerage related claims might be citizens and residents of other jurisdictions, but would be given nondiscriminatory access to the local realization.

It will often be true that the local claimants will not be paid in full from the local assets. In the pending example, are they to lose access to the worldwide assets realized in the main proceeding, including the proceeds of sale of the local real estate? That problem is one already addressed in the Model Law and many domestic bankruptcy laws. The underpaid local claimants have every right to apply to the main proceeding for additional payment, but that right is constrained by a rule of fairness called in common law countries the "hotchpot" rule and codified in the Model Law in article 32.[56] It provides that these claims can be validated in the main proceeding ("proved," as a common lawyer would say), but they will not be paid until the other claimants of the same class in the main proceeding have received payment for the same proportion of their claims as the proportion that the local claimants had already received. The result is that the local claimants will get no less (and no more) than other creditors whom the rules of distribution of the main proceeding put into the same class of creditors.[57]

It is in the referral of claimants and the turnover of assets to the main proceeding that the single distribution rule may change results. This is because the priority classes in the main proceeding will almost certainly differ from those found in each local jurisdiction and because the worldwide debt/asset ratio will be different from that in each local jurisdiction.[58] The effects of the referral will vary depending

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turnover assets. The difficulty of applying foreign law is often cited as a basis for deferring to a foreign forum. *See, e.g.*, Spier v. Calzaturificio Tecnica S.p.A., 663 F.Supp. 871, 875 (S.D.N.Y. 1987) ("[I]t is better to permit the validity of this Italian arbitral award to be first tested under Italian law by Italian courts. That is preferable to an American court seeking to apply the law of the foreign country where the award was made, and entering an order enforcing an award later condemned by the courts of that foreign country.").

55. Although it is often asserted that real estate is governed exclusively by local law in or out of insolvency cases, Professor Weintraub offers examples of common instances where a different law is chosen. RUSSELL J. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS § 8.14 (6th ed. 2010). For example, certain aspects of real estate ownership by a married couple will be governed by local law while others will be governed by the marital domicile. His analysis overall has taught several generations of internationalists the difficulties of a purely territorial approach to any choice of law problem.

56. Model Law, *supra* note 19, art. 32.

57. It must be said that the hotchpot rule is itself not free from difficulties. *See* Ulrik Rammeskow Bang-Pedersen, *Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests*, 73 AM. BANKR. L.J. 385, 407, 426–28 (1999).

58. *See* Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 461–66 & n.26 (1991).

upon the global claims, distribution rules, and procedures adopted in the main proceeding.

2. The United States Example

I offer a more detailed application of the choice of forum approach from my own jurisdiction. We can build on our earlier example, the bankruptcy of a United States condominium developer in Miami as to an American and a Mexican claimant who each could claim a priority for their apartment deposits under our local statute. What should happen if we change our example to make the debtor developer a Spanish company that had constructed and marketed the Miami condominium project, so that the United States is the local jurisdiction? There are two possibilities: a Chapter 15 proceeding is filed and no other United States proceeding or both a Chapter 15 and a Chapter 11 are filed.[59]

If only a Chapter 15 is filed, American law does not prescribe a distribution system[60] and therefore the court need not be concerned with the direct applicability of the United States priority regime. For the most part, that will also be true of relief granted under section 1520 (automatic relief for a foreign main proceeding)[61] and section 1521 (discretionary relief).[62] However, as Judge Gropper points out, section 1521(b) limits one form of relief, the turnover of assets to the foreign representative, by requiring that the court be satisfied that "the interests of creditors in the United States are 'sufficiently protected.'"[63] Given the lack of distribution rules in Chapter 15, who is protected by this provision? It seems clear that the reference to "creditors in the United States" cannot mean only United States citizens and residents, because no such rule would be applied even in the bankruptcy of a United States debtor for the reasons given above.[64] There is also nothing in the Bankruptcy Code that would tie our priority system to local assets.[65]

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59. To avoid complicating the discussion even more, I put to one side the situation in which only a Chapter 11 is filed for a debtor whose home country is outside the United States. I have addressed that problem in a preliminary analysis. *See generally* Jay Lawrence Westbrook, *Multinational Insolvency: A First Analysis of Unilateral Jurisdiction*, *in*2009 NORTON ANNUAL REVIEW OF INTERNATIONAL INSOLVENCY LAW 2 (2009). *See also* Alan L. Gropper, *Current Developments in International Insolvency Law: A United States Perspective*, *in* BANKRUPTCY & REORGANIZATIONS: CURRENT DEVELOPMENTS 2010, at 923–30(discussing recent cases involving foreign debtors filing solitary plenary proceedings in the United States).

60. Sections 507 and 726 do not apply in Chapter 15. 11 U.S.C. §103 (2006).

61. 11 U.S.C. § 1520 (2006).

62. 11 U.S.C. § 1521 (2006).

63. Gropper, *supra* note 6, at 563.

64. See Alesia Ranney-Marinelli, *Overview of Chapter 15 Ancillary and Other Cross-Border Cases*, 82 AM. BANKR. L.J. 269, 317–19 (2008) (describing the mandatory national treatment of foreign creditors under 11 U.S.C. §§ 1513–1514); *see also* WTO Treaty, *supra* note 24; NAFTA, *supra* note 23; Treaty with Argentina Concerning the Reciprocal Encouragement and Protection of Investment, U.S. Arg. art. II § 1, Nov. 14, 1991, 31 I.L.M. 124 (1992) (concerning situations where parties to the treaty would be subject to national treatment); Treaty of Friendship, Commerce and Navigation, U.S.-Japan, art. VII § 1, Apr. 2, 1953, 4 U.S.T. 2063 (establishing that parties to the treaty are accorded national treatment in commercial and business activities). The same is true in England. *See* McGrath v. Riddell (*In re* HIH Cas.& Gen. Ins., Ltd.), [2008] UKHL 21, [10] 1 W.L.R. 852 (H.L.) 863 (Lord Hoffmann) (appeal taken from Eng.).

65. On the contrary, in a full bankruptcy in the United States, we are like a number of other countries in claiming jurisdiction over all assets of the debtor anywhere in the world.

The "interests of creditors in the United States" might refer to creditors who have filed claims in the United States, whatever their nationality, but absent a full United States bankruptcy under an operational chapter of the United States Bankruptcy Code, no claims are filed. As we have seen, Chapter 15 has no system of priorities like that applied in a full American bankruptcy. Does the protection cover every creditor who might file in a theoretical United States proceeding? If so, then the section 1521 protection is owed to every creditor of the debtor wherever located in the world. Even an avuncular Congress would not have gone so far. Thus it is unlikely that the quoted phrase is meant to require that our priority system apply in the foreign proceeding as a condition to turnover.

Looking at the Model Law and its Guide,[66] along with the text of Chapter 15, the conclusion is inescapable that the protection is meant to ensure that creditors having some connection with the United States would not be treated unfairly in the main proceeding. That is essentially the meaning that was given to much more specific and strict language in section 304,[67] so it seems highly unlikely a more restrictive meaning would be found in section 1521(b).[68] The Chapter 15 distinction between main and nonmain proceedings, the ancillary nature of Chapter 15, and the mandate for cooperation[69] all combine to make a restrictive reading unsupportable. That is, as indicated by the earlier analysis, the determination by Congress that we should cooperate necessarily means we should not impose our priority system on the rest of the world, especially given the absence of any statutory language that says we should.

It would obviously be inconsistent with the purpose of Chapter 15 to prevent a cooperative worldwide realization and distribution of the debtor's assets in order to give a few creditors filing in the United States somewhat more, especially when one remembers that many of these local-filing creditors are not Americans and that there is likely to be little evidence that any of them relied on section 507(a)(7) of the Bankruptcy Code in making deposits on their condos.

What if a Chapter 11 has also been filed? Suppose there is pending in Spain, the developer's home country, a proceeding in which a plan has been proposed that will pay all creditors, *pari passu*, fifteen percent of their claims, but is conditioned

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66. Model Law, *supra* note 19, arts. 13–14; UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT, Part 2. V §§ 103–11 (1997), *available at* http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf.; UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT, Part I (emphasizing that "local" creditors are a only a subset of the creditors whose interests are protected under art. 22 of the Model Law).

67. *In re* Compañía de Alimentos Fargo, S.A., 376 B.R. 427, 437 (Bankr. S.D.N.Y. 2007). There Judge Bernstein captured the section 304 jurisprudence: "A foreign bankruptcy system need not, however, 'mirror' United States law for comity to be granted, so long as foreign law is substantially similar and not repugnant to United States law [but are acceptable if not] at odds with our own *fundamental* notions of fairness . . . ." *Id.* Note the court looks for a fundamental difference although former section 304(c)(4) required ". . . distribution of proceeds of such estate substantially in accordance with the order prescribed by [the United States Bankruptcy Code]." 11 U.S.C. §304(c)(4)(2004). Contrast that requirement with the current Chapter 15 requirement for turnover if creditors are "sufficiently protected." 11 U.S.C. §1521(b) (2011). Note also that the *Fargo* standard is similar to that suggested by Professor Ziegel for Canada. *See* Ziegel, *supra* note 46 at 432–34. That approach began with the first case decided under section 304(c)(4) and continued throughout the life of that provision. *See In re* Culmer, 25 B.R. 621, 633 (Bankr. S.D.N.Y. 1982).

68. 11 U.S.C. §1521(b) (2006). *But see* Gropper, *supra* note 6, at 565; Fletcher, *supra* note 18, at 503.

69. 11 U.S.C. §§1517, 1520–1521, 1525–1527 (2006).

upon a common pool of value worldwide, with no preferences under any local law. Suppose that the sale of the Miami property will bring enough over the mortgage to pay all condo-deposit claims at twenty-five percent, but leave nothing for other creditors filing in the United States. Other jurisdictions have indicated a willingness to waive local priorities in favor of the global plan, but the depositors in the Miami condo are adamant. Must the United States court deep six the world wide plan? The answer, thankfully, is no. As Judge Bernstein recognized in *Fargo*,[70] the United States court has broad discretion under section 305(a)(2) to dismiss the Chapter 11 case where the broader purposes of Chapter 15 are served. With the United States Chapter 11 dismissed, only the Chapter 15 case remains and the court can turn over assets unless there is reason to believe that some creditors will be badly treated.[71]

V. ENCOURAGING DEFERRAL TO THE MAIN PROCEEDING: CROSS-FILING AND NATIONAL TREATMENT

So important is the adoption of fair and efficient procedures by the main jurisdiction that their adoption may well come to be an important factor in deference decisions by nonmain jurisdictions. The most helpful next steps that could be easily taken in most jurisdictions would be the adoption of national treatment for priorities and "cross-filing." These procedures have been discussed at length in earlier work by me and by the Danish scholar, Ulrik Bang-Paderson.[72] I will just summarize them here.

A. National Treatment for Priorities

National treatment for priorities, which I called in earlier work "cross priority," means nondiscriminatory treatment with regard to priority claims. As discussed above, such treatment is required by our treaty obligations and simple fairness. Thus the Mexican who has made the deposit on the Miami condominium would get the same priority in any United States bankruptcy proceeding as the American who contracted to purchase the apartment next door.[73] The statutes in most countries do not discriminate against foreigners in their priority systems, although it is also hard to find provisions explicitly confirming that noncitizen creditors get the enjoyment of priority treatment if they belong to a locally defined priority class. Thus it seems that national treatment for priorities is probably the law in most countries, except for taxes,[74] but it is difficult to document.

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70. *Fargo*, 376 B.R. at 433–35. *But see In re* Globo Comunicacoes E Participacoes S.A., 317 B.R. 235 (S.D.N.Y. 2004) (involuntary Chapter 11 petition in United States should not be dismissed in deference to Brazilian main proceeding unless dismissal benefits both creditors and debtor).

71. It is also not a good answer to say that these small creditors will always be paid off, so the problem can be ignored. Priorities can involve large amounts of money (e.g., back pay for thousands of employees) and a number of doctrines such as equitable subordination or subordination of shareholder fraud claims are effectively priority rules that can involve millions of dollars. Indeed, a short step from the current example would be a really large housing development where buyer deposits could reach that level.

72. *Universal Participation*, *supra* note 19, at 419; *Universal Priorities*, *supra* note 19, at 27; Bang-Pedersen, *supra* note 57.

73. 11 U.S.C. §507(a)(7) (2006).

74. *See supra* note 25 and accompanying text.

Obviously, national treatment for priorities is highly important to cross-border cooperation. It is one thing to accept that a certain class of local creditors might not enjoy the same privileged position in a main proceeding; it is quite different to say that they will suffer by comparison with others in the same class. In our Spain-to-Miami example, it should be acceptable, given the value of cooperation, if the Spanish proceeding grants no priority to condominium deposit claimants, but it would be unacceptable to have Spaniards get that priority and not Americans who are in exactly the same position.

Some years ago the remarkable Canadian scholar Jacob Ziegel suggested a similar point in the realm of secured credit. He is quoted earlier in this article to the effect that no international cooperation will be possible without some flexibility with regard to distribution rules.[75] At the same time, none of us would imagine that a local court would release assets to a foreign court whose policy would be simply to ignore a party's secured interest.[76] As a possible distinction in marginal cases, Professor Ziegel suggested "for example a rule requiring the home jurisdiction to accord the same status to the Canadian creditor's claim as under Canadian law but not necessarily the same ranking vis-à-vis other creditors of the same class."[77] He imagines that it might be enough for a local court that the foreign insolvency court would grant secured status to a local secured creditor even though the foreign court's rules might place the local creditor at a different point on the priority ladder vis-à-vis other secured creditors.[78] It would be just a short step further to imagine a home-country rule that would also allow different treatment versus creditors of different classes, as long as all secured creditors were treated the same.[79] The resolution of this and other issues as to secured creditors is beyond the scope of this article, but Professor Ziegel's suggestion illustrates the sort of middle ground that might be sought. Judge Clark's article in this symposium provides a masterful development of a balances approach to the secured credit priority.[80]

Putting aside further development of these ideas on this occasion (with some regret), even this limited discussion permits us to see that national treatment for priorities is both possible and highly desirable, especially for countries that seek deference for their main proceedings.

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75. *See supra* note 46 and accompanying text.

76. *Cf. In re* Treco, 240 F.3d 148 (2d Cir. 2001) (reversing orders of the Bankruptcy Court and the District Court ordering assets turned over to the Bahamas, where secured interests are subordinated to administrative expenses).

77. Ziegel, *supra* note 46, at 430–31 (emphasis removed).

78. The case he was discussing involved competing maritime liens and the possibility that different priority rules among lien holders might apply in relevant jurisdictions. *Id.*

79. For example, the foreign court might impose a "carve out" for the administrator of the foreign proceeding, as in Germany, or in favor of unsecured creditors, as in England. Jay Lawrence Westbrook, Charles Booth, Christoph Paulus & Harry Rajak, A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS 43 & n.68 (2010).

80. Leif M. Clark & Karen Goldstein, *Sacred Cows: How to Care for Secured Creditors' Rights in Cross-Border Bankruptcies*, 46 TEX. INT'L. L. J. 513 (2011).

B. *Cross-filing*

The second highly desirable development to encourage deference and cooperation is "cross-filing." I have used this term to mean permitting an administrator to file claims in each of the debtor's pending insolvency proceedings on behalf of all the claimants in the insolvency proceeding in which that administrator was appointed. In our Spain-Miami example, the Spanish administrator could file in the United States proceeding in Florida as representative of each of the claimants in the Spanish main proceeding and a United States trustee in bankruptcy could do the same in Spain on behalf of all United States claimants. Because of the expense and difficulty of filing and validating claims in a distant jurisdiction, only cross-filing can ensure that all claimants, including smaller and more local claimants, can receive dividends from the main proceeding.[81] It is therefore important as a matter of efficiency and fairness that a main jurisdiction permit such representative filings. The availability of this procedure will provide significant support for advocates of a global rule of distribution.[82]

Closely related is the establishment of local claims processing procedures in cases where there are a substantial number of local claims to be asserted in the main proceeding. Combined with cross-filing, it has the potential to reduce greatly the pressures in favor of territorialism, because it permits claims, especially smaller ones, to be resolved through familiar local procedures in the local language and provides a realistic mechanism for adjudicating disputed claims in a way that is fair to local creditors. For those reasons, the Transnational Insolvency Project recommended it.[83] In the United States, such a rule could be developed and applied through judicial order, but a full-blown system should probably be the subject of rule-making or legislation.

VI. CONCLUSION

The judgment of Lord Hoffmann in the *HIH* case should serve as a signal to other courts guiding them toward a single distribution rule for multinational insolvencies. Courts must operate within the constraints of local statutes, but there is considerable room for judicial creativity in arriving at results that make multinational insolvency procedures more predictable and more fair in ways not inconsistent with local laws.

There are costs to the globalization of our economic system, including some reduction in local autonomy in the management of commercial matters. If we are determined to have a global economy nonetheless, then we should move aggressively to make it work as it should.

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81. The small local creditor would file its claim in the local proceeding and disputes would be resolved there, while the cross-filing in the central main proceeding will ensure that creditor's share of the distribution from that main proceeding.

82. "Universal" cross-filing describes a situation in which all proceedings, main or nonmain, will accept cross-filings from all other administrators. That is the situation within the European Union. *Universal Priorities*, *supra* note 19, at 30–31. Such a system has the potential to create results closer to universalism even in a territorialist system, although the territorialist version is a second-best alternative.

83. PRINCIPLES, *supra* note 2, at 74–76.

Groundwater Reform in India: An Equity and Sustainability Dilemma

DANIEL AGUILAR*

SUMMARY

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INTRODUCTION: THE CURRENT GROUNDWATER CRISIS

A. India's Dependence on Groundwater

The population of India exceeds 1.1 billion people and is growing annually at an astonishing 1.4%.[1] The economy is experiencing even greater growth rates, with roughly 8% increases in gross domestic product (GDP) annually in the past several years.[2] The nation's use of water has naturally intensified in step with the jumps in population and economic growth. India's annual groundwater extraction rate is the highest on earth: an estimated 200 billion cubic meters per year.[3] The country boasts approximately nineteen million groundwater extraction structures, over four times the amount in China, Pakistan, Mexico, and the United States combined.[4] The expanding economy and population make sustainable access to water one of the critical issues dictating the nation's future.[5]

Much of India's heavy reliance on groundwater is attributable to the country's unique climate and how it affects India's largely agrarian economy. The Indian climate is marked by the erratic rain patterns of the monsoon.[6] The summer monsoon, which lasts a period of 100–125 days, accounts for 80% of yearly rainfall;

1. JENNY T. GRÖNWALL, ACCESS TO WATER: RIGHTS, OBLIGATIONS AND THE BANGALORE SITUATION 33 (2008) (Ph.D. dissertation, Linköping University), *available at* http://liu.diva-portal.org/smash/get/diva2:18111/FULLTEXT01.

2. *Id.*

3. Jayanath Ananda, *Water Institutions in India: An Institutional Design Perspective, in* REFORMING INSTITUTIONS IN WATER RESOURCE MANAGEMENT: POLICY AND PERFORMANCE FOR SUSTAINABLE POLICY DEVELOPMENT 100, 106 (Lin Crase & Vasant P. Gandhi eds., 2009).

4. K. D. Sharma, *Groundwater Governance: The Indian Scenario, in* GROUNDWATER AND GOVERNANCE: OWNERSHIP OF GROUNDWATER AND ITS PRICING 277, 278 (Saleem Romani et al. eds., 2007).

5. *See* GRÖNWALL, *supra* note 1, at 34 ("The UN Environmental Program (UNEP) has observed that availability of freshwater is going to be the most pressing problem in India during the coming decades.").

6. K. R. Gupta, *Troubled Water, in* WATER CRISIS IN INDIA 1, 5 (K. R. Gupta ed., 2008).

within this period, 50% of the yearly rainfall occurs over just fifteen days.[7] This lack of substantial year-round precipitation, together with high evaporation levels and uneven rainfall distribution across the country, makes water extremely scarce in many parts of India.[8] Such a climate makes access to groundwater especially important, considering India's heavy dependence on agriculture.[9] Seventy-two percent of the Indian population lives in rural areas,[10] and of that rural demographic, an estimated 69% of residents depend directly on agriculture as their source of livelihood.[11] The erratic monsoon rains drive most farmers to rely almost exclusively on irrigation to support their crops. To demonstrate the magnitude of this dependence on irrigation, in the year 2000, India was estimated to have used approximately 630 cubic kilometers of water for irrigation—84% of the nation's total available water supply.[12] Groundwater constitutes by far the largest source of the total water used for irrigation, with one study estimating that groundwater supplies as much as 90% of irrigation water.[13] In the arid to semi-arid regions, groundwater is virtually the only source of irrigation water sustaining the crops.[14]

In addition to agriculture, the nation's expanding industries, such as textiles, construction companies, and bottled water plants, are also heavy users of groundwater.[15] These industries are using groundwater at increasing rates to satisfy their water needs by drilling tubewells farther and farther below the dropping water tables.[16] Though the impact of industrial withdrawals should not be understated, the bulk of the groundwater extractions are for agricultural purposes rather than for industry.[17]

B. The Groundwater Crisis

India's heavy dependence on groundwater has led the country into a water crisis because it is currently extracting its groundwater at an unsustainable rate.[18] Groundwater depletion is perhaps most evident in the dry regions of the country. A joint study by the Central Groundwater Board (CGWB) and the states shows that

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7. *Id.*

8. *Id.* ("Approximately 64 per cent of the total area of the country accounts for less than 29 per cent of its total water resources.").

9. B. V. Babu & Ramakrishna, *Water Crisis: Origin Identification and Management, in* WATER CRISIS IN INDIA 60, 63 (K. R. Gupta ed., 2008).

10. Vasant Gandhi & Vaibhav Bhamoriya, *Water Institutions and their Relationship to Poverty Alleviation, in* REFORMING INSTITUTIONS IN WATER RESOURCE MANAGEMENT: POLICY AND PERFORMANCE FOR SUSTAINABLE POLICY DEVELOPMENT 320, 320 (Lin Crase & Vasant P. Gandhi eds., 2009).

11. *Id.* at 325.

12. Babu & Ramakrishna, *supra* note 9, at 63.

13. S. N. CHATTERJEE, WATER RESOURCES, CONSERVATION AND MANAGEMENT 13 (2008); *see* Ananda, *supra* note 3 at 106 (discussing groundwater supplies and irrigation water).

14. CHATTERJEE, *supra* note 13, at 13.

15. GRÖNWALL, *supra* note 1, at 66.

16. *Id.*

17. *See id.* at 353 (stating that while multinational companies do extract groundwater, farmers do most extractions).

18. *See* Gupta, *supra* note 6, at 2–3 (discussing UN concern over India's increasing demand for water).

approximately 14.7% of the groundwater units of the country are "over exploited," meaning the current groundwater extraction levels exceed recharge levels.[19] Additionally, approximately 3.9% of the units are "critical," i.e., currently extracted at 90–100% of their capacity.[20] These figures only account for current levels of use, and the number of overexploited regions is expected to continue rising each year.[21] Furthermore, these national-level depletion rates do not fully represent the plight of the arid regions. States that have a considerable number of overexploited units include Andhra Pradesh, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, and Tamil Nadu.[22] According to a study done in 2004, in Gujarat, 31 of the 184 *talukas*[23] were withdrawing greater amounts than the annual recharge levels could support, with twelve talukas drafting 90% of the sustainable level.[24] Additionally, more than 15% of the units were at critical or overexploited levels in Andhra Pradesh.[25]

The alarming overexploitation of groundwater has dire social consequences. The drop in water tables resulting from over-extraction has a harsh effect on impoverished farmers, many of whom depend on small tubewells for groundwater access.[26] When the water tables drop, the small, shallow tubewells are the first to go dry, causing impoverished small farmers to suffer long before the owners of medium to large farms, who generally have greater access to deeper wells and the means to deepen them in the event of a drop in the water table.[27] With little to no financial means to deepen wells or acquire alternative water sources for irrigation, many small farmers face grave poverty when their wells run dry.[28] As a result, small farmers are denied an equitable share in water resources and bear a disproportionate share of the burden of the groundwater depletion crisis. These inequities are further augmented by the indigent farmers' lack of meaningful political influence.[29]

The effects of dropping water tables reach beyond the lack of access to water. Groundwater quality is quickly becoming an issue of equal concern. Overexploited areas are recording increasing levels of arsenic, fluoride, and iron contamination as a natural side effect of over pumping.[30] Such minerals occur naturally in the bedrock and accumulate in increasing amounts as the water table drops.[31] Similarly, falling water levels also raise the incidence of seawater intrusion, which elevates salinity levels to undesirable figures, especially in coastal regions.[32] Human-produced

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19. *Ground Water Development*, INDIA.GOV.IN (Feb. 17, 2011), http://india.gov.in/sectors/water_resources/ground_water.php.

20. *Id.*

21. *Id.*

22. Rana Chatterjee & Raja Ram Purohit, *Estimation of Replenishable Groundwater Resources of India and Their Status of Utilization*, 96 CURRENT SCI. 1581, 1587 (2009).

23. *Id.* at 1588 (defining a *taluka* as a geographic unit of land used for groundwater measurement).

24. *Id.* at 1585.

25. *Id.* at 1587.

26. M.S. Vani, *Groundwater Law in India: A New Approach*, *in* WATER AND THE LAWS IN INDIA 435, 449 (Ramaswamy R. Iyer ed., 2009).

27. *Id.* at 437–38.

28. *Id.*

29. GRÖNWALL, *supra* note 1, at 266.

30. Ananda, *supra* note 3, at 107.

31. GRÖNWALL, *supra* note 1, at 74.

32. *Id.*

pollution from other sources is also on the rise in four major areas.[33] First, roughly three-fourths of all urban wastewater goes untreated, leading to widespread death and disease from sewage-born infection.[34] Second, the release of large quantities of industrial effluent has led to severe groundwater pollution in various states, due largely to a lack of effective enforcement of pollution laws.[35] For example, contamination in the western cities of Bichri and Pali is so severe that the groundwater is not only unfit for human consumption, but is also unusable even for irrigation.[36] Third, agricultural runoff carries with it hazardous chemicals found in fertilizers and pesticides that can eventually taint groundwater sources.[37] Fourth, large amounts of bio-medical and municipal wastes are routinely dumped in close proximity to water sources and can introduce harmful contaminants into the groundwater.[38]

Part of the reason for the increasing incidence of over-extraction is the government-provided subsidies, especially those on electricity.[39] With these subsidies, the cost of pumping falls to artificially low levels.[40] This decreases incentives for farmers to limit or more carefully monitor the efficiency of their extractions. Scholars point to the subsidization of electricity in particular as a cause of the current depletion crisis.[41] The institution of subsidized and often unmetered electricity caused a precipitous jump in water extraction.[42] One study estimates that the number of shallow wells doubled every 3.7 years from 1951 to 1997.[43] These subsidies perpetuate the planting of water-heavy crops in dry regions for which they are ill-suited.[44] Unfortunately, the importance of the subsidies to agricultural commerce makes them politically difficult to repeal.

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33. Paritosh C. Tyagi, *Water Pollution and Contamination, in* WATER AND THE LAWS IN INDIA 329, 330–32 (Ramaswamy R. Iyer ed., 2009).

34. *Id.*

35. *Id.* at 331.

36. *Id.*

37. *Id.*

38. *Id.*

39. Ananda, *supra* note 3, at 107.

40. *See id.* (discussing factors that might contribute to deflated prices).

41. *Id.*; *see also* Vasant Gandhi & Ashutosh Roy, *Institutional Analysis of Ground-Water Institutions in India, in* REFORMING INSTITUTIONS IN WATER RESOURCE MANAGEMENT: POLICY AND PERFORMANCE FOR SUSTAINABLE POLICY DEVELOPMENT 237, 240–41 (Lin Crase & Vasant P. Gandhi eds., 2009) (discussing the way in which "subsidized electricity, lack of metering, the availability of credit, and the commercialization of agriculture" influenced an increase in water extraction that, in turn, lead to an increased frequency of well failures).

42. Gandhi & Roy, *supra* note 41, at 241.

43. *Id.*

44. *See id.* at 240 (determining that the expansion of irrigation areas has led to the growing of crops with greater water requirements).

I. ANALYTICAL CRITERIA AND PRELIMINARY RECOMMENDATIONS

A. *Analytical Model*

In the sections below I will evaluate the reforms to India's groundwater governance system based on three criteria: administrability, equity, and sustainability.

"Administrability" refers to the ability of the government to achieve actual implementation of a given policy. No legal system operates in a vacuum. A policy may be perfectly sound on a theoretical level but wholly ineffective in terms of real-world execution. Limited financial resources, insufficient political will, and any number of other practical constraints on government performance can reduce the most well-meaning reforms to little more than words on a page. Therefore, as common sense dictates, if a policy is not administrable, how the policy would perform in terms of other analytical factors is of little importance.

"Equity" measures the extent to which the reforms operate fairly between different segments of Indian society.[45] The critical question is whether the benefits and burdens of the policy are fairly distributed across the population. For example, if a policy places an inordinately high burden on a politically vulnerable segment of the population—such as the poor or uneducated—in the absence of a compelling justification for such unequal treatment, the policy would be deemed inequitable. Furthermore, because the reforms in question concern a resource that is essential to every person's survival, equitable policy-making is especially important when it affects access to water.

"Sustainability" conveys whether a policy successfully balances the rates of present resource consumption with "the capacity of ecological . . . supply, over a long period of time."[46] For a system of groundwater governance to be viable, it must not only meet the needs of the present generation, but must also ensure that a suitable water supply will be available for future generations.

In Section IV, I will apply these factors to several federal-level reforms: Supreme Court holdings, federal regulatory agency actions, and proposed constitutional amendments. Then in Section V, I will apply the same three factors to several state reforms: a model groundwater bill created for the states, the Andhra Pradesh groundwater legislation, and the Maharashtra groundwater legislation. To conclude, in Section VI, I will offer my own policy suggestions based on these evaluations.

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45. In my analysis, I apply the word "equity" less in its sense as a term-of-art used by lawyers and more in terms of its ordinary use—capturing general notions of justice, fairness, and equality. For similar use of the term in an international law context, *see* Duncan French, *Global Justice and the (Ir)relevance of Indeterminacy*, 8 CHINESE J. INT'L L. 593, 605 n.43 (2009) (distinguishing "equity" from "justice" or "fairness" as being a much more defined and circumscribed term of international law but still retaining a broader context which allows significant discretion to decision-makers).

46. Donald T. Hornstein, *Environmental Sustainability and Environmental Justice and the International Level: Traces of Tension and Traces of Synergy*, 9 DUKE ENVTL. L. & POL'Y F. 291, 292 (1999).

B. *Preliminary Summary of Policy Recommendations*

The most critical problem with India's groundwater reforms is the severe lack of enforcement in both federal and state reform systems.[47] Most improvements in equity and sustainability that the reform systems have the potential to produce are rendered meaningless by the lack of enforcement of the majority of the reforms.

To counteract the lack of enforcement, the government should eliminate the duplicative groundwater regulation occurring between the state and federal systems.[48] Removing the duplicative regulatory bodies and consolidating groundwater regulation in a single authority will improve the operation of the groundwater system by enhancing institutional transparency and democratic participation in the system.[49] Reducing duplicative regulation should make it easier for citizens and government officials to evaluate the effectiveness of the regulators and hold them accountable for shortcomings in enforcement.[50] The current system of duplicative regulatory bodies obscures which body should be held responsible for failings in the groundwater system and therefore impedes the operation of healthy democratic accountability. Admittedly, decreasing duplicative regulation is only a partial solution, but compared to the current system that has produced so few results, modest increases in effectiveness are welcome.

Apart from the major administrability concerns, even if the reforms were fully enforced they would still fail to address the major equity imbalance in the system. Apart from the major administrability concerns, even if the reforms were fully enforced, they would still fail to completely address the major equity imbalance in the system. The current common law property system gives absolute ownership rights over groundwater to landowners while leaving non-landowners with little protection.[51] This is probably the greatest flaw in the groundwater system in terms of equity. This antiquated nexus of landownership and groundwater rights fails to adequately protect the water needs of the millions of poor Indian citizens—a demographic overwhelmingly composed of the landless.[52] Abolishing the rule of absolute groundwater ownership by landowners and implementing a less rigid ownership structure that allows non-landowners to hold rights to groundwater would greatly enhance equity interests. However, the deep-rooted nature of the absolute ownership rule makes overturning the rule an uphill battle.

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47. *See infra* Part III (discussing the limited impact of recent federal reforms through the courts); *see also infra* Part IV (arguing that the greatest defect of state reform is the inability of the state to successfully administrate in its current form with its current resources).

48. *See* Vani, *supra* note 26, at 464–65 (discussing certain activities taken by the centralized national regulatory authority that duplicate the functions of the state and local-level bodies).

49. *See infra* Part VI (arguing that the number of duplicative bodies reduces effectiveness of legislation implementation).

50. *Id.*

51. *See* Vani, *supra* note 26, at 453 (analyzing licensing laws for groundwater rights of non-landowners and their inability to properly restructure groundwater management).

52. *Id.* at 455.

II. HISTORICAL DEVELOPMENT OF INDIAN GROUNDWATER LAW

To properly comprehend and evaluate current reform movements, an understanding of the background legal framework is necessary. The following is a brief summary of the Indian groundwater system, as it developed under the common law.

India's water law is not, nor has it ever been, treated as its own discrete policy area with one self-contained water code or a single line of water-related case law. Rather, laws pertaining to water are scattered amid numerous constitutional provisions, irrigation acts, land use acts, judicial opinions, and various other state and central government laws.[53] In stark contrast to other former colonial countries, India has not strayed far from the British legal system in many of its core legal doctrines.[54] Hence, the groundwater property structure has remained relatively unchanged since colonial times.[55] India inherited much of its water law system from Common English Law.[56] The Indian Easements Act, 1882, which is still in effect today, officially incorporated the British groundwater legal structure into Indian law.[57] The Act deems groundwater to be an easement connected to the land and grants landowners an unrestricted right to use the groundwater below the land.[58] Specifically, every landowner has the right to "collect and dispose within his own limits of all water under the land which does not pass in a defined channel."[59] The Act solidified the notion that surface water is state property, while groundwater is the property of the landowner.[60]

The common law system incorporated by the Act views groundwater as chattel connected to the land, and allows the landowner ownership rights based on the *ad coleum* principle.[61] Unlike with surface waters and underground streams in defined channels, which are governed by the riparian doctrine of reasonable use, landowners have the right to extract percolating groundwater in any amount they desire with no risk of liability from adjacent landowners for overuse.[62] Under the common law, there is no limit to the amount of groundwater a particular landowner may extract.[63] As preeminent Indian water scholar Chhatrapati Singh put it:

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53. Jivash A. Tambe, *Groundwater Ownership and Legal Aspects*, *in* GROUNDWATER AND GOVERNANCE: OWNERSHIP OF GROUNDWATER AND ITS PRICING 379, 381 (Saleem Romani et al. eds., 2007).

54. GRÖNWALL, *supra* note 1, at 333.

55. *Id.* at 341.

56. *Id.* at 333.

57. Tambe, *supra* note 53, at 381.

58. Videh Upadhyay, *Legal Dimensions of Water Resource Management in India: A Review of Legal Instruments Controlling Extractions to Sustainable Limits*, *in* REFORMING INSTITUTIONS IN WATER RESOURCE MANAGEMENT: POLICY AND PERFORMANCE FOR SUSTAINABLE POLICY DEVELOPMENT 123, 126 (Lin Crase & Vasant P. Gandhi eds., 2009).

59. *Id.* at 126.

60. The Indian Easements Act, No. 5 of 1882, INDIA CODE (2008), vol. 4 § 7(g), *available at* http://indiacode.nic.in.

61. Tony George Puthucherril, *Riparianism in Indian Water Jurisprudence*, *in* WATER AND THE LAWS IN INDIA 97, 114 n.55 (Ramaswamy R. Iyer ed., 2009) ("*Cujus est solum ejus usque ad coleum*—He who possesses land possesses also that which is above it.").

62. *Id.* at 115.

63. Chhatrapati Singh, *Water Rights in India*, *in* WATER LAW IN INDIA 7, 18 (Chhatrapati Singh ed., 1992).

> The consequence of such legal framework is that only the land-owners can own groundwater in India. It leaves out all the land-less, and tribals who may have group (community) rights over land but not private ownership. It also implies that rich land-lords can be water-lords and indulge in openly selling as much water as they wish.[64]

Under this system, if Landowner X extracts groundwater that supplies Landowner Y's well, Landowner Y's lack of water is *damnum absque (sine) injuria*—a loss that is not legally recognized, and for which Landowner Y has no viable legal remedy.[65] Even malicious depletion of an aquifer does not produce a valid cause of action.[66]

However, these groundwater rights are not without some limits. The ownership rights apply only to underground percolating waters,[67] and not to underground streams running in defined channels.[68] Though, it should be noted that, practically speaking, the geological makeup of India results in virtually no instances of groundwater flowing in defined channels.[69] Even for percolating water, landowners do not have absolute ownership in the true sense, but rather maintain a usufructuary right to consume the water only so long as it is beneath the owned parcel of land.[70] In other words, once the groundwater flows away from beneath the land, the landowner loses all rights to the water, and the groundwater then becomes subject to the rights and interests of neighboring landowners as it had been under the previous landowner.[71]

III. FEDERAL WATER REFORMS

Change in the groundwater system began in earnest on the federal level. Specifically, some of the most forward-looking reforms of the recent era emanated from the Supreme Court rather than the national or state legislatures.[72] The recent pattern has been for more federal involvement in water governance.[73]

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64. *Id.*

65. GRÖNWALL, *supra* note 1, at 350.

66. *Id.*

67. Puthucherril, *supra* note 61, at 114 (discussing Indian Easements Act § 7(f)).

68. Indian Easements Act § 7(g); *see also* Puthucherril, *supra* note 61, at 114 (discussing the difference between underground percolating water and underground running streams).

69. GRÖNWALL, *supra* note 1, at 343 ("Two-thirds of India is hard-rock terrain, meaning that the groundwater prevails in aquifers of weathered bedrock and jointed, interconnected fissures. There is therefore essentially no such thing as groundwater in defined channels.").

70. Puthucherril, *supra* note 61, at 115 (citing the Indian Easements Act § 7(g) and stating it is interpreted to mean that the landowner "loses all rights and interests in the [water] the moment it passes beyond the boundaries of his property").

71. *Id.*

72. *See* GRÖNWALL, *supra* note 1, at 287, 298 (discussing some early Supreme Court decisions on water rights).

73. *Id.* at 298–303.

A. *Constitutional Development: Policy Reform from the Bench*

Article 246 of the Indian Constitution[74] places water resources in the legislative jurisdiction of the states.[75] In terms of what is placed under the control of the states, "water" encompasses "water supplies, irrigation and canals, drainage and embankments, water storage and water power."[76] According to Article 248, any policy matter not explicitly granted to the states is reserved for the central government.[77] In the early days of independence, the states did little to alter the colonial groundwater system, and the central government was perceived to be able to do little in the realm of groundwater because of the federal divisions of power in Article 248.[78] The first major changes in the groundwater system came from the Supreme Court.[79]

The Indian Supreme Court has more expansive power than the high courts of most other nations.[80] Article 32(2) of the Constitution empowers the Court to issue directions, orders, or writs to enforce the fundamental rights bestowed in the Constitution.[81] Such powers give the Court the tools to give effect to the "abstract declarations of fundamental rights."[82] In this way, the Court can essentially force the hand of the executive and the legislature in order to bring them into conformity with constitutional requirements. Actions brought under Article 32 are termed "constitutional remedies," and the right to initiate such proceedings is itself one of the enumerated fundamental rights of Article 32.[83] The High Courts of the states also have similarly broad jurisdiction.[84] This gives both state and federal courts broad power to enforce fundamental rights.[85]

Some of the most notable reforms have come via the Court's willingness to broaden fundamental rights. Article 21, India's equivalent of the American Bill of Rights, lists a "right to life" as a fundamental right: "No person shall be deprived of his life or personal liberty except according to procedure established by law."[86] Subsequent rulings have interpreted this negative language as recognizing positive rights.[87] Though the provision does not explicitly mention water, courts have

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74. INDIA CONST. art. 246.

75. Vani, *supra* note 26, at 463; GRÖNWALL, *supra* note 1, at 100.

76. INDIA CONST. 6th Schedule § 3A(g), n.3.

77. Kamala Sankaran, *Water in India: Constitutional Perspectives, in* WATER AND THE LAWS IN INDIA 17, 18 (Ramaswamy R. Iyer ed., 2009) (discussing INDIA CONST. art. 248, § 1).

78. *See* GRÖNWALL, *supra* note 1, 298, 333 (explaining the Central Government's lack of authority in water legislation and the failure of States to enact laws).

79. *See* Vrinda Narain, *Water as a Fundamental Right: A Perspective from India*, 34 VT. L. REV. 917, 920 (2010) (discussing the development of the right to water in India through the court system rather than the legislature).

80. GRÖNWALL, *supra* note 1, at 171.

81. *Id.* at 167.

82. *Id.*

83. C. Raj Kumar, *Corruption, Development and Good Governance: Challenges for Promoting Access to Justice in Asia*, 16 MICH. ST. J. INT'L L. 475, 564 (2008) (discussing INDIA CONST. art. 32, § 1).

84. GRÖNWALL, *supra* note 1, at 167 (construing INDIA CONST. art. 226).

85. *Id.* at 167.

86. INDIA CONST. art. 21.

87. For instance, the Court interpreted Article 21 as imputing a positive right to a clean and healthy environment. GRÖNWALL, *supra* note 1, at 162 (discussing Virender Gaur v. State of Haryana (1995) 2 S.C.C. 577, and A.P. Pollution Control Board II v. Prof. M.V. Nayudu (2001) 2 S.C.C. 62).

interpreted the text to recognize a right to water.[88] In *Bandhua Mukti Morcha v. Union of India*, the Supreme Court continued a pattern of liberal interpretations to broaden fundamental rights and recognized the deprivation of clean drinking water as a violation of the Article 21 right to life.[89] The holding was further cemented by *Subhash Kumar v. State of Bihar*, in which the Court held the "[r]ight to live is a fundamental right under Article 21 of the Constitution and it includes the right of enjoyment of pollution-free water and air for full enjoyment of life."[90] In *A.P. Pollution Control Board II v. Prof. M.V. Nayudu*, the Court held in more explicit language that the "right to access to drinking water" was a part of the fundamental right to life.[91]

However, as the law stands today, the reach of the Article 21 right to life is less clear in circumstances concerning access to water for reasons other than basic drinking purposes. The Supreme Court has yet to give definitive rulings on how far the Article 21 rights extend for agricultural and commercial purposes. Demonstrating this point, in *Venkatagiriyappa v. Karnataka Electricity Board,* the High Court of Karnataka was unwilling to extend the Article 21 protections to non-drinking uses.[92] In this case, farmers had constructed bore-wells to extract groundwater for irrigation, but when they applied for electricity service to power the pumps, the Electricity Board declined the application based on a Government Order on groundwater use.[93] According to the Government Order, 825 feet was required to be between public wells sunk by officials and private irrigation bore-wells.[94] The Government Order was intended as a response to the dropping water tables in the public wells.[95] The farmers brought suit, claiming a violation of their fundamental Article 21 right to water.[96] In rejecting the farmers' claim, the Court stated that the Article 21 right protects:

> at the most to have water for drinking purposes, as, admittedly, without it, the life cannot be enjoyed at all. However, the right to have water for irrigation purposes cannot be stretched to the extent of bringing it within the ambit of Article 21 of the Constitution of India.[97]

On the broader environmental scale, the Court has set the ball rolling in recognizing prioritization of environmental concerns over commercial concerns. Over the course of several major cases, a discrete priority has been given to environmental ideals and human life over commercial activities.[98] As the Court held

88. Narain, *supra* note 79, at 920.

89. GRÖNWALL, *supra* note 1, at 289 (discussing Bandhua Mukti Morcha v. Union of India A.I.R. 1984 S.C. 802).

90. *Id.* at 290 (citing Subhash Kumar v. State of Bihar (1991) 1 S.C.C. 598).

91. *Id.* at 292 (citing A.P. Pollution Control Board II v. Prof. M.V. Nayudu (2001) 2 S.C.C. 62).

92. *Id.* at 292–93 (describing Venkatagiriyappa v. Karnataka Electricity Board (1999) (4) Kant. L.J. 482).

93. *Id.*

94. *Id.*

95. *See* GRÖNWALL, *supra* note 1, at 292–93 (describing Venkatagiriyappa v. Karnataka Electricity Board (1999) (4) Kant. L.J. 482).

96. *Id.*

97. *Id.*

98. *Id.* at 293.

in *M.C. Mehta v. Union of India*, "[l]ife, public health and ecology have priority over unemployment and loss of revenue."[99] The judiciary is currently searching for a middle ground to balance the interests of commercial development and sustainability. In *Intellectuals Forum, Tirupathi v. State of AP & Ors.*, the state government's plans for a residential area encroached on the recharge beds of two water tanks, which were being used for irrigation, drinking, and groundwater table recharge.[100] The Court weighed the interests and found in favor of protecting the environment over the need for the new residential area development.[101]

An interesting question for the future is whether the Court will differentiate between the various forms and purposes of irrigation when it balances environmental interests. To this point, the Court has not yet laid down a test that treats irrigation for subsistence farming differently than irrigation for large-scale commercial crop production or, for that matter, extractions for the purpose of exchange in water markets.[102]

The factors the Court chooses to include in its balancing tests in this area are vital. If the Court continues its trend of expanding protection of environmental rights in the face of the rapidly expanding commercial growth, this could be a huge step toward finding a solution to the groundwater problem and other serious environmental issues.

B. The EPA and the Central Groundwater Bodies

No provisions of Article 246 of the Constitution grant the states power to legislate on environmental matters, reserving this area of law for the central government via the reserve clause of Article 248.[103] Entrusting the states with jurisdiction over water and the central government with jurisdiction over environmental matters allows for dual federal and state water regulations because water is a major component of the environment. As a result of this, today's system sees many duplicative functions by the states and the central government.[104]

In 1972, the Ministry of Agriculture created the Central Ground Water Board (CGWB) to oversee exploration, investigation, management, and development for groundwater.[105] Later the central government passed the Environmental Protection Act, 1986 (EPA) to put into practice the initiatives from the UN Conference on Human Environment in 1972.[106] This was a substantial step in bringing the central government into the sphere of regulation of water issues. In the landmark case *M.C. Mehta v. Union of India*, the Supreme Court of India, under Section 3(3) of the EPA, directed the central government to create a federal regulatory body to deal

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99. ASHISH KOTHARI & ANUPRITA PATEL, NAT'L HUM. RTS. COMM'N, ENVIRONMENT AND HUMAN RIGHTS: AN INTRODUCTORY ESSAY AND ESSENTIAL READINGS 16 (2006) (paraphrasing the holding of M.C. Mehta v. Union of India, A.I.R. 1988 S.C. 1115).

100. GRÖNWALL, *supra* note 1, at 295 (discussing Intellectuals Forum, Tirupathi v. State of AP & Ors. A.I.R. 2006 S.C. 1350).

101. *Id.* at 295–96.

102. *Id.* at 296.

103. INDIA CONST. art. 248, § 1.

104. Vani, *supra* note 26, at 464.

105. *Id.*

106. Tambe, *supra* note 53, at 381.

specifically with groundwater extraction problems.[107] Curiously, the Court did not address whether the central government had constitutional authority to regulate groundwater.[108] The Court evaded the question of whether groundwater should be considered an exclusively state-controlled item under Article 246, and instead assumed that groundwater was sufficiently "environmental" to be governable by the central government under the Environmental Protection Act, 1986.[109] After *M. C. Mehta v. Union of India*, the central government created the Central Ground Water Authority (CGWA) to oversee and implement federal groundwater regulation.[110] The CGWA is empowered to control groundwater "development and management" across India, "especially by new industries and projects in over-exploited areas."[111] The CGWA oversees a registration process for entities that construct wells, and it has authority to grant or deny clearance for industrial undertakings and other groundwater development projects.[112] The CGWA may also notify regions that are drafting groundwater and designate them as being either "overexploited" or "critical."[113] By notifying a region, the CGWA may restrict the use of wells in those areas and require registration of any well in the depleted area.[114] Although granted a breadth of power, the CGWA is generally viewed as having had little practical impact since its creation.[115]

C. *Public Trust Doctrine*

In *M. C. Mehta v. Kamal Nath*, the Indian Supreme Court first recognized the Public Trust Doctrine as part of the Indian legal system.[116] This was a further indication of the judiciary's willingness to cut into private ownership rights for the sake of preserving environmental resources. Since the Court first adopted the Public Trust Doctrine, judges have begun to utilize it as a device to spur the executive

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107. *See* Sankaran, *supra* note 77, at 19–20 (discussing the holding in M.C. Mehta v. Union of India (1997) 11 S.C.C. 312).

108. *Id.* at 20.

109. *See id.* at 18 (discussing the Indian Constitution's division of powers between the federal and state governments); *see also id.* at 20 (describing how the Court's classification of water is an issue affecting the environment, and therefore falling within the purview of the EPA).

110. K. C. Sivaramakrishnan, *Drinking Water Supply: Right and Obligation, in* WATER AND THE LAWS IN INDIA 251, 267 (Ramaswamy R. Iyer ed., 2009).

111. *Id.*

112. Tambe, *supra* note 53, at 388.

113. PHILIPPE CULLET, WATER LAW, POVERTY, AND DEVELOPMENT: WATER SECTOR REFORMS IN INDIA 49 (2009).

114. *About Us*, CENTRAL GROUNDWATER AUTHORITY, http://www.cgwb.gov.in/aboutus.htm.

115. CULLET, *supra* note 113, at 49.

116. GRÖNWALL, *supra* note 1, at 175 ("The Public Trust Doctrine is the legal principle that certain resources are preserved for public use, and that the government is required to maintain them for the public's reasonable use. It has its origin in the Roman Empire at the beginning of the fifth century C.E. and was later codified into English common law. The doctrine is based on the need to protect the public's right of access to certain resources. The doctrine lays down the pre-existing *rights of the state*: It holds domain and sovereignty over all shorelands and navigable water. The state, as a trustee, could however not grant exclusive rights to these resources to any single individual or entity. The state furthermore has *duties*: to administer such lands and waters to maintain the flow in the rivers as well as the public's right to fishing and navigation. This applies along with the rights of *landowners*, who were traditionally granted full private ownership of 'their' water bodies and shorelands, with an accompanying right to sell these rights.").

branch into action in environmental cases.[117] Notably, the doctrine has not yet been successfully invoked in cases about groundwater exploitation, though some commentators anticipate that the doctrine may soon apply there as well.[118] Others are skeptical of the real effect these references to the Public Trust Doctrine will have, however.[119] This camp of scholars desires constitutional recognition of the doctrine to assure its future effectiveness; they fear the Public Trust Doctrine is not yet a fully solidified doctrine in the Indian legal system and, thus, is only a weak tool for conservation.[120]

D. Proposed Constitutional Amendments

Several constitutional amendments affecting Article 21 have been proposed in the past decade.[121] In the year 2000, the central government created the National Commission to Review the Working of the Constitution (NCRWC) in order to keep the Indian system up-to-date in light of the country's rapid development.[122] Among the Commission's amendment proposals was the 2002 recommendation to incorporate a new clause in Article 21 that grants any person who has been illegally denied his or her right to life or liberty a right to compensation as a remedy for the violation.[123]

The Commission also recommended a "consolidated right to a clean and healthy environment."[124] The proposed amendment, Article 30-D, dictates that every person shall have the right:

> (a) to safe drinking water;
>
> (b) to an environment that is not harmful to one's health or well-being; and
>
> (c) to have the environment protected, for the benefit of present and future generations so as to
>
> (i) prevent pollution and ecological degradation;
>
> (ii) promote conservation; and
>
> (iii) secure ecologically sustainable development and use of nature resources while promoting justifiable economic and social development.[125]

This explicit statement of a right to safe drinking water would offer the benefit of codifying the case law as it currently stands.[126] Of course, many interpretation

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117. *See id.* at 176 (discussing the relative—and interactive—roles of the courts, legislature, and executive under the Public Trust Doctrine).

118. *See id.* at 177 ("According to Shyam Divan and *Armin Rosencranz*, the doctrine may apply to unregulated areas such as the exploitation of groundwater, though this has yet to be tested.").

119. Ramaswamy R. Iyer, *A Synoptic Survey and Thoughts on Change, in* WATER AND THE LAWS IN INDIA 567, 601 (Ramaswamy R. Iyer ed., 2009).

120. *Id.*

121. GRÖNWALL, *supra* note 1, at 298.

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.* at 299.

issues would still linger, such as the level of purity needed to consider water "safe."[127] This amendment has yet to be enacted.[128]

E. The National Water Policy

In 1987 and again in 2002, the central government formulated and released the National Water Policy (NWP).[129] The 1987 NWP suggested strategies for central and state water management, such as water-conserving crop schedules and responsible irrigation methods.[130] The 2002 version of the NWP emphasized a need for the focus of water governance to shift from water-resource development to efficient water-resource management.[131] Because the NWP only promulgated nonbinding guidelines and not government mandates, it has been criticized as being a superficial political exercise, far from having any kind of meaningful effectiveness.[132] Indeed, to date, the NWP remains a list of statements that the government has not made any substantial attempt to operationalize.[133] Perhaps its primary benefit in the water reform arena has been to maintain awareness of the issues and current strategies, despite the lack of force behind the initiative.

F. Evaluation of Federal-level Reforms

1. Administrability

The Supreme Court's recent expansion of the Article 21 right to life to cover a right to water is, in one sense, an immediately administrable reform, but in another sense it is still lacking in meaningful implementation. In the first sense, the Court's expansion of rights will have the immediate effect of compelling the lower state and federal courts to recognize causes of action brought under the new rights. Likewise, with the sweeping power of the Court granted under Article 32, the Court can compel the executive and legislature to act in accordance with the fundamental rights.[134] But in the other sense, these new rights have only a limited impact because so many of the would-be beneficiaries of the new rights are either ignorant of their rights or politically unable to assert them.[135] Low levels of education and a lack of consistent conduits for information regarding political rights are major impediments, but are only small parts of the problem. The more deep-seated issue is the widespread exclusion of women and untouchables from meaningful political participation and assertion of political rights.[136] Simply announcing a new right to

127. GRÖNWALL, *supra* note 1, at 298.
128. *Id.* at 300.
129. Tambe, *supra* note 53, at 382–83.
130. *Id.* at 382.
131. *Id.* at 383.
132. GRÖNWALL, *supra* note 1, at 300.
133. Iyer, *supra* note 119, at 570.
134. INDIA CONST. art. 32, § 2.
135. *See* GRÖNWALL, *supra* note 1, at 103 ("Rather, ignorance of the rights and obligations conferred by the formal law, as well as deliberate exclusion of untouchables and/or of women, is the deeply entrenched problem.").
136. *Id.* at 103–04.

water does very little to assist the vast segments of the population who are culturally barred from using such rights. This same criticism applies to the proposed amendments, such as Article 30-D, which would codify the rights of existing case law into the Constitution.[137]

These entrenched barriers to the protection of rights have grave effects in contexts other than access to water, and the solution is far from clear. Policy goals for the future that help to educate and empower these oppressed segments of the population will benefit the groundwater realm, as well as many other vital rights areas.

Turning to other federal reforms, the Court's recognition of the Public Trust Doctrine in some environmental areas[138] and the Court's explicit prioritization of "life, public health, and ecology . . . over unemployment and loss of revenue,"[139] are readily implementable for future cases. These developments, along with the Court's demonstrated pattern of giving greater attention to the impacts of environmental degradation, are concrete steps in the right direction. Though, in terms of the Public Trust Doctrine, which has not yet been extended to apply to groundwater, some commentators are skeptical of the real lasting effect the references to the Public Trust Doctrine will have. In the opinion of Ramaswamy R. Iyer: "[O]ccasional judicial pronouncements provide a rather fragile basis for the presumption that it is firmly part of Indian law: an explicit legal (or constitutional) recognition seems necessary."[140] These concerns express doubt in the long-term practical impact of the doctrine that only exists in terms of judicial decree and not explicit constitutional or statutory language. This is similar to the criticisms that the NWP is merely a political rhetorical exercise that will not have a lasting effect. Constitutional amendments should be adopted to cement the existence of these progressive policies.

The federal-level water regulatory bodies, the CGWB and the CGWA, are roundly considered to be administrative failures.[141] It is telling that in a country with some 19 million groundwater structures,[142] and well-documented groundwater depletion problems, the federal Authority is only stepping in to regulate a mere fraction of the depleted areas to control groundwater exploitation.[143] In the words of M. S. Vani: "[W]e now observe the absurdity of a centralised national regulatory authority seeking to identify specific areas and wells around the country to regulate and monitor."[144] The sheer number of groundwater extraction structures that the CGWA is supposedly monitoring makes full implementation all but impossible in the absence of vast central government support that has not yet been forthcoming. An insight into this rampant lack of enforcement is that many of the core functions of the CGWA and CGWB—registering wells, issuing permits, and notifying depleted

137. *Id.* at 298–99.

138. GRÖNWALL, *supra* note 1, at 351–52 (discussing M. C. Mehta v. Kamal Nath, (1997) 1 S.C.C. 388, and analyzing the use of the Public Trust Doctrine in Indian law).

139. *Id.* (analyzing M.C. Mehta v. Union of India, A.I.R. 1988 S.C. 1115).

140. Iyer, *supra* note 119, at 601.

141. CULLET, *supra* note 113, at 49.

142. Sharma, *supra* note 4, at 278.

143. *See* GOV'T OF INDIA PLANNING COMM'N, GROUND WATER MANAGEMENT AND OWNERSHIP 7 (2007), *available at* http://planningcommission.nic.in/reports/genrep/rep_grndwat.pdf.

144. Vani, *supra* note 26, at 464–65.

areas—are duplicative[145] of the functions of many state groundwater authorities, which are further described in Section V below.

2. Equity

As noted in the section above, recognizing new fundamental rights, such as a right to water, does little to alter entrenched social and political inequities in accessing political protections. Until further progress is made in ensuring the political equity and participation of all groups of Indian society, it is primarily men of higher castes who will benefit from the right to water, while members of less fortunate demographics go virtually unprotected.[146] That fact notwithstanding, recent court decisions are certainly steps forward in terms of equitable access to water. The Supreme Court's recognition of the Public Trust Doctrine is an acknowledgment that in some circumstances private owners can be barred from exploiting resources to the detriment of the wider population. Though this doctrine is not yet effective for groundwater issues, it is positive progress in keeping India in stride with the advancing environmental policies of other nations.

The creation of the EPA and the Court's prioritization of environmental and human values over industrial water uses[147] are positive steps toward ensuring that the interests of nature and the impoverished are not overshadowed by the demands of commercial development. However, the poor and underrepresented are still left vulnerable because the right to water has not yet been extended from just drinking water to certain vital nondrinking uses, such as subsistence food production.[148] Nor has there been constitutional recognition of prioritization among the different kinds of irrigation.[149] Many important determinations affecting equity are still to be made.

Until the central government puts forth a substantial effort to fully enact and enforce them, the CGWA, CGWB, and NWP are too ineffective to meaningfully benefit issues of equity.

3. Sustainability

Turning to the effect of federal reforms on sustainability issues, Ramaswamy R. Iyer is correct in expressing a need for explicit constitutional bases for some of the newly emerging environmental protections, such as the Public Trust Doctrine and the prioritization of water use for environmental preservation and human sustenance over industrial use.[150] Sustainable water resource policies are not possible unless there is a certain degree of stability in the core doctrines protecting sustainable use.

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145. *Id.*

146. *See* GRÖNWALL, *supra* note 1, at 103–04 (["V]illages are often overtly divided along gender, age, caste, community, educational and political party lines, resulting in groups being left out.").

147. GRÖNWALL, *supra* note 1, at 293 (discussing the Court's analysis in M.C. Mehta v. Union of India, A.I.R. 1988 S.C. 1115).

148. *Id.* at 292 (discussing Venkatagiriyappa, (1999) (4) Kant. L.J. 482 and quoting: "No Article in the . . . Constitution specifically deals with the right of a citizen to draw subsoil water for irrigation, business or drinking purposes.").

149. *Id.* at 296 (discussing Intellectuals Forum, A.I.R. 2006 S.C. 1350).

150. *See* Iyer, *supra* note 119, at 601 (urging the prioritization of water for human consumption and environmental use rather than for private use).

As intimated in the sections above, it only makes sense that if India desires to have natural resources that will outlast the current generation, it should protect these resources with laws that are most likely to outlast the current generation. Therefore, constitutional adoption of the Public Trust Doctrine and other environmental policies is necessary to protect the current judge-made reforms from being overturned by a less progressive Supreme Court in the future. Lasting resources need lasting policies to govern them. If the Court continues in its current direction, groundwater will hopefully soon become a part of the Public Trust. Including surface water in the Public Trust and not tying it to groundwater ignores the basic science behind the water cycle. Recognizing groundwater as part of the Public Trust would be a key step in linking law with modern scientific knowledge about watershed preservation.

The prioritization of environmental and human values over industrial water uses,[151] assuming the policy continues to be implemented, will help future sustainability by putting current industrial practices in the proper long-term context: forgoing certain projects now, though costly for the moment, is the best decision if it ensures the availability of resources for future needs.

Regarding the federal regulatory bodies, similar to their effect on equity, the CGWA, CGWB, and NWP are currently too ineffective to have lasting impact on sustainable practices. Pending adequate funding and meaningful implementation, commentators are correct to view these regulatory bodies as a political façade.

IV. STATE GROUNDWATER REFORMS

A. *Model Groundwater Bill for the States*

Outside of the progressive opinions of the judiciary, the next significant step away from the common law system of private groundwater ownership came when the central government formulated a model groundwater bill. Unlike with air, coastline, and environmental issues, the central government did not have direct legislative jurisdiction over groundwater.[152] Thus, in lieu of directly legislating on groundwater, in 1970, the central government presented the states with a model groundwater bill as a template: the Model Bill to Regulate and Control the Development and Management of Groundwater (the "Model Bill").[153] Part of the motivation for the creation of the Model Bill was that by that point in time the states had done little on their own to regulate groundwater.[154]

The central government has subsequently reissued the Model Bill in 1992, 1996, and 2005.[155] The primary thrust of the Model Bill is to drastically expand state control over groundwater by instituting registration for most of the groundwater infrastructure and requiring permits for groundwater use in overexploited areas.[156]

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151. *See* GRÖNWALL, *supra* note 1, at 293 (summarizing the Court's analysis in M.C. Mehta v. Union of India, A.I.R. 1988 S.C. 1115 at 302).

152. GRÖNWALL, *supra* note 1, at 104.

153. Philippe Cullet & Roopa Madhav, *Water Law Reforms in India: Trends and Prospects, in* WATER AND THE LAWS IN INDIA 511, 514 (Ramaswamy R. Iyer ed., 2009).

154. *Id.* at 516.

155. Upadhyay, *supra* note 58, at 127.

156. *See* Philippe Cullet & Roopa Madhav, *Water Law Reform: Sectoral Issues, in* WATER AND THE

Presently, no states have adopted the entire Model Bill,[157] but many have borrowed some of its primary features.[158] The key provisions of the bill are summarized in the following three subsections.

B. *Establish a State Ground Water Authority*

Under the Model Bill, the state shall establish a Ground Water Authority,[159] which is empowered to "notify" areas of the state where the Authority deems it necessary to "regulate and control the development and management of groundwater."[160] The Authority can "take steps to ensure that exploitation of ground water resources does not exceed the natural replenishment to the aquifers."[161] The Authority must maintain an up-to-date database containing groundwater information.[162] Furthermore, the Authority shall have the right to send representatives to enter any property to gather scientific data, inspect wells, and seize equipment used for unauthorized sinking of a well, and other similar powers of enforcement.[163]

C. *Create a Permit Requirement*

The Model Bill requires that anyone who wants to begin pumping groundwater in a notified depleted area (with the exception of pumping with handpumps) must receive a permit from the Authority,[164] which even if received, may be subject to various restrictions on extraction.[165] Citizens cannot be refused a permit without having the "opportunity of being heard."[166] The Authority will evaluate various factors in considering whether or not to grant a permit, including:

(a) the purpose or purposes for which ground water is to be used;

(b) the existence of other competitive users;

(c) the availability of ground water;

(d) quantity of ground water to be drawn.

(e) quality of ground water with reference to use;

(f) spacing of ground water structures keeping in consideration the purpose for which ground water is to be used;

LAWS IN INDIA 516, 517 (Ramaswam R. Iyer ed., 2009) (stating that the bill seeks to broaden the state's control over the use of groundwater by imposing registration and permit requirements).

157. Upadhyay, *supra* note 58, at 130.

158. CULLET, *supra* note 113, at 128.

159. Model Bill to Regulate and Control the Development and Management of Ground Water § 3 (Ministry of Water Resources 2005), *available at* http://www.ielrc.org/content/e0506.pdf. (last visited May 20, 2010) [hereinafter Model Bill].

160. *Id.* § 5.

161. *Id.* § 5(5).

162. *Id.* § 5(6).

163. *Id.* § 12(1).

164. *Id.* § 6(1).

165. Model Bill, *supra* note 159, § 6(2).

166. *Id.* § 6(3).

(g) long-term ground water level behaviour;

(h) its likelihood of adversely affecting water availability of any drinking water source in its vicinity;

(i) any other factor relevant thereto.[167]

Section (i) serves as a catchall for any relevant factors not listed.

D. Create a Registration Requirement

The Model Bill requires every owner of already existing groundwater extraction structures in the notified groundwater-depleted areas to register the structure with the Authority.[168] The information required for registration includes: the purpose of the extraction, the location of the well, the type of pumping device, the quantity of the groundwater pumped, the hours of operation of the well, and various other factors.[169] The owners of drilling rigs also must register their drilling machinery with the Authority.[170] People adversely affected by implementation of the restrictions of the bill are not entitled to recover any compensation from the government.[171]

Each subsequent revision of the Model Bill maintained the same framework of the 1970 version.[172] In 2005 the authors of the bill added a chapter on "Rainwater Harvesting for Ground Water Recharge,"[173] which allowed the CGWA to identify certain areas in need of rainwater harvesting structures and to put out directives for building the structures.[174]

Again, no state has adopted the Model Bill outright.[175] However, as discussed below, starting in the 1990s, states began to adopt legislation that was substantially influenced by the Model Bill.

E. Currently Enacted State Groundwater Legislation

In the past ten years, most states have adopted or begun the process of adopting their own groundwater regulation statutes.[176] State regulation of groundwater takes place on several different levels of local government. The local government institutions in India are the *Panchayati Raj Institutions*, also referred to as *Panchayats*.[177] The 73rd Amendment, enacted in 1992, allows the state legislatures

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167. *Id.* § 6(5).
168. *Id.* § 7(1).
169. *Id.* § 7(2).
170. *Id.* § 9(1).
171. Model Bill, *supra* note 159, § 14.
172. CULLET, *supra* note 113, at 126–28.
173. Upadhyay, *supra* note 58, at 128 (discussing Model Bill § 19).
174. *Id.*
175. *Id.* at 130.
176. CULLET, *supra* note 113, at 129.
177. GRÖNWALL, *supra* note 1, at 103 ("The *Panchayat* system of governance in India has *Grama Panchayats* as the basic unit of administration, consisting of one, but mostly several, revenue villages. Villages can also be grouped into a cluster, a *hobli*. In most States, such as in Karnataka, there are two levels above the *Grama Panchayats:* the *Taluk* and district (*Zilla*) *Panchayat*. To a certain extent, the *Grama Panchayats* answer to the *Taluk* and *Zilla* levels of government.").

the power to bestow on the *Panchayats* "such powers and authority as may be necessary to enable them to function as institutions of self-government."[178]

Below are overviews of two different state legislative enactments. They show heavy influence from the Model Bill, but go beyond the Model Bill's system in various ways.

1. Andhra Pradesh

In the mid-1990s, Andhra Pradesh became the first state to promulgate completely new water regulatory bodies, many of which were in response to the urging of the World Bank.[179] Many other states began to follow suit.[180] Among the water-related reforms were the Andhra Pradesh Ground Water (Regulation for Drinking Water Purposes) Act, 1996[181] and the Andhra Pradesh Water Resources Development Corporation.[182] The focus here is on the Andhra Pradesh Water, Land and Trees Act (WLATA), 2002, which utilizes the Model Bill approach of instituting a permit and registration system under the supervision of a state groundwater authority.

The WLATA creates the Andhra Pradesh State Water, Land and Trees Authority[183] and places all groundwater resources under the control of the Authority.[184] The Act mandates that "the owners of all the wells including those which are not fitted with power driven pumps and water bodies in the State shall register their wells/water bodies with the Authority."[185] The Authority may forbid any individual or entity from pumping in any area of the state if it is determined that "pumping in such area is likely to cause damage to the level of groundwater or cause deterioration or damage to natural resources or environment."[186] The prohibition on pumping can extend up to six months at a time and can be extended by the Authority if harmful conditions are still present.[187] Notably, there are no enumerated guidelines in the statute for what constitutes "damage to the level of groundwater" or "deterioration or damage to the natural resources or environment."[188] The enforcement officer is apparently granted broad discretion in suspending pumping rights.

Additionally, in the interest of preserving public drinking water sources, no person or entity may sink a well within 250 meters of a public drinking water source without Authority permission, with the exception of wells constructed for "public

178. *Id.* (discussing INDIA CONST. art. 243G).

179. CULLET, *supra* note 113, at 118.

180. *Id.* at 118.

181. Upadhyay, *supra* note 58, at 137.

182. CULLET, *supra* note 113, at 118.

183. An Act to Promote Water Conservation, and Tree Cover and Regulate the Exploitation and Use of Ground and Surface Water for Protection and Conservation of Water Sources, Land and Environment and Matters, Connected Therewith or Incidental Thereto §3(1) (2002), *available at* http://www.ielrc.org/content/e0202.pdf [hereinafter WLATA].

184. *Id.* § 8(1).

185. *Id.* § 8(2).

186. *Id.* § 9(1).

187. *Id.*

188. *Id.*

drinking purpose[s] and handpump[s] for public or private drinking purpose[s]."[189] The WLATA is unlike the Model Bill in this respect. The Model Bill was criticized for not prioritizing different water uses and thereby putting drinking water on the same priority level as commercial purposes.[190] The WLATA, in contrast, sets aside drinking purposes from other purposes and provides special protection.

Drawing heavily from the Model Bill, the WLATA empowers the Authority to classify certain areas as "over exploited" for renewable periods of six months,[191] during which time no wells may be dug except for handpump wells or other wells for public drinking water.[192] Furthermore, the Authority has the power to issue guidelines to improve the groundwater quality in overexploited areas "by suitable measures,"—another broad grant of discretion.[193]

Even in areas not designated as overexploited, if a well is determined to be harming a public drinking water source, the Authority may prohibit extraction for any purpose for a renewable period of six months.[194] If such measures are determined to be insufficient protection, the Authority has discretion to seal off the well permanently.[195] For both permanent and temporary suspension of pumping, well owners are given the right to a hearing before the pumping prohibition takes effect.[196]

In another break from the Model Bill, § 12(4) of the WLATA contains provisions specifically aimed at regulating extractions for the sale of water.[197] The Authority may completely disallow extractions from overexploited sources when the extraction is for the purpose of selling water.[198] This provision demonstrates the government's increasing tendency to prioritize basic human sustenance over commercial interests. The Authority may even take control of any well that is operated in contravention of the Act, and the well may be closed at the expense of the owner.[199] Departing from the Model Bill even further, when a well is permanently sealed by the states, and the well had been previously used for viable agricultural or industrial activity, the owner has a right to receive from the government fair market value for the well and other expenses, such as the price of the affected crop in the case of a well used for irrigation.[200] The Model Bill does not offer such compensation.

2. Maharashtra

The reforms going on in the state of Maharashtra are the most far-reaching and progressive of any yet implemented by the states.[201]

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189. WLATA, *supra* note 183, § 10(1–2).
190. CULLET, *supra* note 113, at 129.
191. WLATA, *supra* note 183, § 11(1).
192. *Id.* § 11(3).
193. *Id.* § 11(4).
194. *Id.* § 12(1).
195. *Id.* § 12(2).
196. *Id.* § 12(1–2).
197. WLATA, *supra* note 183, § 12(4)(a).
198. *Id.*
199. *Id.* § 15 (1–2).
200. *See id.* § 16 (detailing compensation for closed wells); *cf.* Model Bill, *supra* note 159, § 14 (barring claims of compensation for closed wells).
201. CULLET, *supra* note 113, at 119–20.

Maharashtra passed the Maharashtra Groundwater (Regulation of Drinking Water Purposes) Act, 1993 (MGWA).[202] The MGWA disallows construction of wells within 500 meters of sources of public drinking water, regulates extractions within a kilometer of public sources of drinking water in water scarcity areas, and prohibits building wells in "overexploited" watersheds.[203]

The most broad-reaching institutional reforms adopted by Maharashtra are in the Maharashtra Water Resources Regulatory Authority Act (MWRRA) 2005.[204] The MWRRA was enacted as the result of efforts to amend the MGWA, which is still currently in effect but has been extensively supplemented by the MWRRA.[205] The MWRRA contains many of the same regulatory devices as the Model Bill and the Andhra Pradesh Act discussed above—namely the registration and notification system.[206] To avoid repetition, the analysis below focuses only the elements of the statute that set it apart from precursor acts.

The MWRRA introduces a regulatory system that encompasses both surface water and groundwater, approaching water regulation on the river basin level.[207] The result is a more holistic, integrated approach to water law than other state statutes before it.[208]

An even more striking feature of this act is the use of "entitlements" rather than permits for water use.[209] The Maharashtra Act states that "no person shall use any water from any water source without first obtaining an entitlement from the respective River Basin Agency."[210] The MWRRA contemplates this concept of "sub-surface entitlements," which are essentially state-issued rights to extract a certain quantity of water to be used within a set of broad purposes.[211] The main difference between entitlements and the permits used in other acts is that entitlements are created to be fully tradable.[212] This system is intended to create a market to incentivize the most efficient uses of water.[213]

The MWRRA sets up requirements for trading water entitlements and considers each entitlement to represent "usufructuary rights which may be transferred, bartered, bought or sold on annual or seasonal basis within a market system and as regulated and controlled by the Authority."[214] There are also functions

202. Upadhyay, *supra* note 58, at 135.

203. *Id.*

204. Maharashtra Water Resources Regulatory Authority Act, 2005, *available at* http://www.lead-journal.org/content/05080.pdf [hereinafter MWRRA]; CULLET, *supra* note 113, at 119.

205. Sanjiv Phansalkar & Vivek Kher, *A Decade of the Maharashtra Groundwater Legislation: Analysis of the Implementation Process*, 2 L. ENV'T AND DEV. J. 69, 73–4 (2006); *see* MWRRA, *supra* 204, § 12(8) (stating that the MWRRA shall abide by the provisions of the MGWA).

206. *See* Phansalkar & Kher, *supra* note 205 (describing the provisions of MGWA and MWRRA).

207. CULLET, *supra* note 113, at 120.

208. *See id.* (describing the integrated approach of the MWRRA).

209. *Id.* at 121.

210. Vani, *supra* note 26, at 452.

211. *Id.* at 452–53.

212. *Id.* at 452.

213. *See* CULLET, *supra* note 113, at 120 (stating that the MWRRA has been given the power to promote efficient water use).

214. MWRRA, *supra* note 204, § 11(i)(i).

for entitlements to be reevaluated if there are concerns about the sustainability of use.[215]

The MWRRA system of entitlements is coupled with an equally new concept in the realm of state groundwater legislation: the principal of "equitable distribution" of resources. The first listed purpose of the MWRRA is "to determine the distribution of Entitlements for various Categories of Use and the *equitable distribution* of Entitlements of water within each Category of Use on such terms and conditions as may be prescribed."[216] This enumerated acknowledgement of the need to ensure equitable distribution is an important movement toward ensuring that equity concerns factor into groundwater planning, but it is subject to several criticisms, which are further examined below.

Perhaps the most controversial provision of the MWRRA is §12(11), which dictates that any person with more than two children has to pay 50% more than the regulated water rate to obtain an entitlement for agriculture.[217] As Cullet notes, a potential flaw of the arrangement is that a small farmer with more than two children could end up paying 50% more for water than the wealthy owner of a large farm one plot over.[218]

In keeping with the free-market agenda of the MWRRA, the Authority is also charged with determining criteria for pricing based on full-cost recovery of the administration, operation, management, and maintenance of water projects.[219] Also, the Authority will govern pollution based on the "polluter pays" principle.[220]

Unlike the Model Bill, the MWRRA gets local officials involved in the regulation process. Rules under the MWRRA "require that the *Gram Panchayat* (GP) must be cognizant of violations and make a written complaint to the Block Development Officer (BDO) should a violation be observed."[221] Furthermore, proponents of decentralization applaud the fact that the MWRRA does not require the chairs or members of the Authority to be government ministers of civil servants.[222] While the selection process for members favors the selection of civil servants to the Authority, this novel provision is a step away from the more centralized management structure of past legislation.[223]

Other states have followed Maharashtra's lead and enacted their own statutes that are closely based on the MWRRA.[224] For instance in 2008, Uttar Pradesh

215. *See id.* § 11(j) ("Entitlements may be subject to review at intervals of not less than three years and then, only if warranted by concerns about, the sustainability of the level of allocation.").

216. *Id.* § 11(a) (emphasis added).

217. *Id.* § 12(11).

218. Cullet & Madhav, *supra* note 153, at 525.

219. MWRRA, *supra* note 204, § 11(d).

220. *Id.* § 12(5).

221. Upadhyay, *supra* note 58, at 136–37.

222. CULLET, *supra* note 113, at 120.

223. *Id.*

224. *Id.* at 119.

adopted its own act based on the Maharashtra model.[225] Several other states are soon expected to soon follow suit.[226]

F. Evaluation of State-level Reforms

1. Administrability

The success of the state and central regulatory schemes, as they now stand, hinges on the government's ability to register and license wells.[227] Arguably, the greatest defect in the state reforms is that they have proven difficult to successfully administer in their present forms, given current resources.[228] Using the MGWA as an example, according to official Maharashtra studies, only a meager 10% of the water extracted in scarcity areas is ever officially "declared," a reporting requirement mandated under § 4 of the MGWA.[229] Perhaps even more troubling, between 1996 and 2000, actions to restrict withdrawal in water-scarcity areas were taken by the MGWA in only 15 cases.[230] These reports are particularly striking considering Maharashtra contains over one million wells and other extraction structures. Like the CGWA and the CGWB, the law is just no match for the vast number of wells that must be regulated. Many statutes from other states have not seen any implementation at all.[231]

The same poor administration results have come in Andhra Pradesh under the WLATA as well. Despite the good intentions of the legislature, the Authority is grossly underequipped with databases, machinery, and technicians necessary to give the Act any sort of meaningful implementation.[232]

Further hindering successful implementation, research suggests that corruption is especially high in India's water management sector.[233] A 2004 study reported that more than 40% of individuals polled had bribed state water employees to alter water meter figures and to decrease water bills.[234] Likewise, 12% polled had bribed administrators to expedite the installation of new water connections.[235] Currently, none of the proposed or enacted state groundwater statutes adequately deal with the extensive corruption problem. Corruption hinders the implementation of many laws, not only those pertaining to water. Because the problem is so rampant in the water

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225. Government of India Planning Commission, *Mid Term Appraisal for Eleventh Five Year Plan 2007–2012*, § 21.41, *available at* http://www.planningcommission.gov.in/plans/mta/11th_mta/MTA.html; *see also* Uttar Pradesh Water Management and Regulatory Commission Act, 2008, *available at* www.ielrc.org/content/e0803.pdf.

226. *Id.*

227. Vani, *supra* note 26, at 453.

228. *See id.* (questioning the government's ability to control millions of groundwater structures with limited administrative resources).

229. Upadhyay, *supra* note 58, at 135.

230. *Id.*

231. Vani, *supra* note 26, at 453.

232. Upadhyay, *supra* note 58, at 138.

233. GRÖNWALL, *supra* note 1, at 34.

234. *Id.*

235. *Id.*

arena, any government initiative that successfully decreases corruption in general could lead to exponential increases in the implementation of groundwater policies.

A common criticism of both the Model Bill and the Andhra Pradesh Act is that their implementation problems are attributable to lack of empowerment of the local-level governing bodies.[236] The acts rely solely on a top-down, state-level enforcement approach for millions of wells.[237] The MWRRA, on the other hand, is notable for its effort to involve local governing bodies.[238] Still, it is questionable how much this approach has improved implementation.

Compared to Andhra Pradesh's WLATA and other state statutes, Maharashtra's MWRRA is relatively new; therefore, the true effectiveness of its more progressive features has not been as extensively examined. Because of the poor implementation track record of the MGWA, the MWRRA's predecessor, and the fact that the MWRRA is based on the same system as the CGWA and the WLATA, the MWRRA has an uphill battle toward achieving effectiveness.

In sum, the whole regulatory method behind the Model Bill and its state counterparts appears to be, as Philippe Cullet puts it, "the brainchild of an era that promoted governmental intervention without necessarily thinking through all the checks and balances that needed to be introduced alongside."[239]

2. Equity

The Model Bill falls short of adequately advancing equitable access to water for three main reasons. First, the Bill fails to prioritize different groundwater uses, such as placing drinking water uses ahead of irrigation uses.[240] Failing to rank drinking water above other uses leaves open the possibility of issuing permits for commercial irrigation that would endanger the drinking water supply of others. The poor would be most likely to suffer under this scheme because they have fewer options to obtain water if groundwater becomes unavailable.[241] Second, the Model Bill does not distinguish between commercial and non-commercial uses or between small and big users, which could produce similar inequitable results.[242] Third, the Model Bill only considers the rights of landowners, while leaving non-landowning water users out of the regulatory equation.[243]

The Andhra Pradesh Act, the WLATA, is similar to the Model Bill in several of the above respects. The WLATA differs, however, because it provides preferred treatment for drinking water uses, such as the prohibition on sinking a well within 250 meters of a public drinking water source, which is a provision unlike any in the Model Bill.[244] Also, the WLATA draws an important distinction between water uses by its power to completely prohibit extractions from overexploited areas for the

236. *See* Upadhyay, *supra* note 58, at 138 (noting that the law does not empower the *Gram Panchayat* or *Gram Sabha*, which are local governing bodies in India).

237. *Id.*

238. *Id.* at 1.

239. CULLET, *supra* note 113, at 129.

240. *Id.*

241. Vani, *supra* note 26, at 437–38.

242. CULLET, *supra* note 113, at 129.

243. *Id.*

244. WLATA, *supra* note 183, § 10(1–2).

purpose of selling water.[245] This reveals at least some tendency to prioritize use based on human sustenance over commercial interests.

The Model Bill and other state statutes do not provide avenues for public participation in the regulatory scheme.[246] None of the implemented state statutes make serious efforts to include public participation in the regulatory equation.[247] Even the most progressive legislation does not include public involvement as a priority.[248]

To reiterate, the MWRRA, is seen as the most progressive of the state statutes. In an attempt to decentralize the regulatory structure, the MWRRA places some power in the local *Gram Panchayats*.[249] The Act also does not require members of the Authority to be government officials, which leads to more independence from the central state authorities.[250] Both of these innovations are steps toward achieving more meaningful local involvement and less top-down decision making, which can often be disconnected to local needs.

The MWRRA's system of entitlements, rather than permits, exposes the statute to several equity concerns. Trading entitlements could result in disproportionate transfers to wealthy farmers who would not have incentives to make sure the water is being used in a way that does not harm the surrounding area.[251] Or, worse yet, the entitlements could be bought up in bulk by a corporation, which would result in complete loss of control of the groundwater supply at the local level.[252]

Furthermore, the MWRRA's idea of "equitable distribution" is fundamentally flawed because it only tries to establish equity among land-owning water users.[253] Non-landowners, who are often small, impoverished farmers, have no provision to protect them.[254] This gap between the landed and landless farmers stems from the basic common-law connection of water rights with land ownership. Until a fundamental shift is made from the common law absolute ownership system, this inequity will continue. Section VI below has a more detailed land reform discussion.

Also, the MWRRA provision charging 150% of the fair market rate for water entitlements for users with more than two children has obvious equity problems as well.[255] While the concern with slowing population growth is evident in the provision, it seems almost intentionally aimed at barring the impoverished farmers, who often depend on the labor of large families to work the crops, from receiving the necessary groundwater entitlements. Ironically, the poor farmers with the most children are often the ones with the least extra income, which would be needed to pay the added

245. *Id.* § 12(4)(a).

246. *See* CULLET, *supra* note 113, at 129 ("Recent legislative activity by states indicates that they are generally ready to follow the framework provided by the model bill .... There is no specific provision for public participation in this scheme.").

247. *Id.*

248. *Id.*

249. Upadhyay, *supra* note 58, at 136.

250. CULLET, *supra* note 113, at 120.

251. *Id.* at 125.

252. *Id.*

253. Cullet & Madhav, *supra* note 153, at 525.

254. *Id.*

255. *Id.*

amount required for the stepped-up entitlement price. This is a cutthroat method of incentivizing small household sizes.

3. Sustainability

If the Model Bill and the state bills were enforced exactly as they were written, they would likely do a great deal to improve sustainable use of groundwater resources. The permitting and registration systems would give the government a clear window into types of groundwater uses and levels of extractions—all of which would be helpful in keeping groundwater use at safe levels. But the statutes are simply not being enforced.[256]

Among the state acts, the MWRRA shows greater promise because it approaches water regulation on the river basin level, rather than attempting to regulate surface water under one authority and groundwater under another authority.[257] This holistic method recognizes the interrelated properties of the water cycle and makes an attempt to take all relevant water bodies into account to enhance sustainable use. Other state statutes, some recently enacted and some still in the proposition stage, follow the lead of the MWRRA in this regard.[258] Hopefully successful implementation of these provisions is close on the horizon.[259]

Concerning pollution and its effect on sustainability, the Model Bill and the vast majority of the state acts are silent about pollution because the EPA has set up an independent institutional framework under the purview of the central government to legislate on such matters.[260] Thus, the pollution problems of millions of wells dispersed across the country are placed under the authority of the central government.[261]

V. POLICY RECOMMENDATIONS

After evaluating the effectiveness of the current groundwater reforms, it is unmistakable that the reforms could be improved in numerous ways. In addition to the critiques and recommendation I have made above, there are other key policy recommendations that are necessary to institute a more effective groundwater system.

A. Responsible Governing Amid Equity and Sustainability Conflicts

There is a fascinating tension between reforms that promote equity and those that promote sustainability. The two interests are often at odds with each other. Policymakers in the groundwater arena are caught between fighting for water access for the poor and oppressed of the present generation and fighting to sustain an adequate water supply for future generations. In other words, a policy that promotes

256. *Id.* at 511–34.
257. *See* CULLET, *supra* note 113, at 120 (describing the river basin approach).
258. *Id.* at 119.
259. *See id.* (describing the state of various reform efforts in India).
260. Vani, *supra* note 26, at 462.
261. *Id.*

political and economic equality in the here-and-now often clashes with policies that promote intergenerational equity interests. For instance, if the Indian Supreme Court were to extend the right to water by including a right to have water for basic irrigation, this would be a step forward for guaranteeing equitable access to water. But by virtue of making water extraction available to greater segments of the population, expanding the rights structure in this manner would only *quicken* groundwater depletion in overexploited areas. For example, the current depletion crisis has been caused largely by two factors: greater access to extraction equipment and government-subsidized electricity for pumping.[262] Depletion levels were skyrocketing[263] while poverty activists rejoiced that the poor were improving their per capita income because of increased access to groundwater to nourish their crops.

Policymaking while balancing equity and sustainability interests requires finding a middle ground between the two. As the preceding analysis of India's groundwater reforms demonstrates, the middle ground is difficult to determine. There is no set formula for deciding how best to balance the political needs of today and the environmental needs of tomorrow. With that in mind, I assert that when policymakers are striking these sorts of balances, they must construct a system that elevates institutional transparency and democratic participation. In this way, the equity/sustainability balance will be subject to proper review. In applying this principle to India's groundwater reform situation, the first thing I would suggest is to make it a priority to eliminate duplicative regulations on the state and federal levels, which I address in the next section.

B. Eliminating Duplicative Regulatory Bodies

Having multiple regulatory bodies conducting the same types of regulations reduces institutional transparency. This makes it more difficult for citizens and officials to monitor the effectiveness of the system and to hold delinquent institutions accountable.[264] The duplicative existence of both the Central Ground Water Authority (CGWA) and the respective state-level groundwater authorities is a paradigmatic example of this principle.[265] In this case, both state and federal entities are empowered to enforce virtually the same regulations on the same groundwater users.[266] Having two duplicative bodies in place hinders the ability of citizens to hold the government accountable for the regulatory failures of either institution. For instance, if a state is experiencing rapid declines in the water table and no institution

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262. Ananda, *supra* note 3, at 106–07.

263. Stephen Foster & Hector Garduno, *Groundwater Resources of India: Towater a Framework for Practical Management and Effective Administration, in* GROUNDWATER AND GOVERNANCE: OWNERSHIP OF GROUNDWATER AND ITS PRICING 20, 20–23 (Saleem Romani et al. eds., 2007).

264. *See* Sidney A. Shapiro & Rena Steinzor, *Capture, Accountability, and Regulatory Metrics*, 86 TEX. L. REV. 1741, 1750–51 (2008) (linking deficiencies in institutional accountability with duplicative regulation by multiple environmental regulatory actors); *see also* John Yoo, *Administrative Law under the George W. Bush Administration: Looking Back and Looking Forward*, 58 DUKE L.J. 2277, 2305–2306 (2009) (commenting on the benefits of centralized control of public administration, Yoo supports the notion that eliminating duplicative agency regulation can decrease redundancies and enhance agency accountability).

265. *See* Vani, *supra* note 26, at 464–65 (discussing the numerous duplications between the CGWQ and state and local-level authorities).

266. *Id.*

has notified the area to limit groundwater pumping, duplicative regulation makes it unclear which institution should be held responsible. The greater the number of regulatory bodies, the easier it is for institutions to shift the blame and avoid political backlash. Admittedly, there are many reasons why the CGWA and the state Authorities have not come close to successfully implementing groundwater regulations—lack of funding being a primary cause. Still, eliminating needless regulatory duplication would save government resources and grease the wheels of political accountability.[267] Clearly, this recommendation is only a partial solution to the overall administrability problem. But in the face of the considerable lack of enforcement of the reforms, even a minor increase in reform effectiveness is meaningful progress.

If the government does decide to cut or consolidate duplicative programs, regulatory effectiveness should increase no matter whether the surviving regulatory authority is state or federal: the benefits of increased political accountability apply in either case. However, state regulation would likely be more responsive to the specific groundwater needs of any given region. Likewise, accountability for state regulation would be more direct and more immediate than for federal regulation due to the greater proximity of state regulators to their state constituencies.

C. *Reforming Basic Groundwater Rights Structure*

Shifting focus to another critical fault in the reform policies, neither the Model Bill, the state bills, nor the recent Supreme Court cases make any endeavor to redefine the groundwater property rights structure.[268] This is the heart of the failure of many of the reforms to create a working system. If we are content to leave in place the underlying common law system that gives absolute ownership to landowners, updating the groundwater system is the wrong starting point, given current inequities in land ownership. The current picture of land ownership is indicative of the large disparities. Ten percent of all rural households claim to be "landless."[269] In Maharashtra the percentage of rural landless households was 18%; in the state of Sikkim it was as high as 31%.[270] The poor are still far more likely to be landless or to own only scant amounts of land.[271] Studies estimate that land distribution enactments have gone unimplemented in over 98% of the regions where they are supposedly in effect.[272] These disparities in land ownership cause parallel disparities in groundwater ownership.

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267. A counterargument to this proposition is that having duplicative regulatory bodies increases efficiency by providing an additional strata of regulators to enforce provisions. My argument is that the Indian context presents a different situation. Because actual implementation of the regulatory statutes is so shockingly low, the additional levels of regulators have yielded virtually no additional benefit. The most productive step at this point is correctly affixing blame on an underperforming government body to encourage positive change. As long as institutions can pass the buck to the other layers of the regulatory system, improvement is unlikely.

268. Vani, *supra* note 26, at 453.

269. *See id.* at 455 (The study defined "landless" as owning zero to .002 hectares. A hectare is equal to 1,000 square meters).

270. *Id.*

271. *See id.* ("[T]he Scheduled Castes (SCs) and Scheduled Tribes (STs), which are the groups that have the highest concentration of poor in India, are at the bottom of the scale.").

272. Vani, *supra* note 26, at 457.

To reiterate, groundwater rights belong only to landowners and can only be transferred when the plot of land is transferred.[273] Thus the poor who cannot afford to buy land are legally incapable of purchasing a right to pump groundwater as well.[274] An ideal solution is to separate land rights from water rights, as many other nations do, and make water its own independently tradable commodity. This change would make water available without regard to land ownership.[275]

As a practical suggestion for reform, this is, of course, quite naïve. Though doing away with the common law structure and essentially starting from scratch would solve many problems, it is highly unlikely that such reforms would ever come to pass in the absence of a major political crisis, such as an aggressive regime change. For the time being, policymakers are left building upon a core system that was never tailored for the groundwater needs of India in the first place.

VI. FINAL REMARKS

The groundwater crisis is a startlingly complex problem, intertwining numerous political actors and resource beneficiaries. And in the case of India, even a less-significant policy problem is exacerbated by the fact that over a billion people are affected by broad-reaching policy decisions. The future livelihoods of many depend on resolution of the crisis. The common law groundwater system was imported from Great Britain, and imposed virtually unchanged on a colony in South Asia with a completely alien climate and topography.[276] Now, a century and a half later, that legal system deserves to be responsibly reformed to adequately address the needs of modern India. The groundwater rights of one-sixth of the world's population hang in the balance.

273. *Id.* at 449.
274. *Id.*
275. *Id.*
276. GRÖNWALL, *supra* note 1, at 358.

The Right to Vote for Non-Resident Citizens: Considered Through the Example of East Timor

CAROLINE CARTER*

SUMMARY

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INTRODUCTION

Citizenship has traditionally provided the basis for voter eligibility in national elections in countries throughout the world. The International Covenant on Civil and Political Rights, a fundamental human rights treaty, establishes the right to vote as a matter of international human rights law. Unlike the other rights articulated in that treaty, the right to vote is specifically conveyed only to citizens. For a citizen

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living outside of his homeland, however, the right to vote under international human rights law remains ambiguous. The potential right to vote for non-resident citizens raises a further normative question of whether the extension of such a right is consistent with theoretical positions regarding the formation of political communities.

Non-resident citizen voting rights provide an opportunity to examine the relationship that people who live outside their country of citizenship have with their homeland. Furthermore, it raises the question of how this relationship does and should affect laws regarding enfranchisement of non-resident citizens. And finally, non-resident citizen voting is significant because it provides a window for critically analyzing the traditional connection of voting rights to citizenship and considering whether this connection is consonant with general theories regarding the makeup of political communities.

This paper contends that the right to vote for non-resident citizens should fall within the scope of international human rights law. Although international human rights law has not yet addressed this issue, this paper's position finds support for its argument in the language of the International Covenant on Civil and Political Rights and the comments issued by the Human Rights Committee concerning the right to vote. The paper does not argue that all non-resident citizens should be given an indiscriminate right to vote under international human rights law. Rather, the right to vote for non-resident citizens should depend on the type of election and the general reason for the non-resident citizen population's absence from the country. This conclusion comports with many of the theoretical arguments concerning voting rights and closely resembles a framework already established in an international human rights law decision opining on a similar issue. Recent elections in East Timor highlight the importance of the type of election and reason for citizens' absence and demonstrate how changes in these two features affect the way in which the right to vote should be viewed.

The paper will begin in Part I with a discussion of the relevant international human rights law and the applicability of this law to non-resident citizens voting rights. Part II will then describe the theoretical arguments addressing and affecting the question of non-resident citizen voting rights.[1] Part III will examine the issue of non-resident citizen voting using the recent elections in East Timor as a case study for considering this issue.

1. This note analyzes the question of voting for citizens that are not currently residing in their home country. It does not focus on the larger conceptual question of whether citizenship should be redefined in an era of increased migration and improved communication. *See, e.g.*, Kim Barry, *Home and Away: The Construction of Citizenship in an Emigration Context*, 81 N.Y.U. L. REV. 11 (2006) (a theoretical examination of citizenship and voting rights). Furthermore, the note does not limit the definition of non-resident citizen by either long-term or temporary absence from the country; rather, it is meant to include a person legally defined as a citizen by the home country, who is not currently residing in that country.

I. INTERNATIONAL HUMAN RIGHTS LAW

A. *The International Covenant on Civil and Political Rights*

The International Covenant on Civil and Political Rights (ICCPR) is the primary codification of political rights in the area of international human rights law.[2] This treaty, which entered into force on March 23, 1976, has been ratified by 167 nations.[3] Article 25 of the ICCPR instantiates the right to vote as a principle of international human rights law, stating in relevant part that:

> Every citizen shall have the right and the opportunity, without any of the distinctions mentioned in article 2 and without *unreasonable restrictions*: . . . (b) to vote and to be elected at genuine periodic elections which shall be by universal and equal suffrage and shall be held by secret ballot, guaranteeing the free expression of the will of the electors.[4]

The distinctions in article 2, which article 25 refers to, include "race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status."[5] Notably absent from this list is residency. Since residency is not specifically prohibited as a basis for discrimination under article 2, the question then becomes whether residency requirements may be considered a reasonable restriction for enfranchisement under article 25.

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2. *See* International Covenant on Civil and Political Rights (ICCPR), G.A. Res. 2200A (XXI) A, U.N. Doc. A/RES/2200A(XXI), art. 2 (Dec. 16, 1966) (establishing that all rights discussed in the covenant are available to all people involved. It also describes the duties taken on by States that adhere to the Covenant). Article 41 of the International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families also specifically grants to migrant workers and their families the right to vote in their country of origin. Since this treaty only covers a limited group of people and has only been signed by forty-two states, this note does not focus on it but merely notes its existence and applicability to this topic. International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families, G.A. Res. 45/158, art. 41 (Dec. 18, 1990), *available at* http://www2. ohchr.org/english/law/cmw.htm.

3. U.N. Multilateral Treaties Deposited with the Secretary General (MTDSG), Chapter IV, Section 4, *available at* http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IV-4&chapter=4 &lang=en.

4. ICCPR, *supra* note 2, art. 25 (emphasis added). In contrast to the ICCPR, the American Convention on Human Rights expressly addresses the question of residency as a legitimate restriction on the right to vote, by stating that "[t]he law may regulate the exercise of the rights [of citizens to vote] . . . *only on* the basis of age, nationality, *residence*, language, education, civil and mental capacity, or sentencing by a competent court in criminal proceedings." American Convention on Human Rights, art. 23, Nov. 22, 1969, *available at* http://www.oas.org/juridico/English/treaties/b-32.html (emphasis added). The European Convention on Human Rights does not define the right to vote by citizenship at all, stating simply, "The High Contracting Parties undertake to hold free elections at reasonable intervals by secret ballot, under conditions which will ensure the free expression of the opinion of the people in the choice of the legislature." Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, art. 3, Mar. 20, 1952, Council of Europe, *available at* http://conventions.coe.int/ Treaty/en/Treaties/Html/009.htm. The European Commission on Human Rights has interpreted the right to be "subject to such restrictions imposed by the Contracting States as are not arbitrary and do not interfere with the free expression of the people's opinion." X. v. The United Kingdom, App. No. 7730/76, 15 Eur. Comm'n H.R. Dec. & Rep. 137, 138, (1979).

5. ICCPR, *supra* note 2, art. 2.

The Human Rights Committee (HRC), which is the body tasked with overseeing the implementation of the ICCPR, has issued a general comment further clarifying the right established under article 25.[6] The comment provides examples of restrictions that are likely to be reasonable, such as requiring a higher age for election to office than is required for voting.[7] The Comment's only mention of residency restrictions is to state that "[i]f residence requirements apply to registration [of voters], they must be reasonable."[8]

The Human Rights Committee has not opined on the specific issue of non-resident citizen voting rights, but it addressed the reasonableness of residency restrictions in a different context. In *Gillot v. France*, a group of French citizens residing in New Caledonia brought a claim to the HRC based on the fact that they were not allowed to vote in the 1998 referendum because they did not meet a ten-year residency requirement.[9] The referendum was the first step in a self-determination process for the people of New Caledonia, a French overseas community.[10] The HRC's holding in the case is that

> it is not in a position to determine the length of residence requirements. It may, however, express its view on whether or not these requirements are excessive .... [T]he Committee has to decide whether the requirements have *the purpose or effect of restricting in a disproportionate manner, given the nature and purpose of the referendums in question, the participation of the 'concerned' population* ....[11]

The HRC held that the residency restrictions for the New Caledonia referendum were reasonable given the facts of the particular case.[12]

Although this case did not specifically address the factual situation of non-resident citizens' voting rights, the standard articulated by the HRC in *Gillot* for determining the reasonableness of residency restrictions seems likewise applicable to the issue of whether the disenfranchisement of non-resident citizens may be reasonable. The standard articulated in *Gillot* can be separated into two parts: the first consideration is the nature and purpose of the election, and the second is the purpose or effect of disenfranchising the group in question.

A separate but connected consideration for non-resident citizen voting relates to the obligations of State Parties once they determine who is enfranchised. The HRC's general comment to article 25 asserts: "States must take effective measures to ensure that all persons entitled to vote are able to exercise that right. Where registration of voters is required, it should be facilitated and obstacles to such registration should not be imposed."[13] This raises the question, which will be

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6. U.N. Office of the High Commissioner for Human Rights, CCRP: General Comment No. 25: Article 25 (Participation in Public Affairs and the Right to Vote), The Right to Participate in Public Affairs, Voting Rights and the Right of Equal Access to Public Service, U.N. Doc. CCPR/C/21/Rev.1/Add. 7 General Comment No. 25, 57th Sess. (July 12, 1996) [hereinafter General Comment No. 25].

7. *Id.* para. 4.

8. *Id.* para. 11.

9. Human Rights Committee, Gillot v. France (Commc'n. No. 932/2000).

10. *Id.*

11. *Id.* para. 14.2 (emphasis added).

12. *Id.* para. 15.

13. General Comment No. 25, *supra* note 6, para. 11.

discussed later, of whether simply enfranchising non-resident citizens is sufficient or whether further steps need to be taken to facilitate voting for non-resident citizens. In conducting an analysis of objective and reasonable restrictions, further state obligations would certainly constitute an important factor.

B. The ICCPR's Extra-Territorial Reach

In order to apply the right to vote under the ICCPR to the issue of non-resident citizen voting, it is essential that the treaty have a binding effect on state parties outside of their territorial borders.[14] There are two ways in which the treaty can be read to apply extra-territorially; this paper will make both arguments in order to demonstrate that the case in favor of the applicability of article 25 outside of the territory of the state is stronger than is generally acknowledged in the scholarship on non-resident citizen voting.

Article 2 of the ICCPR is often used to limit the applicability of article 25 to the territorial confines of the state.[15] The relevant language cited in favor of this reading is that "[E]ach State Party to the present Covenant undertakes to respect and to ensure to all individuals *within its territory and subject to its jurisdiction* the rights recognized in the present Covenant . . . ."[16] The language of this provision can be read in two different ways; the ambiguity turns on how the word "and" is to be understood.

One reading of article 2 is that the phrase means that the ICCPR only applies to individuals who are *both* "within the territory and subject to its jurisdiction." The United States has taken this position, arguing that it is supported by a plain reading of the text.[17] The Human Rights Committee has taken the other view, which it clearly articulates in General Comment 31:

> Parties are required by article 2, paragraph 1, to respect and to ensure the Covenant rights *to all persons who may be within their territory and to all persons subject to their jurisdiction.* This means that a State party must respect and ensure the rights laid down in the Covenant to anyone within the power or effective control of that State Party, even if not situated within the territory of the State Party.[18]

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14. Since the HRC case dealt with a situation of people that were disenfranchised within the state, the Committee did not have to directly address the question of extra-territorial application of the ICCPR. *Gillot*, Commc'n No. 932/2000.

15. Ranier Baubock, *Stakeholder Citizenship and Transnational Political Participation: A Normative Evaluation of External Voting*, 75 Fordham L. Rev. 2393, 2409–10 (2007).

16. ICCPR, *supra* note 2, art. 2 (emphasis added).

17. Comments by the Government of the United States of America on the Concluding Observations of the Human Rights Committee, U.N. Doc. CCPR/C/USA/CO/3/Rev.1/Add.1, at 2 (2008), *available at* http://daccess-dds-ny.un.org/doc/UNDOC/GEN/G08/404/60/PDF/G0840460.pdf?OpenElement.

18. H.R. Comm., General Comment 31, (Eightieth Session, 2004), The Nature of the Gen. Legal Obligation Imposed on States Parties to the Covenant, U.N. Doc. CCPR/C/21/Rev.1/Add.13, para. 10 (2004), *available at* http://www.unhchr.ch/tbs/doc.nsf/(Symbol)/CCPR.C.21.Rev.1.Add.13.En?Open document [hereinafter General Comment No. 31] (emphasis added).

Under the HRC's interpretation of article 2, the ICCPR would likely apply to non-resident citizens.

There is another reading of the ICCPR that supports the proposition that non-resident citizen voting rights fall within the purview of the treaty. The general comment to article 25 states that, "[I]n contrast with other rights and freedoms recognized by the Covenant (which are ensured to all individuals within the territory and subject to the jurisdiction of the State), article 25 protects the rights of 'every citizen.'"[19] Based on this understanding of article 25, the right to vote under the ICCPR protects all citizens irrespective of the fact that they may be residing outside of their country of citizenship. This understanding of article 25's reach is the most consistent with the text of the treaty. But even if Article 2 is used as the basis for determining the reach of Article 25, the Human Rights Committee's articulated understanding of Article 2 would allow for the consideration of non-resident citizen voting rights under the treaty.

C. *Application to Non-Resident Citizen Voting Rights*

International law does not appear to establish a *per se* rule that all non-resident citizens have a legal right to vote, but the HRC has articulated a standard for determining the reasonableness of residency restriction that could be applied to the issue of non-resident citizen voting rights.[20] The first important consideration mentioned by the HRC in its opinion was the nature and purpose of the election.[21] The second consideration, stated in the *Gillot* opinion, was the effect on the persons disenfranchised by the residency restriction, given the nature and purpose of the election.[22] In the context of non-resident citizens, the reason for their absence from the country would be a significant factor in understanding the reasonableness of any restriction.

The statement in General Comment No. 25 of the ICCPR requiring states to take measures to ensure that people who are enfranchised are able to vote raises several questions about how to factor this element into a determination of voting rights. One issue concerns how to view the cost of facilitating voting in light of the right to vote. The cost of organizing an election at the international level is cited as one of the main reasons for not allowing external voting.[23] If simply enfranchising non-resident citizens but requiring them to travel to the homeland is insufficient under the ICCPR,[24] then cost arguably has a role to play in determining whether non-resident citizens have a right to vote in the first place. The relative strength of the non-resident citizens' stake in the election and the cost of facilitating voting

19. General Comment No. 25, *supra* note 6, para. 3.

20. *Id.* para. 11.

21. *See Gillot*, CCPR/C/75/D/932/2000, paras. 13.6–13.8, 14.2 (While deciding: 1) whether criteria used to determine restricted electorates are objective, and 2) whether or not the restrictions have a disproportionate effect, the court noted that both considerations must also take into account "the nature and purpose" of the referendums in question).

22. *Id.* para. 14.2.

23. ANDREW ELLIS ET. AL., VOTING FROM ABROAD: THE INTERNATIONAL IDEA HANDBOOK 8 (2007).

24. Israel, Taiwan, El Salvador, and Slovakia all enfranchise non-resident citizens in this way. Peter J. Spiro, *Perfecting Political Diaspora*, 81 N.Y.U. L. REV. 207, 212 (1964).

opportunities may have to be balanced in deriving a conclusion regarding whether this group has the right to vote under international human rights law.[25]

There is a further issue, which will be examined later in the discussion of the elections in East Timor, of how the obligation to facilitate voting applies when there are different types of non-resident citizens (e.g., political refugees, permanent expatriates, or temporary students, to name a few). If the right to vote is granted to non-resident citizens based on a generalized conception of the non-resident citizen being a refugee, for example, then the question becomes whether the state has the same obligation to facilitate voting for both the refugee and the person who left voluntarily and does not intend to return. The East Timor example provides a useful case study for exploring this question.

II. THE THEORETICAL DEBATE CONCERNING NON-RESIDENT CITIZEN VOTING

In recent years, several scholars have begun to analyze the issue of non-resident citizens voting from a theoretical and normative perspective.[26] Arguments have focused on the perceived relationship between non-resident citizens and their home country, raising the question of how to view voting rights in the absence of a territorial connection to the state.[27] Because voting is often cited as the quintessential act of participation in a political community,[28] theoretical arguments regarding the nature and makeup of political communities are at the center of any debate that seeks to define the limits of membership in such a community.[29] Arguments addressing voting rights for non-resident citizens generally focus on the interest or stake of the non-resident citizen in the outcome of the election.[30] Although scholars disagree about what level of interest in the election is sufficient to support a normative conclusion that non-resident citizens should be either enfranchised or disenfranchised, there is implicit consensus that this calculation should be based upon a generalized conception of the non-resident citizenry's stake

25. *See, e.g., id.* at 226, n.110 (outlining a distinction between short- and long-term nonresidents, and noting that while short-term nonresidents "will likely maintain an interest in" local matters, "[l]ong-term nonresidents, by contrast, may appropriately be excluded from matters of local governance on the ground that they will likely have lost the requisite stake in such affairs").

26. *See, e.g., id.* at 209 (exploring normative aspects of external citizenship). *See generally* Barry, *supra* note 1; Jamin B. Raskin, *Legal Aliens, Local Citizens: The Historical, Constitutional and Theoretical Meanings of Alien Suffrage*, 141 U. PA. L. REV. 1391 (1993).

27. *See, e.g., id.* at 218 (outlining two competing views and noting that the premise that "nonresidents do not live with the consequences of their vote" is increasingly tenuous in the face of globalization since, for example, "many nonresidents own property, operate businesses, and have made other investments" at home).

28. *See, e.g., id.* at 209 (calling voting "the only significant right in modern democracies that distinguishes the citizen from the alien").

29. *See, e.g.*, Raskin, *supra* note 26 at 1454 ("While there is nothing in this theory inherently requiring the political inclusion of aliens . . . 'the renovation of political communities, by inclusion of those who have been excluded, enhances everyone's political freedom.'" (quoting Frank Michelman, *Law's Republic*, 97 YALE L.J. 1493, 1495 (1988))).

30. *See, e.g.*, Spiro, *supra* note 24 at 226.

in the country and the outcome of the election.[31] This section will focus, in particular, on the works of two scholars—Claudio López-Guerra and Rainer Baubock. The reason for this focus is that the theoretical arguments made by these two scholars highlight themes that recur throughout the debate on this topic and, therefore, provide a useful basis for discussion.

Addressing the question of non-resident citizen voting rights, Claudio López-Guerra articulates a theory of democracy based on the work of Robert Dahl that leads him to the conclusion that non-resident citizens who have no intention of returning to the homeland must be disenfranchised.[32] López-Guerra suggests that the proper standard for determining membership in a democratic polity should be based on whether the individual will be governed by the decisions that an elected body makes; those who are merely affected by such decisions should not be included, and thus should not be given the right to vote.[33] Under this theoretical model, voting ought to be based primarily upon residency rather than citizenship—with exceptions for temporary, short-term absence for citizens, and temporary visits in the case of residents.[34]

Rainer Baubock challenges this argument by calling it too "strictly territorial."[35] He points to obligations—such as taxation and military conscription—that countries sometimes impose on their citizens extra-territorially.[36] He further argues that, "A strictly territorial conception of political community is not plausible in a world where large numbers of people move across international borders and settle abroad."[37] Baubock concludes that there will be a gap between the territorial jurisdiction of states and a more expansive "political community of citizens."[38]

Baubock supports a stakeholding analysis, which is essentially a more nuanced version of the *governed by* or *affected by* standard, as a way of determining the normative legitimacy of non-resident citizen voting.[39] He argues that a consideration of the stakes or interests of non-resident citizens in the homeland provides a way to assess membership in a community and strikes the proper balance between rejecting strictly territorial conceptions of state while also conceding that political borders should not be eliminated entirely.[40] An analysis of the stakes that non-resident citizens have in the home country "serves as a normative yardstick for evaluating particular arrangements in different countries."[41] This position leads him to the

31. *See, e.g.*, Baubock, *supra* note 15, at 2408, 2420–22 (discussing the stakes for expatriates); Claudio López-Guerra, *Should Expatriates Vote?*, 13 J. OF POL. PHIL. 216, 222–32 (2005) (discussing the *affected by* concept and reasons for the enfranchisement of expatriates).

32. López-Guerra, *supra* note 31, at 216–17, 219–20.

33. *Id.* at 222, 225–26.

34. *Id.* at 228, 232. *See also* Ruth Rubio-Marin, *Transnational Politics and the Democratic Nation-State: Normative Challenges of Expatriate Voting and Nationality Retention of Emigrants*, 81 N.Y.U. L. REV. 117, 130 (2006) (arguing that voting rights should be based primarily upon residency rather than citizenship).

35. Baubock, *supra* note 15, at 2418–19.

36. *Id.*

37. *Id.* at 2419.

38. *Id.*

39. *Id.* at 2421–22.

40. *Id.*

41. Baubock, *supra* note 15, at 2422.

conclusion that external voting is not a universal right, but it may be a right depending on the strength of the non-resident citizenry's interest in the election.[42]

Other scholars raise the idea of looking at the stake or interest of non-resident citizens in the home country, or in a particular election. Ruth Rubio-Marin and Peter Spiro both raise and reject the argument that non-resident citizens will be irresponsible voters, by pointing to the significant interests (and sometimes continuing obligations) that they often have in the homeland.[43] Spiro further notes that the usually more arduous steps necessary to vote externally are indicators of the interests of non-resident citizens in the outcome of the election.[44]

The scholarship addressing the issue of non-resident citizen voting rights is consistent in that it all focuses on the interest of the non-resident citizen in his homeland.[45] Claudio López-Guerra's *governed by* and *affected by* distinctions provide useful benchmarks for determining the legitimacy of non-resident citizens' right to vote, particularly if it is not viewed in a strictly territorial sense.[46] López-Guerra's conclusion that permanent non-resident citizens should be disenfranchised rests on an explicit understanding of the emigrant as one who does not intend to return to his country of citizenship.[47] The territorial restraints López-Guerra places on the *governed by* standard become weaker once the non-resident citizen moves out of the category of permanent absence, but the *governed by* concept remains useful.

Rainer Baubock's stakeholder standard better articulates the spectrum of relationships that non-resident citizens could have with the homeland.[48] Under the stakeholder analysis, *clearly governed by* and *merely affected by* can be seen as opposite ends of the spectrum, with varying degrees between them.[49] Like López-Guerra, Baubock articulates his standard based on the subjective viewpoint of the external citizen, focusing on his connection to the homeland and the election.[50] He states that, "Individuals whose circumstances of life link their future well-being to the flourishing of a particular polity should be recognized as stakeholders in that polity with a claim to participate in collective decision-making processes that shape the shared future of this political community."[51] This perspective actually shares much in common with López-Guerra's model in that both are focused on the individual non-resident's reason continued connection to the homeland. The stakeholder model provides a useful analytical tool for thinking about membership in a political community.

Despite beginning from the position of the non-resident citizenry's subjective interest in the election, both Baubock and López-Guerra ultimately derive objective standards that establish bright line rules for enfranchisement.[52] Since López-Guerra

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42. *Id.*
43. Spiro, *supra* note 24, at 218; Rubio-Marin, *supra* note 34, at 128–29.
44. Spiro, *supra* note 24, at 219.
45. *Id.* at 218; Rubio-Marin, *supra* note 34, at 128; Baubock, *supra* note 15, at 2421.
46. López-Guerra, *supra* note 31, at 217.
47. *Id.* at 216–17.
48. Baubock, *supra* note 15, at 2395–96.
49. *Id.* at 2420.
50. *Id.* at 2422.
51. *Id.*
52. *Id.* at 2426 ("[Baubock's] conclusion is therefore that second and subsequent generations of citizens born abroad should be granted external voting rights only if they fulfill some additional condition,

argues from the premise of an individual's intention not to return, he supports state practices that disenfranchise non-resident citizens after a certain period of absence from the country.[53] Baubock's attempt to translate his subjective stakeholder standard into an applicable objective standard likewise leads him to the conclusion that only first-generation citizens should be enfranchised, absent special circumstances.[54] This bright-line result seems contrary to the subjective intent analysis, yet it highlights the difficulty of enfranchisement, which is that it is always based on an objective standard that will in some way be either over- or under-inclusive.[55] The following section will seek to apply the theoretical issues raised by these scholars to the recent elections in East Timor.

III. EAST TIMOR

The Democratic Republic of Timor-Leste (hereinafter referred to as East Timor) presents an interesting case study for examining the issue of voting rights for non-resident citizens. It also helps demonstrate the importance that changes in the type of election and reasons for non-resident citizens' absence make in understanding the right to vote. Beginning in 1999, there were three significant and very different voting opportunities in East Timor that occurred in less than ten years.[56] Over the course of the past ten years, the reasons for non-resident citizens'

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such as a certain period of prior residence in the country concerned (which would turn them again into first generation emigrants)."); López-Guerra, *supra* note 31, at 216–17 ("In this article [López-Guerra] maintain[s] that if we accept—as perhaps all contemporary democratic theorists do—that long-term residency in a democratic state is what should entitle people to full political rights, regardless of their ethnicity and national origin, then we must also endorse the idea that permanent non-residents should be disenfranchised.").

53. López-Guerra, *supra* note 31, at 217–18 .

54. Baubock, *supra* note 15, at 2426.

55. While the use of an objective standard of some sort—citizenship, residency, or stake holding—comports with traditional state practice, it is useful to consider for a moment whether there is an alternative to such a standard. Writing on the topic of local government law in the United States, Jerry Frug suggests a system "in which everyone gets five votes that they can cast in whatever local elections they feel affect their interest . . . . They can define their interests differently in different elections, and any form of connection that they think expresses an aspect of themselves at the moment will be treated as adequate." Jerry Frug, *Decentering Decentralization*, 60 U. CHI. L. REV. 253, 329 (1993). Given that a person only has a limited number of votes, he will choose to vote in elections in which his interest is strongest. *Id.* at 330. If he chooses to place all five of his votes in the same election, he may do so. *Id.* Although Frug was focused on the effect such a system would have on local government practice, this suggestion is also significant because it completely eliminates the need to develop an objective standard for voting. If extended to the international level (five votes may be excessive at the international level, but the same point could be made if each person were given two votes), this model would divest voting rights from its traditional basis in citizenship or residency. At the theoretical level, it is contrary to López-Guerra's *governed by* and *affected by* distinction. It is not entirely inconsistent with the stakeholder model, although the difference is that the individual would decide for himself the extent of his interests in an election. As a practical matter, this policy suggestion is unlikely to gain any momentum given that it runs counter to conventional practice in every state. It is partly for this reason, however, that it is valuable to consider. In addition to eliminating the objective model, it raises the question of whether theoretical considerations of the right to vote actually project a particular normative idea or if they merely provide a justification for traditional state practice.

56. This note will focus on the 1999 Referendum, the 2001 Constituent Assembly election, and the 2007 Parliamentary election. There were also Presidential elections in 2002 and 2007; while these elections were certainly important, this note will not focus on them because they do not raise any new issues not already present in the other three elections. BUREAU OF EAST ASIAN AND PACIFIC AFFAIRS, *Background Note: Timor-Leste*, http://www.state.gov/r/pa/ei/bgn/35878.htm (last visited Feb. 19, 2011) (providing a

absence from the country also dramatically changed. The East Timor example is instructive because it highlights the importance that both the type of election and the reason for expatriation play in an analysis of the legal right and normative legitimacy of non-resident citizen voting.

A. Background on the Elections

East Timor is a small half-island nation that was a colony of Portugal for approximately 400 years.[57] Portugal began the process of decolonization in 1974, and during the process political parties became active in East Timor.[58] By 1975, there were two main political parties; União Democrática Timorense (Timorese Democratic Union, or UDT) and Frente Revolucionaria de Timor Leste Independente (Revolutionary Front of Independent East Timor, or Fretilin).[59] UDT was known for having close connections with Indonesia. Fretilin was a left-leaning party; at the time many claimed that it was Marxist, often comparing it to the Mozambican political party, Frelimo.[60] A short power struggle between the parties began in August 1975, but by December 1975 Indonesia took over the country with military force.[61] Indonesia claimed that it invaded to keep the country from being taken over by the allegedly communist Fretilin; many nations quietly accepted this explanation given the global situation at the time, but the United Nations never recognized the Indonesian occupation of East Timor.[62] Many of the leaders of Fretilin who were not captured or killed fled to Portuguese colonies, most notably Mozambique, where they sought to raise international awareness of the situation in East Timor.[63] Others joined the military resistance movement on the ground, which fought against the Indonesian army until the United Nations took over the

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brief overview of the governmental and political history of East Timor) (hereinafter *Background Note: Timor Leste*).

57. Accounts differ regarding when Portugal actually first held East Timor as a colony, but 400 years is a good rough approximation. *See* EAST TIMOR GOVERNMENT, *History of East Timor*, *available at* http://www.easttimorgovernment.com/history.htm (last visited Feb. 19, 2011) (stating the East Timor was a colony of Portugal beginning in the 16th century); *Background Note: Timor-Leste*, *supra* note 56 (stating that Portuguese and Dutch traders first arrived in the 16th century but that Portugal really took control in the 17th century). Japan occupied East Timor from 1942 to 1945. *Id.*

58. *Background Note: Timor Leste*, *supra* note 56.

59. *Id.* The political party Fretilin originally went by the name Associao Social Democratica Timorese (Timorese Social Democratic Association or ASDT) but later changed to Fretilin. EAST TIMOR GOVERNMENT, *supra* note 57. I will use the term Fretilin because that is how the party is known today.

60. *See* EAST TIMOR GOVERNMENT, *supra* note 57 (describing Indonesia's involvement in UDT).

61. *Background Note: Timor-Leste*, *supra* note 56.

62. *Id.*

63. DAMIEN KINGSBURY, EAST TIMOR: THE PRICE OF LIBERTY, 105–06 (2009); José Ramos Horta, for example, was a leader in the original Fretilin Party; he received the Nobel Peace Prize in 1996 for his diplomatic efforts in bringing international attention to the situation in East Timor. INTERNATIONAL CRISIS GROUP, TIMOR LESTE'S PARLIAMENTARY ELECTIONS 3 (2007), *available at* http://www.crisisgroup.org/~/media/Files/asia/south-east-asia/indonesia/b65_timor_leste_s_parliamentary_elections.ashx.

administration of the country in 1999.[64] While other Timorese were also living abroad, there was no internationally recognized refugee problem until late 1999.[65]

In light of the ongoing military resistance to Indonesian rule and the increasingly vociferous opposition in the international community to violent acts committed by the Indonesian military,[66] the Indonesian government agreed to allow the United Nations to organize and administer a referendum in which "citizens" of East Timor could vote on whether to become an independent nation or gain special autonomy as part of Indonesia.[67] On August 30, 1999, a clear majority of Timorese voters, 78.5 percent, voted for independence.[68]

Following the vote, violence broke out throughout the country. One source summarizes the ensuing events as follows:

> Timorese militias organized and supported by the Indonesian military (TNI) commenced a large-scale, scorched-earth campaign of retribution. While pro-independence FALINTIL guerillas remained cantoned in UN-supervised camps, the militia and the TNI killed approximately 1,300 Timorese and forcibly relocated as many as 300,000 people into West Timor as refugees. The majority of the country's infrastructure, including homes, irrigation systems, water supply systems, and schools, and nearly 100% of the country's electrical grid were destroyed.[69]

To put the number of West Timorese refugees into context, the population of East Timor was approximately 800,000 in 1999.[70]

A force of international peacekeeping troops, led by Australia and known as the International Force for East Timor (INTERFET), was sent to East Timor to quell the violence.[71] They arrived on September 20, 1999, and violence subsided soon after.[72] The United Nations Transitional Administration in East Timor (UNTAET)

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64. *See* John Taylor, *Simply . . . A Brief History of East Timor*, 253 NEW INTERNATIONALIST MAGAZINE (1994), *available at* http://www.newint.org/features/1994/03/05/simply/ (describing Fretilin's underground resistance); *Background Note: Timor-Leste*, *supra* note 56.

65. UNITED NATIONS HIGH COMMISSIONER FOR REFUGEES, *Timor-Leste*, 2002 UNHCR STATISTICAL Y.B., http://www.unhcr.org/414ad5af7.html.

66. In particular, the Santa Cruz Massacre in 1991, which was caught on film and broadcast throughout the world, brought East Timor to the attention of many people throughout the world and mobilized much support for the Timorese resistance movement. The film shows Indonesian troops firing on a large group of primarily young Timorese attending a memorial service at the Santa Cruz Cemetery; more than 271 people were killed in the massacre. EAST TIMOR AND INDONESIA *ACTION* NETWORK (ETAN), *The Santa Cruz Massacre: November 12, 1991*, *available at* http://www.etan.org/timor/SntaCRUZ.htm (last visited Mar. 24, 2011).

67. U.N. TRANSITIONAL ADMIN. IN EAST TIMOR (UNTAET), *East Timor—UNTAET, Background*, http://www.un.org/en/peacekeeping/missions/past/etimor/UntaetB.htm (last visited Mar. 24, 2011). Since East Timor was not a country at the time of the referendum, there was no legal definition of citizenship; it is for this reason that the word citizen is in quotation marks.

68. *Id.*

69. *Background Note: Timor-Leste*, *supra* note 56.

70. *World Bank Search*, THE WORLD BANK, http://search.worldbank.org/all?qterm=east+timor+population (last visited Apr. 9, 2011).

71. *Background Note: Timor-Leste*, *supra* note 56.

72. *Id.*

was established by a UN Security Council resolution on October 25; UNTAET was tasked with the administration of the country as it transitioned to independence.[73]

As the situation in the country stabilized, Timorese political party leaders that had been abroad began to return.[74] Refugees also began to repatriate with the help of the Office of the United Nations High Commissioner for Refugees (UNHCR) and the International Organization for Migration (IOM).[75] By November 1999, an estimated 90,000 refugees had returned to East Timor.[76] By the end of 2000, approximately another 50,000 refugees had returned to East Timor; in 2001, approximately 18,000 repatriated; and by 2002, nearly 32,000 refugees repatriated.[77]

In 2001, UNTAET organized an election to select the members of the Constituent Assembly, who would be responsible for both drafting a constitution for the nation and serving as the national legislative body.[78] After the constitution was signed into law, East Timor formally became an independent country on May 20, 2002.[79] The Constituent Assembly became the National Parliament.[80]

In 2006, violence broke out again, after a dispute concerning alleged discrimination within the armed forces caused a rift between the eastern and western parts of East Timor.[81] Despite the violence, there was not a significant exodus from the country, in part because Indonesia closed the border between East and West Timor.[82] Approximately 150,000 people fled their homes but remained within the country as internally displaced persons.[83]

In 2007, the government of East Timor, with support from the UN, organized and conducted the first national parliamentary elections as an independent nation.[84]

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73. *The United Nations and East Timor—A Chronology*, U.N. TRANSITIONAL ADMIN. IN EAST TIMOR, http://www.un.org/en/peacekeeping/missions/past/etimor/Untaetchrono.html (last visited Feb. 24, 2011).

74. *Id.* (noting the return of José Ramos Horta). Many of the top Fretilin leaders in 1999, including Mari Alkatiri, Rogerio Lobarto, Ana Pessoa, Roque Rodriguez, and Jose-Louis Guterres, were abroad in Mozambique during the Indonesian occupation and returned to lead the party and the new government after the election. KINGSBURY, *supra* note 63.

75. *The La'o Hamutuk Bulletin, Vol. 4, No. 5, November 2003, Part 2*, LA'O HAMUTUK, http://www.laohamutuk.org/Bulletin/2003/Nov/bulletinv4n5b.html (last visited Mar. 24, 2011) [hereinafter *La'o Hamutuk Bulletin*].

76. *See The United Nations and East Timor—A Chronology*, *supra* note 73. A report by the local NGO, La'o Hamutuk, put this number closer to 125,000, including approximately 43,000 returns made without the assistance of UNHCR. *La'o Hamutuk Bulletin*, *supra* note 75.

77. *La'o Hamutuk Bulletin*, *supra* note 75, tbl.1.

78. U.N. Transitional Admin. in East Timor Reg. No. 2001/2, On the Election of a Constituent Assembly to Prepare a Constitution for an Independent and Democratic East Timor, UNTAET/REG/2001/2 (Mar. 16, 2001), *available at* http://www.un.org/peace/etimor/untaetR/reg20012.pdf [hereinafter Reg. No. 2001/2].

79. *See East Timor—UNTAET, Background*, *supra* note 67 (noting the Constituent Assembly's transformation into a national parliament).

80. *Id.*

81. *Background Note: Timor-Leste*, *supra* note 56.

82. *See Indonesia Temporarily Closes Border with East Timor*, FORBES.COM, (May 26, 2006), www.forbes.com/feeds/afx/2006/05/26/afx2775091.html (last visited April 1, 2011) (discussing the Indonesian president's closure of the Timor border).

83. *Background Note: Timor-Leste*, *supra* note 56.

84. *Id.* As noted above, presidential elections also took place in 2007, a month after the Parliamentary elections. This note will focus on the parliamentary elections, although the laws for the two were virtually the same with regard to enfranchisement of voters.

This election was the first in the cycle of normal and periodic elections required by the constitution and further articulated in national laws.[85]

B. *Enfranchisement of Voters*

Each of the three elections described above differed with regard to the enfranchisement of non-resident citizens and how voting was facilitated for this group in the case in which they were enfranchised. For the 1999 Referendum, since East Timor was not an independent country at the time of the election, there was no legal definition of citizenship.[86] The electoral laws had to create an approximate definition that consequently sought to be as inclusive as possible.[87] The definition included all persons over seventeen who were either born in East Timor, who had a parent born in East Timor, or who was a spouse of a person qualifying under either of these categories.[88] A second notable feature of the 1999 Referendum was the organization of voting and registration centers outside of the territory. Centers were located in several cities in Indonesia and Australia, as well as other external locations in which East Timorese were known to reside.[89]

In 2001, enfranchisement was similarly broad, but accommodations for external voting were eliminated.[90] The definition of eligible voters was similar to that in place in the 1999 Referendum.[91] The electoral law expressly stated, however, that, "All persons eligible to vote . . . who have registered in East Timor and who are present in East Timor on polling day may vote for the national representatives."[92]

The 2007 parliamentary and presidential elections not only did not offer external-voting opportunities but further restricted voter eligibility to residents of East Timor.[93] In this election, there was actually a legal definition of citizenship

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85. CONST. OF THE DEMOCRATIC REPUBLIC OF EAST TIMOR MAR. 22, 2002, § 65; Law on the Election of the National Parliament (Law 6/2006, art. 4.1) (Dec. 28, 2006), *available at* http://www.eastimorlawjournal.org/ East_Timor_National_Parliament_Laws/Law-2006-06.pdf.

86. Kanis Dursin, *Hundreds of Indonesians in East Timor Virtually Stateless*, JAKARTA POST, May 22, 2004, *available at* http://www.etan.org/et2004/may/15-21/22hundred.htm.

87. *See* Brett Lacy, *Building Accountability, Legitimacy, and Peace: Refugees, Internally Displaced Persons, and the Right to Political Participation*, INT'L FOUND. FOR ELECTORAL SYS. (IFES) 14 (2004), http://www.ifes.org/publication/024df7ba77f3bae87709edc67743fba8/08_04_Hybl_BrettLacy.pdf (describing in general the processes of external voting and how they "would include all those who had played a role in the territory's turbulent history").

88. U.N. Mission in East Timor (UNAMET), Agreement Regarding the Modalities for the Popular Consultation of the East Timorese through a Direct Ballot (May 5, 1999), *available at* http://www.un.org/peace/etimor99/agreement/agreeFrame_Eng03.html [hereinafter Agreement Regarding the Modalities].

89. The cities in Indonesia were Jakarta, Yogyakarta, Surabaya, Denpasar, and Ujung Pandang; in Australia, registration centers were located in Sydney, Darwin, Perth, and Melbourne. Registration and voting centers were also set up in Lisbon, Portugal; Maputo, Mozambique; Maucau; and New York. *See id.*

90. *See* Reg. No. 2001/2, *supra* note 78, § 5 ("All persons eligible to vote, as defined in section 30 of the present regulation, who have registered in East Timor and who are present in East Timor on polling day may vote for the national representatives.")

91. *Compare* Reg. No. 2001/2, *supra* note 78, § 30, *with* Agreement Regarding the Modalities, *supra* note 88.

92. Reg. No. 2001/2, *supra* note 78, § 5.

93. Law on the Election of the President of the Republic (Law 7/2006, art. 4.1) (Dec. 28, 2006), *available at* http://www.eastimorlawjournal.org/East_Timor_National_Parliament_Laws/Law-2006-07.pdf; Law on the Election of the National Parliament, *supra* note 85.

established by both the constitution and a specific law regarding citizenship.[94] This definition of citizenship differed from those used in the previous two elections but not in any way that would tend to disenfranchise Timorese living outside of the country.[95] Dual citizenship is permitted.[96] The election laws, however, enfranchised only those citizens "residing in the national territory."[97]

C. *Analyzing the Legal and Normative Right to Vote in the Context of the East Timor Elections*

The three elections discussed above offer an ideal opportunity to explore the issue of non-resident citizen voting rights. The distinct types of elections, the changing nature of the non-resident citizen population, and the concurrent changes in the laws enfranchising this group of people all provide useful avenues for considering how the right to vote should be viewed both legally under international human rights law and normatively under a theoretical analysis of political community makeup. The fact that these three distinct elections all occurred recently and in the same country highlights the significance that changes in the above-mentioned factors play in considerations of non-resident citizen voting rights.

The first issue that is immediately apparent upon consideration of the Timor examples is the legal limitation caused by attaching the right to vote to citizenship in international human rights law. For the 1999 Referendum and the 2001 Constituent Assembly—votes of unquestionable importance to the future of the country—the legal identity of a Timorese citizen did not exist. Therefore, under any reading of the language of the covenant, Article 25 of the ICCPR is inapplicable to these two elections. It is striking that elections of such fundamental significance would fall outside of the scope of Article 25.[98]

Assuming that Article 25 of the ICCPR could be applied to the 1999 Referendum, however, the question then becomes whether a restriction that disenfranchised non-resident "citizen" voters is unreasonable as a matter of international human rights law and/or normatively undesirable as a theoretical matter. The standard articulated by the Human Rights Committee in *Gillot v.*

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94. CONST. OF THE DEMOCRATIC REPUBLIC OF EAST TIMOR Mar. 22, 2002, § 3; Law on Citizenship (Law 9/2002), *available at* http://www.eastimorlawjournal.org/East_Timor_National_Parliament_Laws/Law-2002-09.pdf [hereinafter Law on Citizenship].

95. *Compare* Reg. No. 2001/2, *supra* note 78, § 30, *and* Agreement Regarding the Modalities, *supra* note 88, *with* CONST. OF THE DEMOCRATIC REPUBLIC OF EAST TIMOR MAR. 22, 2002 § 3, *and* Law on Citizenship, *supra* note 94.

96. Law on Citizenship, *supra* note 94, § 5.

97. Law on the Election of the President of the Republic, *supra* note 93, art. 4.

98. These elections, and the 1999 Referendum in particular, seem likely to fall under the scope of Article 1 of the ICCPR. Article 1 grants that, "All peoples have the right of self-determination. By virtue of that right they freely determine their political status . . . ." ICCPR, *supra* note 2, art. 1. Article 1 does not explain how that right is to be carried out; the general view, however, is that it relies on other articles—Article 25 in the case of elections—for the instantiation of the right. Anna Batalla, *The Right of Self-Determination—ICCPR and the Jurisprudence of the Human Rights Committee* (preserved at Unrepresented Nations and Peoples Org. Symposium, *The Right to Self-Determination in International Law* (Sept. 29–Oct. 1, 2006)), *available at* http://www.unpo.org/downloads/ AnnaBatalla.pdf. *Gillot v. France,* for example, also dealt with a self-determination vote; the Human Rights Committee analyzed the issue primarily from the right established under Article 25. *Gillot*, *supra* note 9, paras. 12.1–13.16.

France is helpful in considering this question: Would a residency restriction in the 1999 Referendum have "the purpose or effect of restricting in a disproportionate manner, given the nature and purpose of the referendums in question, the participation of the 'concerned' population?"[99] Baubock's stakeholder model will likewise be useful in analyzing the issue.

The composition of the non-resident Timorese population at the time of the Referendum is the first issue that must be addressed in order to begin the analysis. The "concerned population" unquestionably includes people that have fled the country for fear of persecution.[100] As mentioned above, many of the top leaders of the political party Fretilin were abroad until after the Referendum.[101] Given the many instances of violence known to have been committed by the Indonesian Army during the twenty-five-year period in which Indonesia controlled East Timor, it is inevitable that people fled the country in fear of persecution.[102] At the same time, however, the UNHCR notes no refugee problem in Timor prior to the Referendum.[103] Other Timorese were also undoubtedly out of the country because they were working or studying, not because of a fear of persecution.[104] When the grant of voting rights is considered on a general basis for all non-resident citizens, to what extent should the proportional *number* of people with a particularly strong interest in the outcome of the election determine whether or not the right is extended?

While the number of people abroad as refugees[105] may not have been significant, they undoubtedly had a strong stake in the outcome of the election (to invoke the stakeholder position articulated by Baubock).[106] Indeed, for many the outcome of the election would decide whether they would be able to return to their home country.[107] In that sense, they can be said to be "governed by" the outcome of the election in some very real sense. Baubock's stakeholder model would seem to support the conclusion that this group should be enfranchised in the election. This conclusion is readily apparent, but it is important to note that many of the people with the strongest claims of interest in the election have been absent from the country for twenty-five years. This extended absence highlights an issue raised

99. *Gillot, supra* note 9, para. 14.2.

100. *See id.*, para. 13.16 (presenting the Committee's belief that limiting participation in local referendums to those that have proven sufficiently strong ties to the territory would not be unreasonable).

101. *See supra* note 74 and accompanying text.

102. *The United Nations and East Timor—A Chronology*, *supra* note 73; *see supra* note 66 and accompanying text.

103. *The United Nations and East Timor—A Chronology*, *supra* note 73.

104. The voting centers set up for the 1999 Referendum are indicative of the places in which Timorese were known to reside outside of the country. The presence of centers in multiple Indonesian cities demonstrates the fact that Timorese were spread throughout Indonesia. *See* Agreement Regarding the Modalities, *supra* note 88, E(b) (providing that registration centers would be set up in the Indonesian cities of Jakarta, Yogyakarta, Surabaya, Denpasar, and Ujung Pandag).

105. I use the word "refugees" to indicate a general notion of someone abroad because of fear of persecution, not as a legal term of art.

106. *See* INTERNATIONAL ORGANIZATION FOR MIGRATION, CASE STUDIES ON THE PARTICIPATION OF CONFLICT FORCED MIGRANTS IN ELECTIONS 56–57 (2003), *available at* www.geneseo.edu/~iompress/PEP%20Case%20Studies%202003.pdf (noting that the estimate of the external vote was only 30,000, but also noting that there were at least 40,000 internally displaced refugees).

107. *See, e.g.*, *Exiled Leader Returns to Timor*, BBC NEWS, Dec. 1, 1999, http://news.bbc.co.uk/2/hi/asia-pacific/544415.stm (reporting on the return of political leader Jose Ramos Horta after twenty-four years of exile, following the independence of East Timor).

earlier that generalized arguments in favor of disenfranchising non-residents after a certain number of years, based on a perceived disinterest in the election, is not applicable in all countries and for all elections.

The other part of the HRC's standard for determining the reasonableness of residency restrictions is based on the nature and purpose of the referendum. The purpose of the 1999 Referendum was to determine the future political status of the territory as an independent nation or autonomous region within the country of Indonesia.[108] This referendum therefore falls under any of the characterizations that empirically have resulted in the enfranchisement of non-resident citizens or that normatively support such enfranchisement: post-conflict, transition to democracy, and vote for independence.[109] East Timor, together with South Africa, Eritrea, Cambodia, Iraq, and Kosovo, is an example of a country in which voting rights were expanded abroad to include non-resident citizens in elections that determine independence or establish a post-conflict democratic government.[110]

Given the significance of the 1999 Referendum, and the fact that many abroad had such an invested interest in the outcome of the election, this referendum exemplifies the type of election in which non-resident citizens should have a right to vote both as a legal matter under international human rights law and as a normative matter under any of the theories articulated in the previous section. This conclusion highlights the problem with attaching the right to vote under international human rights law to citizenship.

The 2001 Constituent Assembly elections were also conducted without an official definition of citizenship and therefore fall outside of the scope of Article 25 of the ICCPR.[111] Nevertheless, assuming *arguendo* that the ICCPR was applicable in this election, the legal and normative conclusions for non-resident "citizen" voting rights are substantially less clear than in the case of the referendum. The nature and purpose of the Constituent Assembly election was truly transformational: it was both to elect individuals that would draft the Constitution and to elect a body that would serve as the legislature.[112]

The nature of the non-resident "citizen" population also differed from the 1999 Referendum. The influential diplomatic front had returned to Timor, and many were in fact running as candidates in the election.[113] Many other Timorese had also

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108. *See* INTERNATIONAL ORGANIZATION FOR MIGRATION, *supra* note 106, at 56 (explaining the political history behind the referendum and its intent to allow the East Timorese to decide if they were going to be an independent nation or an autonomous region within Indonesia).

109. *See* IDEA HANDBOOK, *supra* note 23, at 11, 94 (citing instances of non-resident enfranchisement in independence elections as well as the historical use of external voting by non-residents in post-conflict transitions to democracy).

110. *Id.* at 11, 18–19; Ben Goldsmith, *Out-of-Country Voting in Post-Conflict Elections*, ACE PROJECT: THE ELECTORAL KNOWLEDGE NETWORK, *available at* http://aceproject.org/today/feature-articles/out-of-country-voting-in-post-conflict-elections (last visited May 17, 2010).

111. *See East Timor—UNTAET, Background*, *supra* note 67 (describing the Constituent Assembly's mandate of "writing and adopting a new Constitution and establishing the framework for future elections and a transition to full independence).

112. *Id.;* Lurdes Silva-Carneiro de Sousa, *Some Facts and Comments on the East Timor 2001 Constituent Assembly Election*, 8 LUSOTOPIE 299, 300 (2001), *available at* www.lusotopie.sciencespobordeaux.fr/desousa.pdf.

113. Most of the top leadership of Fretilin consisted of individuals that had resided abroad during the Indonesian occupation. INTERNATIONAL CRISIS GROUP, *supra* note 63, at 3.

returned to the country after its separation from Indonesia.[114] On the other hand, there were still a number of Timorese refugees located in West Timor, where they fled following the post-Referendum violence.[115]

Given the presence of a large number of refugees and the transformative nature of the election, there is a strong argument that the non-resident citizen population ought to be given the right to vote in the Constituent Assembly election as a matter of international human rights law. The determination that the Constituent Assembly election presents a strong enough case that voting for non-resident citizens could be considered a legal right under international human rights law (again ignoring the problem of citizenship) raises the question of whether, or to what extent, this obligates the state to facilitate this right. Would facilitating voting in the refugee camps in West Timor satisfy this requirement, or would broader voting opportunities provided in locations where many Timorese continued to reside also be required? If the right to vote is based on a conception of the non-resident citizen population as refugees, then non-refugees would have the benefit of voting even if that subjective interest did not apply to them. But in terms of facilitating the vote, the question that this point raises is whether the state is obligated only to facilitate the vote for that group whose situation was considered when establishing the legal right to vote under international law, or whether it must include all of the non-resident citizen population.

The 2007 Parliamentary and Presidential elections represent the start of normal, periodic elections governed by a constitution and laws defining citizenship.[116] Furthermore, the refugee crisis had been resolved.[117] In considering the nature and purpose of the election, the restriction of voting rights to residents is unlikely to be considered a violation of international human rights law. While many non-resident citizens likely maintain interests in Timor such that extending voting rights to them may be legitimate as a normative matter, their interest does not rise to the level that it did in the case of the 1999 Referendum and also arguably in the case of the 2001 Constituent Assembly election. The violence that erupted in the year before the election, however, raises several questions. While there is no empirical evidence

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114. UNITED STATES COMMITTEE FOR REFUGEES AND IMMIGRANTS, U.S. COMMITTEE FOR REFUGEES WORLD REFUGEE SURVEY 2001—EAST TIMOR, June 20, 2001, *available at* http://www.unhcr.org/refworld/docid/3b31e16118.html (describing the repatriation process and efforts through 2001).

115. An International Federation for East Timor report states that "[a]pproximately one-tenth of the East Timorese population is excluded not only from registration and voting, but from the entire nation-building process. The approximately 80,000 East Timorese people still trapped in refugee camps and elsewhere in West Timor and Indonesia have just as much right as the rest of the compatriots to participate in the development of their soon-to-be independent nation, and we urge all relevant authorities to redouble their efforts to enable them to do so." Press Release, International Federation for East Timor, 2001 Constituent Assembly Elections Observer Project (Sept. 3, 2001), *available at* http://www.etan.org/ifet/2001plus/op01eng.html.

116. The Presidential election is the second such election, although it is the first for East Timor as an independent nation. *See World Briefing–Asia: East Timor: Gusmão Wins Presidency*, N.Y. TIMES, Apr. 18, 2002, *available at* http://www.nytimes.com/2002/04/18/world/world-briefing-asia-east-timor-gusmao-wins-presidency.html (reporting on the presidential election prior to the enforcement of the Constitution, which came into effect in May 2002); CONST. OF THE DEMOCRATIC REPUBLIC OF EAST TIMOR §§ 81(3), 93 (requiring elections for both the president and parliament every five years); *see also id.*, §3 (defining citizenship).

117. There was a serious problem with internally displaced persons but the electoral laws took this problem into consideration. *See supra* notes 93–97 and surrounding text (limiting voting rights to residents); Lacy, *supra* note 87 (noting that almost one-third of the population was internally displaced).

indicating that any significant number of Timorese fled the country following independence, non-resident Timorese likely had family members that were affected by the violence and perhaps even living in IDP camps throughout the country.[118] These non-resident citizens therefore may have felt a strong stake in the election, since the political leaders in control of the government were widely blamed for causing the problems that led to the violence.[119] Nevertheless, this paper argues that such an indirect interest, while perhaps legitimate as a normative matter, is not sufficient to create a right to vote under the international human rights law.

Overall, in understanding the right to vote for non-resident citizens, these three elections highlight the importance of the type of election and the nature of their reasons for absence from the country. These two factors, with the addition of the possible requirement to facilitate voting, should be balanced in reaching a conclusion regarding how the right to vote should be perceived in each election. This paper supports such a balancing standard, as opposed to any bright line rules, as the best method for determining whether non-resident citizens should be given the right to vote under international human rights law.

CONCLUSION

This paper has argued for the applicability of international human rights law to the debate over non-resident citizen voting. The International Covenant on Civil and Political Rights enshrines the right to vote as a fundamental human right, although it bases this right upon a particular notion of membership in a political community: citizenship. Article 25 of the ICCPR allows for reasonable restrictions to the extension of voting rights; the right to vote therefore should not be considered universally applicable to all citizens but rather qualified on the basis of the strength of citizens' stake in the outcome of the election.

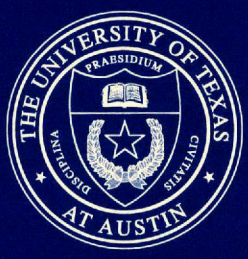
Furthermore, this paper has argued that the right to vote under international human rights law should be determined on the basis of the nature of the election and the interests of the non-resident citizen population in the election. Such a standard is consistent with both an opinion articulated by the Human Rights Committee on a separate but related matter and with the stakeholder arguments regarding membership in a political community.

This paper has highlighted a tension present in both the scholarship and in the standard articulated in the ICCPR and by the Human Rights Committee, which is that any attempt to create an objective standard based on generalized conceptions of the interests of the non-resident citizen population will necessarily always be either over- or under-inclusive. The HRC opinion in *Gillot v. France* provides the best articulation of an objective standard for considering this issue, which avoids bright lines that unnecessarily project a particular conception of non-resident citizenship on countries and elections to which it does not apply. This tension will remain to some extent, but it can be minimized by a particular consideration for the facts and

118. *See Timor-Leste*, INTERNAL DISPLACEMENT MONITORING CENTRE, http://www.internal-displacement.org (select "Timor-Leste" from "Country Pages" dropdown menu) (estimating that 150,000 people were displaced as a result of the 2006 violence in East Timor) (last visited Mar. 24, 2011).

119. *See* INTERNATIONAL CRISIS GROUP, *supra* note 63, at 1 (stating that Alkatiri and Lobato, Fretilin Vice President, are responsible for the violence of 2006).

circumstances of each case. The example of East Timor highlights the importance of such an individualized consideration and of the questions that will be raised when conducting such an analysis.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