A Prohibition on Discretion Under Section 304(B)
of the Bankruptcy Code

Sarika Kapoor
A PROHIBITION ON DISCRETION UNDER SECTION 304(b) OF THE BANKRUPTCY CODE

by Sarika Kapoor*

INTRODUCTION

Bankruptcy law is designed to allow creditors to vindicate their rights in a single forum where the debtor’s affairs can be sorted out.¹ This body of law seeks to protect creditors and to ensure the maximum possible return on their investment when the debtor/borrower files for bankruptcy.² The law is designed to give creditors some incentive to lend money to debtors who may never repay them. The procedure that bankruptcy law follows reassures creditors that the debtor does not have, nor is attempting to hide other assets.³ Bankruptcy law concerns itself with the creditors’ ability to use laws to recover what they are owed. Outside bankruptcy, creditors are limited in what they can do to collect on their loans. It is primarily for this reason that creditors are concerned that they receive the due priority of their claim when the debtor files for bankruptcy.⁴

---

¹ Ms. Kapoor is a student at the Hofstra University School of Law. She would like to express her deep gratitude to Professor Alan Resnick of the Hofstra University School of Law for his guidance, encouragement and invaluable expertise in bringing this Note to fruition.


³ L. KING & M. COOK, CREDITORS’ RIGHTS, DEBTORS’ PROTECTION AND BANKRUPTCY 777 (1985)

⁴ BANKRUPTCY REFORM ACT OF 1978 (THE “BANKRUPTCY CODE” OR THE “CODE”) § 707(b), 11 U.S.C. §§101-151, 326 (2002). § 707(b) of the Bankruptcy Code allows the bankruptcy judge to deny debtors a fresh start if the fresh start would work a substantial abuse of the bankruptcy process. 11 U.S.C. § 707(b) provides, in complete form, as follows:

After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions [that meet the definition of “charitable contribution” under section 548(d)(3)] to any qualified religious or charitable entity or organization [as that term is defined in section 548(d)(4)].
From this perspective, therefore, creditors' rights and remedies should be emphasized.5

The United States Bankruptcy Code does not limit itself to the debts of an individual debtor; corporations, too, may file.6 The eligibility requirements of section 109(a) are also applicable to an insolvency proceeding, including liquidation and reorganization.7 Generally, all interested parties8 would prefer seeing the corporate entity continue in existence if it is at all possible to save the business.9 Consequently, Chapter 1110 is often the preferred solution for corporate debtors because it keeps people employed, promises a higher return and more money to creditors than liquidation, and corporate shares may retain some value.

The legislative history is replete with discussions of developing policies to “protect the investing public, protect jobs, and help save troubled businesses.”11 This helps further “overriding community goals and values” in bankruptcy12 of “the public interest” beyond the interests of the claimants.13 The legislative history also acknowledges that it is more “economically efficient” to reorganize than to liquidate a company.14

Often, many American companies incorporate in a foreign jurisdiction in order to reap the maximum tax benefits possible in tax haven jurisdictions

---

5 BAIRD, supra note 1, 33 (While bankruptcy law seeks to provide creditors with remedies to collect on their investments, it also provides debtors with a fresh start. "Bankruptcy law allows creditors to scrutinize the debtor's affairs and, assuming no misbehavior is found, provides the debtor with a fresh start.").
6 11 U.S.C. § 109(a) (2002). Section 109(a) sets forth who may file for relief under the United States Bankruptcy Code. This section, read in conjunction with Section 101(41) defining “person” confirm that a person includes a corporation. 11 U.S.C. §109(a) provides, in complete form, as follows: "109. Who may be a debtor
(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title."
7 See id.
8 E.g., creditors, employees, stockholders.
9 Brian A. Blum, The Goals And Process Of Reorganizing Small Businesses In Bankruptcy, A J. SMALL & EMERGING BUS. L. 181, 223-24 (2000) (“The reason society may wish to see these businesses survive also seems self-evident at first glance: If the business is kept alive, there is a greater prospect that it will generate returns that will increase creditor recovery. Moreover, one may hope for benefits beyond that from survival of the business. Its rehabilitation may salvage all or some of the investment of its owners (whose interests in its survival are, of course, subservient to the claims of its creditors, but are nevertheless compelling), preserve all or some of its workers' jobs, and contribute to the well-being of the community in which it operates and to the economy at large.”).
10 Chapter 11 was enacted to further goals apart from the mere enhancement of claimants' wealth.
14 See supra note 11.
abroad. Regardless of why they seek to incorporate in an off-shore jurisdiction, generally, these same companies continue to conduct business in the United States and identify America as their principal place of business. For this reason, not only are their assets in the United States, but more importantly, their creditors are in the States as well. Since most creditors are located in America, the United States has a compelling interest in ensuring the administration of the ailing foreign corporation. Under the American bankruptcy system, simply by owning property in the United States, foreign incorporated corporations become eligible for filing bankruptcy in the States. Unfortunately, however, America has no mechanism of compelling these corporations to file bankruptcy in the United States. The current United States Bankruptcy Code recognizes that the state of incorporation, i.e., the foreign country, is also an acceptable place to dissolve the corporate entity.

Where the principal bankruptcy proceeding is in the foreign country, the foreign representative typically seeks to hold creditors (located anywhere) at bay while sorting through the debtor’s affairs and thoroughly administering the proceedings. A foreign representative must meet the Code criteria for the position. Then the foreign representative can utilize the four options to assist in protecting and administering assets of the foreign debtor located in the United States. First, the foreign representative can file a petition under Code § 304 to commence a case ancillary to the foreign proceedings (the “Ancillary Proceeding”). Second, the foreign representative can file an involuntary petition under Code § 303(b)(4) to commence either a full chapter 7 liquidation proceeding or a chapter 11 reorganization proceeding. Third, the foreign

15 A tax shelter is defined in several sections of the Internal Revenue Code (I.R.C.). One general definition is a “plan or arrangement if a significant purpose of such partnership, entity, plan or arrangement is the avoidance or evasion of Federal income tax.” I.R.C. § 6662(d)(2)(C)(iii)(III) (2002). The term “tax haven” specifically refers to a country which imposes little or no tax on income earned domestically or in foreign countries. See generally Connie Guang-Hwa Yang, Note, Taiwan’s Control Of The Tax Sheltering Use Of Tax Haven Base Companies: Substance Over Form Rule Or Subpart F-Type Legislation?, 31 COLUM. J. TRANSNAT’L L. 231 (1993).

16 It should also be noted that often these corporations are multi-national corporations. For all intents and purposes, these corporations have as their “home” jurisdiction a state of incorporation other than the United States. For a fuller discussion on “home” jurisdictions and transnational insolvencies, see, generally Robert K. Rasmussen, A New Approach To Transnational Insolvencies, 19 MICH. J. INT’L L. 1(1997).

17 Real property at the very least.

18 See supra note 7.

19 This Note highlights the significance of having a company file bankruptcy in the United States.


21 11 U.S.C. §101(23) (2002) provides, in complete form, as follows: “[F]oreign proceeding” means proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor’s domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization.”


Fourth, the foreign representative can seek dismissal of a pending bankruptcy case or suspension of all pending bankruptcy proceedings under Code § 305(a)(2).26

11 U.S.C. § 304 governs cases filed in bankruptcy courts that are ancillary to foreign proceedings.27 Section 304 deals with cross border insolvency proceedings. Because a section 304 proceeding does not commence a full bankruptcy case with all of the protections and benefits for a debtor that a full proceeding affords, the bankruptcy court saw no need to engraft the eligibility requirements of section 109(a)28 onto a section 304 proceeding.29 This is because it is only an ancillary proceeding that is designed primarily to supplement the principal bankruptcy proceeding abroad.30

11 U.S.C § 304(b) provides, in complete form, as follows:
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.

Under this section, the foreign representative must affirmatively request injunctive or other relief in order to preserve the status quo while the affairs of the corporate debtor are sorted out.31 Without personal jurisdiction over the creditor, the enjoinder of creditor action against the debtor and its assets under Section 362 of the Bankruptcy Code cannot be enforced.32 The foreign

27 See supra note 23.
28 See supra note 7.
30 See supra note 23.
31 See id.
representative seeks the assistance of the United States courts by asking that an
injunction similar to the scope of an automatic stay be implemented. This helps stop individual creditors located in America, who are not bound to the laws of the foreign jurisdiction, from taking actions that would thwart the reorganization or the liquidation of the foreign incorporated debtor corporation. Thus, if an affirmative request for an ancillary proceeding is not made by the foreign representative, upon notice of a bankruptcy proceeding abroad, American creditors would be able to attach to the debtor’s assets located in America in order to satisfy their claims. Clearly, this would not assist the administration of the bankrupt’s estate.

Under Section 304 of the Code, the Bankruptcy Judge has discretion in determining whether or not the United States will then (upon request) cooperate with the bankruptcy laws of the foreign jurisdiction in administering the foreign incorporated debtor’s estate. Generally, the United States bankruptcy courts will look at the factors set forth in 11 U.S.C. §304(c) to determine whether or not to become an arm of the bankruptcy court of the foreign jurisdiction.

If the foreign representative chooses not to request such relief, alternatively he can file a full scale involuntary petition in American courts under 11 U.S.C. §303(b)(4) which would then trigger an automatic stay. An involuntary proceeding means that a principal proceeding would be in the

33 11 U.S.C. §362 (2002). “Automatic stay” is defined as the statutory bar (that becomes effective immediately upon the filing of a voluntary petition under the Code) on “all debt collection efforts against the debtor or property of his bankruptcy estate” on account of a debt arising before the bankruptcy petition was filed. BLACK'S LAW DICTIONARY 134 (6th ed. 1990). There is, however, a lengthy list of exceptions to the automatic stay. See 11 U.S.C. §362(b) (2002).

34 BAIRD, supra note 1, 169

35 See id. (“Allowing creditors to take action during the bankruptcy proceeding would undermine bankruptcy’s pro rata sharing rule.”).


37 11 U.S.C. §304(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... ”)(emphasis added).

38 See supra note 24 (This section governs involuntary cases commenced “by a foreign representative of the estate in a foreign proceeding concerning such person.”).

39 Practicing Law Institute PLI Order No. A4-4282 November-December 1989 The Basics of Bankruptcy and Reorganization 1989 BASICS OF STAY OF COLLECTION ACTIVITIES David G. Epstein 517-PLI/Comm 633, 635 (The filing of a voluntary petition under Chapter 7, Chapter 11, Chapter 12, or Chapter 13, or the filing of an involuntary petition under Chapter 7 or Chapter 11 automatically “stays,” i.e., restrains, creditors from taking further action against the debtor, the property of the debtor, or the property of the estate to collect their claims or enforce their liens.).
United States and the American Bankruptcy laws would control. Although filed much less frequently than voluntary cases, the laws of the United States relating to bankruptcy authorize qualified creditors to take the initiative and file involuntary petitions against certain debtors who fail to pay their debts. Thus, under appropriate circumstances, creditors can force debtors into the federal bankruptcy courts.

Generally, American creditors prefer that the proceeding take place in the United States. The familiarity of the United States system makes it easier to accept the determination of a bankruptcy proceeding by an American trustee. Familiarity with the fair and respected policies of American bankruptcy law also allows for an efficient administration of the estate—one that is not only tolerated but accepted by creditors in America. American law is also preferred when adjudicating these claims merely because it is convenient. Undoubtedly, it is easier for a creditor to participate in a bankruptcy proceeding in the United States as opposed to a foreign jurisdiction. For these reasons, American creditors urge for their claims to be adjudicated under American bankruptcy law.

This Note contemplates and limits the proposed remedy to the following situation: the debtor corporation is incorporated in a foreign jurisdiction. Despite the foreign state of incorporation, its principal place of business remains in the United States. The majority of its assets, property, and creditors are also located in the States. However, the official state of incorporation remains a jurisdiction other than one that is subject to and bound by the bankruptcy laws of the United States. As such, the debtor corporation, rather than filing a bankruptcy petition in the United States, files the insolvency proceeding in the foreign state. On behalf of the foreign state, the foreign representative affirmatively requests the United States to implement a stay and become an arm of the bankruptcy court of the foreign jurisdiction.

Part I of this Note will explore the background of the current state of bankruptcy law as it involves foreign proceedings and urge for a non-discretionary regimen. Part II of this Note will examine Section 304(c) factors and analyze the different approaches taken by the American courts in deciding various requests for relief. Part III will propose the benefits, as well as the drawbacks, of adhering to a non-discretionary regimen in administering the assets located in America of a debtor filing the principal bankruptcy proceeding in a foreign nation. Finally, Part IV analyzes the effects of such an approach together with a forthcoming solution—legislation proposed by the United States.

---

40 See supra note 36.
41 Practicing Law Institute PLI Order No. A4-4316 September 13-14, 1990 International Commercial Agreements 1990: Handling Basic Problems in Negotiating, Drafting, and Litigating BANKRUPTCY AND THE PROBLEMS OF MULTI-JURISDICTIONAL WORKOUTS Martin N. Flics Michael J. Ireland 553 PLI/Comm 175 (“Both U.S. debtors and creditors may prefer U.S. bankruptcy jurisdiction because familiarity with the U.S. system may make it easier to gauge the results of a bankruptcy here. In addition, it would probably be more convenient for a U.S. party to participate in a bankruptcy administered in the United States, and the automatic stay is probably farther reaching than any stay that could be obtained in a foreign court.”).
House of Representatives which seeks to affect the way said ancillary proceedings are initiated and conducted in United States courts. Congress seeks to adopt a new Chapter 15 to the Code to govern ancillary cases and other cross border insolvency matters via this legislation.


The present Bankruptcy Code recognizes the need to maintain a fair relationship between debtors and creditors. One of the primary concerns of the Bankruptcy Code is to protect and preserve the rights of creditors. Under section 304 of the Bankruptcy Code, a foreign representative is permitted to institute a proceeding in the United States ancillary to a foreign bankruptcy action. This section essentially opens the United States Bankruptcy courts to proceedings ancillary to foreign insolvency proceedings, where the entity that is subject to foreign proceedings qualifies for insolvency administration under foreign law, but does not fall within the Code’s definition of “debtor.” Section 304 allows the bankruptcy court to enjoin any action or proceeding in the United States against the debtor with respect to property involved in the foreign proceeding or against such property, to require the turnover of property of the estate to the foreign representative, or to order any other appropriate relief.

The objective of turning over property or granting any other relief is to allow the foreign representative to seize the property located in America and thereafter distribute the property through the processes of the foreign proceeding. Once a claim by a foreign representative is filed in American courts, Section 304 (b) provides for various remedies including an order to turnover the property to the foreign representative for administration by all creditors. However, the turnover of property remedy is subject to the provisions of section 304(c). Thus, while the court is permitted under subsection (b) to order the turnover of such property in order to administer the assets located in America, and to prevent dismemberment by local creditors of assets located here, under

---

43 11 U.S.C. §101(10) (2002). The Code defines a creditor as an entity that has a claim against the debtor which arose at the time of or before the order of relief concerning the debtor, and in certain conditions, even after the petition was filed. A “claim” means the right to payment whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed undisputed, legal, equitable, secured or unsecured, or the right to an equitable remedy. 11 U.S.C. §101(5) (2002).
44 Cunard S.S. v. Salen Reefer Servs., 773 F.2d 452 (2d Cir. 1985) (The guiding premise of the Bankruptcy Code, like its predecessor, the Bankruptcy Act is the equality of distribution of assets among creditors.).
45 See supra note 23.
46 See supra note 37.
48 See infra text accompanying note 52.
49 Based on proper methods of statutory interpretation, under the plain meaning of the statute, subsection (b) of Section 304 uses the word “may” to describe what relief the court may grant, if it

126
the provisions of subsection (c), American courts are required to consider several factors in determining whether to turnover such property. Subsection (c) provides the principles by which the bankruptcy courts are to be "guided" in exercising their discretion whether or not to grant relief.

Section 304(c) provides in complete form:

In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—

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

The aim of section 304 is to promote the "economical and expeditious" administration of the foreign estate consistent with the factors enumerated in section 304(c). While the statute accords primacy to no one of these factors, many courts have taken a variety of approaches towards accommodating foreign bankruptcy proceedings including emphasizing comity to the practical exclusion of other Section 304(c) factors.

Under this approach judges are involved in a rather extensive analyses researching and comparing the laws of the foreign jurisdiction with those of the United States and applying subjective views to already sensitive facts. In

chooses to grant relief at all. However, if the court chooses to grant relief, it is required to do so "subject to the provisions of subsection (c)." This is because subsection (c) contains the word "shall" imposing a mandate thereby leaving no room for discretion.

See supra note 36. § 304(c) provides in pertinent part: "In determining whether to grant relief under subsection (b) the court shall be guided by what will best assure an economical and expeditious administration of such estate..." (emphasis added).

See id.

See id.

See id.


Silverman, supra note 53, at 399-400 ("The court in an ancillary proceeding is free to mold appropriate relief in near blank check fashion." (citing In re Culmer, 25 Bankr. 621, 624 (Bankr.)

127
essence, the bankruptcy judge must decide which forum, the United States court or the foreign jurisdiction court, should process the claims of the American creditor. If the bankruptcy court so decides, it can remit all of the United States’ creditors to the foreign jurisdiction where the principal proceeding is filed. Consequently, removing discretion from the hands of the American judges, when dealing with foreign ancillary proceedings would not only facilitate the analysis of determining which jurisdiction’s laws to comply with of whether to have the insolvent’s estate administered locally or abroad, with bright line rules but would promote the policies behind section 304 as well.

Discretion takes time and thwarts the expeditious administration of the bankrupt’s estate. It is unnecessary for the determination of whether to turnover assets (or grant other appropriate relief) located in America to be bound by the factors and considerations outlined in section 304(c). Removing discretion from the hands of the American bankruptcy judges will have the double benefit of not disappointing those who are expecting precision from an analysis of these factors because an analysis of section 304(c) factors inherently involves a subjective interpretation and evaluation of these factors. In sum, there is no need for a statutory mandate in turning over the foreign debtor’s property located in the United States. American judges can, after evaluating factors outlined in section 304(c), prevent a stay from being implemented. Similarly, they can compel creditors located in America to address their claim in the jurisdiction of the principal proceeding. In an effort to adopt a more homogenous and predictable outcome, there should be a general prohibition on discretion under section 304 of the Bankruptcy Code. American judges and/or trustees should not be afforded discretion when determining whether or not the United States will cooperate with the bankruptcy laws of the foreign jurisdiction, i.e., the place of the principal bankruptcy proceeding.

Discretion in providing a section 304(b) remedy, e.g., in ordering the turnover of property to the foreign representative, should be prohibited because American courts should not be compelled to determine whether to grant turnover requests. Assuming that the foreign tribunal would apply American substantive law in the first instance, the American creditor might nonetheless be confronted with the argument that the distribution scheme under the foreign bankruptcy law would not recognize the American creditor’s rights, particularly one attempted after the filing of the foreign bankruptcy petition. For this

56 See supra text accompanying note 37.
58 See Douglass G. Boshkoff, United States Judicial Assistance in Cross Border Insolvencies, 36 INT’L & COMP. L.Q. 729, 745 (1987) (“The turnover of assets has been called the ultimate test of a U.S. court’s willingness to cooperate with a foreign proceeding.”).
59 See supra note 37.
60 One such creditor’s right is the right to a set off. A “set off” is defined as “a debtor’s right to reduce the amount of a debt by any sum the creditor owes the debtor; the counterbalancing sum owed by the creditor.” BLACK’S LAW DICTIONARY 640 (2d ed. 2001).
reason, such requests should generally be refused, if not for any other reason but that the goals of section 304(c) would otherwise be overlooked.

Under the current bankruptcy law, essentially the only requirement for being able to file bankruptcy in America is ownership of property. However, the presence of property in the United States is not a requirement for invoking section 304. The district court in *Haarhuis v. Kunnan Enterprises, Ltd.*, was presented with a section 304 proceeding that was filed to enjoin a specific civil contract action that was pending against the foreign debtor in that district. The Plaintiff in the pending action argued that the bankruptcy court had no jurisdiction under section 304 if the foreign debtor had no property or business presence in the United States. The district court held that a section 304 proceeding need not meet the qualifications of a “debtor” under the Code. It stated:

[ILL IN fact, to hold the presence of property in the United States to be a jurisdictional prerequisite under section 304 would diminish much of its usefulness as an adjunct to foreign insolvency proceedings. Foreign representatives might have no interest in protecting a foreign debtor’s assets of negligible value, yet be vitally concerned with defending the corpus of a foreign debtor’s estate abroad against a U.S. judgment that would likely be given recognition in the foreign proceeding.]

Although owning property in America is not a prerequisite for invoking section 304, many debtors that file bankruptcy in a foreign jurisdiction also have some asset in the United States that American creditors compete to seize to secure their claims. Allowing discretion in the hands of judges is too risky and prejudicial to American creditors who, at the very least, may be inconvenienced, by having to pursue their claims abroad. It is by abolishing the discretionary mandate of section 304 to turn over the foreign debtor’s property that, even after a fair and proper assessment of section 304(c) factors, the underlying goals of 11 U.S.C.S. §304, an economical and expeditious administration of each estate, be fully served.

II. SECTION 304(C) FACTORS AND COMPETING APPROACHES FOR DETERMINING REQUESTS FOR RELIEF

11 U.S.C. §304 was designed by Congress as an efficient and less costly alternative to commencing a plenary proceeding. It is therefore limited to proceedings aimed at aiding the principal proceeding abroad. Among the remedies provided for a section 304 petition is the turnover of property of the

---

61 See supra note 6 (stating that only persons who reside, are domiciled, own property, or have a place of business in the United States can be debtors).
63 See id. at 254.
64 See *Haarhuis*, 223 B.R. at 255.
foreign estate or the proceeds of such property, to the foreign representative. The decision to employ any of these remedies, however, must be made within the ambit of section 304(c) factors.65

The legislative history of section 304 is helpful in its statement of the general purpose of section 304. However, it is sparing in its specific guidance. House and Senate Reports accompanying the legislation observe that the section 304(c) factors are “[g]uidelines ... designed to give the court maximum flexibility in handling ancillary cases” and that “[p]rinciples of international comity and respect for the judgments and laws of other countries suggest that the court be permitted to make the appropriate orders under all of the circumstances of each case, rather than being provided with inflexible rules.”66

The Congressional purpose behind section 304(c) was to mediate between two conflicting approaches in dealing with international insolvencies.67 Since the adoption of this section by Congress in 1978, American courts have emphasized different factors in resolving whether cooperation with the foreign bankruptcy proceeding is satisfactory. Among the more popularly cited factors is comity. Comity is “the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other person [sic] who are under the protection of its laws.”68

The underlying rationale of comity extends and ties in with another §304(c) factor: protection of claim holders in the United States against prejudice and inconvenience in the procession of claims in such foreign proceeding.69 Courts sometimes pay particular attention to whether, under the foreign bankruptcy law, United States creditors would have the ability to pursue their rights to at least the extent that American courts would permit and whether the United States creditors would be similarly protected under the foreign bankruptcy laws.

There are three main approaches to dealing with international bankruptcies involving multi-national debtors and cross-border insolvencies:

1. Traditional approach70
2. Economical and expeditious approach71
3. The balanced approach72

Under the traditional approach, the judge simply ignores the interests of the foreign bankruptcy proceeding. This proceeding is also more commonly

---

65 See supra note 48.
69 See supra text accompanying note 51.
71 Id. at 531.
referred to as “territorialism.” Here, the focus is on the United States creditors and the concern is equal protection for the American creditors. This approach “uses local assets to satisfy local claimants in local proceedings with little regard for proceedings or parties elsewhere.”73 Most requests for turnover of assets are denied under this approach especially if it can be shown that the American creditors’ claims would not receive the same priority it is entitled to under United States law. Under this approach, while comity is not completely disregarded, it is not given total deference either; it is within a court’s discretion, even though courts are biased against the foreign proceeding.

Under the economical and expeditious approach, the judge emphasizes international comity to best assure the expeditious administration of the debtor's estate.74 This approach does not deem local creditors to be a determinative factor; rather, the focus is on international comity. It seeks to promote both equality and maximization to recover for all creditors, irrespective of where they are located.75 Therefore, unless the foreign based rights are substantially prejudicial to the American creditors, the American judge will often allow foreign courts of competent jurisdiction to adjudicate and resolve the debtor’s estate. The Supreme Court, however, has recognized that deference to foreign courts is due “whenever extending comity will neither violate domestic public policy nor prejudice the rights of United States citizens.”76 The mere fact that the laws of the foreign jurisdiction do not mirror United States’ law does not violate U.S. public policy.77

In Emory v. Grenough, the Plaintiff was a native of Massachusetts, who contracted a debt to the Defendant, who was also a resident of that state. Subsequently, the Plaintiff moved to Pennsylvania, and filed a bankruptcy petition (which, in its terms and operation, was analogous to the bankruptcy laws of England). His debts were duly discharged, and he then returned to Boston. Upon return, the Defendant had him arrested for the old debt. The Plaintiff sued,78 and appealed his discharge decree. The court overruled the plea, judgment was entered for the Plaintiff, and the Defendant subsequently appealed. The Appellate Court held that “by the courtesy of nations, whatever laws are carried into execution, within the limits of any government, are considered as having the same effect everywhere, so far as they do not occasion a prejudice to the rights of the other governments, or their citizens.”79 This full faith and credit mentality became the grounds for what is more commonly referred to as “universalism.”80

73 See Maxwell Communications, 170 B.R. at 816.
74 See supra note 70, at 408.
76 Emory v. Grenough, 3 U.S. 369 (1797).
77 Id.
78 Defendant then caused the suit to be moved from State to Circuit Court.
79 See Emory, 3 U.S. at 370 n.1.
80 See Maxwell, 170 B.R. at 816.
Finally, the balanced approach argues that the United States should utilize and review all of the criteria set forth in Section 304(c) by Congress for judicial consideration. A balanced approach would arguably best carry out the legislative intent. In arguing that the focus on comity and essentially the dismissal of other section 304(c) factors is wrong, Professor Ronald J. Silverman writes:

Had the legislature intended to make comity a pre-eminent element, it would have been simple enough to have added comity to the initial phrasing of Section 304(c)....However the legislature did not so emphasize comity; in fact, comity was relegated to a position far down the list of factors, to numerical position five...by inference it is clear that the other factors do not represent a mere enumeration of the elements included within the comity doctrine....

This approach begs for an equal assessment of all factors, i.e., a more balanced approach.

Whatever the approach adopted, all American bankruptcy courts are guided by the purposes of section 304 to avoid a piecemeal distribution of assets. The injunctive power of section 304 can be used to enjoin enforcement actions that would dismember assets of the estate in the United States, one of the stated purposes for a section proceeding in its legislative history. Removing the discretion from the hands of American judges when deciding whether to provide section 304 relief to the foreign trustee will not compromise the underlying goals and policies of bankruptcy law and, in particular, section 304 petitions. Consequently, a bright line approach, that is, a nondiscretionary scheme, should be adopted because the few detrimental effects are clearly outweighed by the many benefits it provides.

III. A NON-DISCRETIONARY REGIMEN

In applying section 304, bankruptcy courts have continued to show “a distinct judicial preference for deferring to the foreign tribunal litigation respecting the validity or the amount of the claims against the foreign debtor.”

---

82 See id. at 409-10.
83 For a discussion on the general preference in the American system of avoiding a piecemeal approach, see, Frederick Tung, Is International Bankruptcy Possible?, 23 MICH. J. INT’L L. 31, 35 (2001) (“States have traditionally pursued a territorial approach. Each state applies its own laws with respect to the debtor's assets and creditors within its own borders. The result is a piecemeal, territorial disposition of the firm's assets and uncoordinated, territory-based distribution of value to creditors, in which each territory typically favors local creditors. This territorial approach has long been the bête noire of international bankruptcy scholars, on both efficiency and fairness grounds.”).
84 See supra note 64, at 35.
85 In re Rubin, 160 B.R. 269, 283 (Bankr. E.D.N.Y. 1993) (qualifying the preference on the condition that the laws of the foreign jurisdiction are not repugnant to those of the United States and
Notwithstanding this announced preference, section 304(c) contains factors in addition to comity that the bankruptcy courts are directed to consider in evaluating requests for injunctive relief. While the current law has outlined factors to determine whether cooperation with a foreign jurisdiction for the administration of a multi-national debtor’s estate is warranted, as demonstrated above, the approach adopted by an American Judge rests primarily on how the underlying policies are interpreted. Discretion may be most consistent with one factor and concern outlined in the Code’s section 304(c) factors. However, discretion is unnecessary because a more objective and clinical analysis would reach the same result. Among the two competing approaches, courts should err on the side of adopting the territorialism approach.

Clearly, a non-discretionary regimen would run against the legislative intent. However, bankruptcy courts today continue to adopt an expansive view of section 304 in order to give the flexible rules of the statute any effect. While discretion allows for justice to be served on a case-by-case basis, judges are also concerned about crafting rules with minimal stretches of the law. The current approach suggests that the policy considerations that lie behind the precise balancing of debtor and creditor interests reflected in specific provisions in the Code will be absent from the analysis. To the contrary, under the non-discretion scheme, that is, a “bright line” test, the true intentions of the factors outlined in subsection (c) will be given effect.

There are many benefits in not allowing judges to arbitrarily decide whether to cooperate with the bankruptcy laws of a foreign jurisdiction. One such benefit is that in dealing with nations that would normally result in American judges allowing the suit to proceed in the foreign jurisdiction, a prohibition on discretion will not make a difference. Universalists might argue that having two proceedings, one in the foreign jurisdiction and the other in the States, is against the notions of judicial economy, because the equality of similarly situated creditors and the economy of judicial resources are of

---

further, arguing that comity should be withheld only when its acceptance would be contrary or prejudicial to the interests of the nation called upon to give it effect).

86 See supra text accompanying notes 50-53.
87 See discussion supra Part II and text accompanying notes 69-71.
88 See supra Part II.
90 See generally Chris Lenhart, Note, Toward A Midpoint Valuation Standard In Cram Down: Ointment For The Rash Decision, 83 CORNELL L. REV. 1821, 1868 (1998) (“Adopting a system of valuation that forgoes fact-intensive inquiries, which impose considerable transaction costs on debtors, creditors, and the judicial system, will promote the larger bankruptcy system goals of reducing litigation and maximizing the value in the bankruptcy estate.”).
91 See, supra text accompanying note 87.
92 “Arbitrarily deciding” is used to refer to the notion that discretion is, by definition, subjective. There is no method to a judge determining whether the United States will cooperate with a foreign jurisdiction.
93 Irrespective of the approach adopted by the Judge. See generally discussion supra Part II and text accompanying notes 69-71.

133
paramount concern under a universalist approach. However, given the policy rationales of bankruptcy law as a whole, i.e., maximum return on creditors' investment, the benefits of such an approach are outweighed by the burdens of judicial economy.

A case study is warranted to illustrate the effects of such an approach where the laws of the foreign jurisdiction and the American bankruptcy laws are parallel. When the foreign representative seeks the cooperation of the United States to prevent American creditors from having a claim to the American assets of the corporate debtor, section 304 is routinely invoked. For example, the Bahamas' laws are nearly identical to those of the United States, and which adopt a similar balancing approach that typically results in deference to Bahamian law. "In balancing these frequently competing concerns, courts will look to both the overall structure of the foreign law and the specific factual scenario a given case presents. Overall, as some of the cases indicate, the modern trend is to grant section 304 petitions under a much lower showing of similarity than early section 304 cases adopted." Removing discretion from the hands of judges in a United States-Bahamas insolvency proceeding would be more beneficial for American courts than Bahamian courts because, regardless of where the estate is administered, in the United States or the Bahamas, the result will be the same. The American judge, when deciding whether comity was warranted, already determined that while the law of the foreign jurisdiction may not be a "carbon copy" of the American system, in general, it comports with American laws and policies. In fact, only then will principles of comity be allowed to flourish because only at that time will due regard to the foreign laws be given.

For instance, in the often cited case, In re Culmer, a banking company which did not do business in the United States at the time liquidation was sought, but had accounts in United States banks, brought an ancillary proceeding to the liquidation proceeding in the Bahamas under 11 U.S.C. §304. The petition sought injunctive relief in addition to an order that property in the United States be turned over to the Bahamas for administration in the Bahamian liquidation proceeding, in accordance with Bahamian law. After application of all the factors in 11 U.S.C. §304(c), the court concluded that each factor was fulfilled; therefore, because the record was devoid of any evidence of prejudice and the legal requirements for affording comity to Bahamian proceedings had been satisfied, the court granted the petition. The court also granted the petition because the liquidation laws of the Bahamas were in harmony with

94 See supra note 23. See also, supra text accompanying notes 22-30.
96 Id.
97 In re Culmer, 25 Bankr. 621 (S.D.N.Y. Bankr. 1982). In re Culmer was the first case to rule on a turnover order under §304.
98 Id. at 623.
99 Id. at 627.
Those of the United States. Specifically, the court stated, "[t]his Court is satisfied that the Bahamian proceeding is inherently fair and regular." The court further announced that in its view the central issue for determination in a section 304 proceeding was whether the relief sought would afford equality of distribution of the available assets. The court found that the Bahamian proceeding satisfied both the principle of equality of distribution and the individual factors enumerated in section 304(c). The analysis of the Culmer court prompted the observation that section 304 grants bankruptcy courts the authority to mold relief "in near blank check fashion." According to the court, allowing these creditors to prevail over the relief requested by the Bahamian liquidators "would grant them preferences to which they were not entitled either in a Bahamian liquidation...or in a United States bankruptcy." A tangential benefit from such an approach is the prevention of a race to the bottom. In the absence of a bright line rule prohibiting the use of discretion in determining whether to grant a foreign representative's request to implement automatic stay, a similar race to the bottom is feared in this context as well.

The term 'race-to-the-bottom' refers to a progressive relaxation of standards, spurred by interstate competition to attract industry, that also occasions a reduction in social welfare below the levels that would exist in the absence of such competition. The widely accepted theoretical model for the race-to-the-bottom is non-cooperative game theory, of which the classic Prisoner's Dilemma is perhaps the most well-known example. According to this model, although all states would be better off if they each cooperated with each other by collectively maintaining optimally stringent standards, the incentives are such that each state will instead relax its standards in an ultimately unsuccessful bid to attract industry.

If "American" corporations are allowed to file bankruptcy in a nation other than the United States, American creditors risk losing control of American assets. Add to it the possibility that American judges might over value comity and defer to the foreign jurisdiction, American creditors are severely crippled in

100 Id.
101 Id. at 628.
102 Id.
103 Id. at 624.
104 Id. at 629.
106 Id. at 274.
107 See supra text accompanying note 64.
the "race to grab." A race to grab is one where creditors are permitted to obtain judicial liens on account of existing debts before other creditors or take property from the debtor. The race includes both physical grabs of property and grabs of judicial liens. The United States would be compelled to provide incentives to these corporations to file bankruptcy locally, in order to encourage American filings and to serve the policies and purposes of Bankruptcy law. For this reason, a non-discretionary regimen would be the optimal solution, as it would prevent a weakening of the American laws to match or parallel the foreign laws. A race to the bottom should be averted.

When a foreign nation is indifferent to the idea of corporate debtors filing for bankruptcy in the United States (or for that matter even urges them to file in the States), and the debtor files in the United States, Section 304 of the Bankruptcy Code no longer applies. Instead, a plenary bankruptcy proceeding is sought for the proper and complete resolution of the debtor's estate. When this occurs, a race to the bottom is averted in that American laws are no longer forced to weaken their laws to match those of the foreign competitors.

On the other hand, a foreign representative can, at his option, commence an involuntary case which would trigger an automatic stay. However, under this scenario, the foreign representative would be an ordinary creditor with an interest in all assets, including those located in America. Moreover even if the foreign representative decides to pursue this alternative of filing a full scale involuntary petition under 11 U.S.C. §303(b)(4) thereby triggering automatic stay, section 304 would not become applicable because section 304 only plays a role in ancillary proceedings. Automatic stay would require that the principal proceeding be held in the United States.

---

108 Todd Kraft & Allison Aranson, Transnational Bankruptcies: The Section 304 And Beyond, 1993 COLUM. BUS. L. REV. 329, 353-354 (1993) ("Forum selection in a universal system becomes more a question of convenience to the parties than a race to grab the property.").


110 See supra notes 2, 11-14 and accompanying text.

111 See supra note 108 at 173 n.57 (stating that "[i]n the international context, the race is not only among ordinary creditors, but also among national jurisdictions. While creditors protect their interests by moving as quickly as possible in their respective countries, the corresponding courts protect their national public policies by moving as quickly as possible to gain adjudicative power over debtors' assets before those assets are removed by debtor or foreign court action.").

112 See supra notes 27-30 and accompanying text.

113 See supra note 108.

114 11 U.S.C. §303(b)(4) provides, in complete form, as follows:

"An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title— ... (4) by a foreign representative of the estate in a foreign proceeding concerning such person."

The Revision Notes and Legislative Reports comment that a foreign representative may file an involuntary case concerning the debtor in the foreign proceeding, in order to administer assets in this country.

115 See supra notes 38-40 and accompanying text.
Under section 362 of the current Bankruptcy Code, it is required that hearings on motions for relief from the stay be held expeditiously to determine the issues arising out of the estate. In general, section 362 provides for an automatic stay immediately upon the filing of the bankruptcy petition.\textsuperscript{116} It prevents the continuation or commencement of any action or proceeding against the debtor, the enforcement of any judgment against it or its property, any act to obtain possession of its property or to exercise control over it, and any act to create or enforce a lien against the property.\textsuperscript{117} The rights of the parties affected by the stay are not extinguished but merely held in abeyance while the debtor endeavors to effect a satisfactory method of providing the creditors with relief, or its equivalence, as ultimately determined by the bankruptcy court.\textsuperscript{118}

The United States Bankruptcy Court in that instance, may terminate, annul or modify the stay for cause, including the lack of adequate protection or if the debtor does not have equity in the property and it is not necessary to an effective reorganization.\textsuperscript{119} The Court may also lift the automatic stay if it finds that the petition was filed in bad faith. In this instance, discretion should not only be allowed but it should be heavily employed in dismissing the frivolous suit.

In this scenario, the foreign representative will not have to request injunctive or other relief because the automatic stay would enjoin creditor actions in the United States.\textsuperscript{120} If a nation of competent jurisdiction, such as the Bahamas, allows the corporate debtor to file bankruptcy in America under the theory that its main objective is only to have corporations incorporate there, section 304, in that case, would be rendered moot because the principal place of bankruptcy would be here in the United States. In such a situation the interests of American creditors would continue to be protected and the policies and underlying goals of American Bankruptcy law would not be compromised.\textsuperscript{121} Therefore, in order to prevent a race to the bottom and in order to protect the rights and interests of creditors situated in America, there needs to be a general prohibition on use of judicial discretion in granting relief from liabilities to a debtor who files bankruptcy here in the States.

Another benefit to removing judicial discretion regarding whether to cooperate with the bankruptcy laws of a foreign nation is precisely that it would make judges' decisions less capricious. Where there is even the slightest discrepancy in the laws of the United States and that of the foreign nation, under a strict non-discretionary regimen, it will not be left up to the judge to decide whether to abide by principles of comity or not. Several bankruptcy courts have refused to defer to foreign insolvency schemes that would not accord claims of

\textsuperscript{116} See supra note 33.
\textsuperscript{117} Id.
\textsuperscript{118} Id.
\textsuperscript{119} See supra note 33.
\textsuperscript{120} See supra notes 30-31 and accompanying text.
\textsuperscript{121} See id.
an American holder a priority comparable to that accorded those claims under the Code.\textsuperscript{122}

For instance, Canada is one nation whose bankruptcy laws are different from those of the United States. Since Canadian law categorizes various creditors and assigns different levels of priority to each,\textsuperscript{123} occasionally, American creditors with a claim to the assets of a Canadian debtor are not afforded the same level of priority and are thereby prejudiced.\textsuperscript{124} Although it may be difficult to imagine a situation where the American judge will allow the turnover of assets located in America to a Canadian representative, under a non-discretionary protocol, the "difficulty" would be eliminated completely. Under this approach,\textsuperscript{125} Canadian representatives would have notice that American judges will not even have the opportunity to analyze their claims based on factors in section 304(c) of American Bankruptcy Law including comity.

In \textit{In Re} Toga Mfg. Ltd.,\textsuperscript{126} the bankruptcy trustee of a Canadian debtor petitioned for an injunction against all of the debtor's creditors from commencing any action against the debtor or its assets. The American bankruptcy court held that comity required that the claim of the American lien creditor against the debtor be litigated in Michigan courts.\textsuperscript{127} The American

\textsuperscript{122} See \textit{In re} Toga Mfg. Ltd., 28 Bankr. 165 (Bankr. E.D. Mich. 1983) (claim of U.S. lien creditor against foreign creditor against foreign debtor must be litigated in U.S. Court); \textit{In re} Lineas Aereas de Nicaragua S.A., 10 Bankr. 790 (Bankr. S.D. Fla. 1981) (U.S. assets may be used only to satisfy claims of U.S. creditors); \textit{In re} Berthoud, 231 F. 529 (S.D.N.Y. 1916) (U.S. Court had jurisdiction to commence involuntary bankruptcy proceeding against foreign debtor whose only major U.S. contact was a U.S. $30,000 bank account; Disconto Gesellschafi v. Umbreit, 208 U.S. 570 (1908) (United States must protect the rights of its own citizens to local property before permitting property to be removed from its jurisdiction; Hilton v. Guyot, 159 U.S. 113 (1895) (holding that comity is not to be extended if it would violate the laws and public policy of the United States to do so). \textit{But see} Cornfeld v. Investors Overseas Servs., 471 F. Supp. 1255 (S.D.N.Y. 1979) (holding that the Canadian winding up procedures were jurisdictionally sound and consistent with U.S. bankruptcy policy); Clarkson v. Shaheen, 544 F.2d 524 (2d Cir. 1976) (acknowledging Canadian bankruptcy trustee’s claim to records of debtor located in the United States because right of foreign trustee will be recognized as long as court has jurisdiction over bankrupt and there is no prejudice to local creditors or violation of laws or public policy of the state); Waxman v. Kealoha, 296 F. Supp. 1190 (D. Haw. 1969) (Canadian bankruptcy trustee could bring an action in bankruptcy against Hawaiian incorporators and stockholders of Hawaiian corporation to recover amounts owed on stock subscriptions, because U.S. Courts typically extend comity in such cases, unless to do so would prejudice local creditors); Canada Southern Ry. Co. v. Gebhard, 109 U.S. 527 (1883) (refusing to allow U.S. bondholders of a Canadian corporation in reorganization to sue on their bonds).

\textsuperscript{123} See Bankruptcy Act, R.S.C., ch. B-3 §107 (1970) (Can.). Section 107 of the Canadian Bankruptcy Act divides creditors into four classes for purposes of priority distribution. First, there are secured creditors who are entitled to enforce their claims irrespective of their debtors' bankruptcy proceedings. Second, preferred creditors receive a special priority by virtue of Section 107(a) through (j), and they share pari passu as among preferred creditors in any particular sub-class of preferred creditors. Third, ordinary creditors are those creditors among which no distinction is made as to judgment creditors and non-judgment creditors. However, judgment creditors are not treated as possessing any security. Fourth, and finally, deferred creditors are those creditors who, as a matter of policy, receive no payment unless and until all other creditors are paid.

\textsuperscript{124} See, \textit{e.g.}, note 125 and accompanying text.

\textsuperscript{125} See supra notes 69-71 and accompanying text.


\textsuperscript{127} \textit{Id.} at 168.
Court took judicial notice of the close geographic proximity of Canada and the United States, specifically, Wayne County, Michigan and Essex County, Province of Ontario and held that the American creditor would not be inconvenienced by litigating its claim in Canada, and that the American claim would receive just treatment of its claim against the debtor in Canadian courts. However, the claim would not receive the priority recognition “substantially in accordance with the order prescribed by this title” as required by Section 304(c)(4). Based on the perceived failure of the Canadian law to provide the judgment lien creditor any priority for its claim, the bankruptcy court ruled that the turnover request should not be granted. It specifically rejected the argument that the principle of comity should control, noting that section 304(c) contained a number of factors for a bankruptcy court to consider.

The holding in *Toga* was widely criticized and commentators are still split in their views. Universalists criticize *Toga* as an approach that emphasizes territorialist factors in section 304(c) in contrast to the approach in *Culmer* that emphasizes the universalist factors in section 304(c). Adopting a non-discretionary scheme of statutory interpretation will avoid these differences of opinion.

Unlike the Judge’s opinion in *In Re Toga Mfg. Ltd*, under the non-discretionary interpretation scheme, the decision to adjudicate the claim in the United States will not be based on the discretionary exercise of comity or a balancing approach involving the remaining five factors; rather, the claim will be litigated in the United States because of a statutory mandate that prescribes an outcome for a basic skeleton of facts. Consequently, a general prohibition on discretion under section 304 will not violate any policy of the American Bankruptcy Law.

Similarly, in *Clarkson Co., Ltd. v. Shaheen*, a New York court issued a temporary injunction ordering the Canadian corporate officials to turn over corporate records to the Canadian bankruptcy trustee. The American court held, inter alia, that there was indeed a reason for the court to recognize the Canadian bankruptcy. The court held that comity required the New York courts to recognize the statutory title of an alien trustee in bankruptcy “as long as the foreign court had jurisdiction of the bankrupt and the foreign proceeding has not resulted in injustice to New York citizens, prejudice to creditors’ New York statutory remedies, or violation of the laws or public policy of the state.” (Emphasis added.)

---

128 Id. at 170-71.
129 See supra note 126.
130 See supra note 127.
131 See supra note 96.
133 See supra note 2 (including fresh start for debtor and an equitable distribution to unsecured creditors).
135 Id. at 629.
A general prohibition on discretion under section 304 will reconcile and facilitate the handling of significant differences in the substantive bankruptcy laws of the various countries. It will also reduce, if not avoid completely, the temperamental recognition of foreign bankruptcy proceedings by some countries. In addition, the lack of certainty as to which jurisdictions' bankruptcy law will apply until the proceedings are actually commenced will be minimized in the case of a multi-jurisdictional bankruptcy. Overall, the adoption of this approach will increase the probability that a desirable jurisdiction will administer certain assets. And perhaps most importantly, such an approach raises the chances that a specific creditor will have a higher yield on their investment than they otherwise would. Furthermore, under this regimen, American creditors will not have to forego the protections that they have traditionally provided their own participants, including, for example local employees and local tax authorities.

This approach is not without flaws; therefore, it faces much criticism. One possible criticism is that this approach is hostile towards United States' relations with other nations. This is because it fails to consider the benefits that other jurisdictions might offer. For example, depending on the foreign jurisdiction, generally, a secured creditor in that jurisdiction may realize on its collateral considerably sooner than in the United States where secured creditors are stayed from action along with all other creditors.

Under such an approach, the benefits of the foreign jurisdiction are overlooked because it fails to imagine a situation where the American creditors may be better off than they are in the United States. Nevertheless, while this approach may deny the American creditors any additional advantages from pursuing their claims abroad, the situations where they will receive additional perks are few and far between to forego the entire approach for a discretionary protocol.

Another criticism against this scheme is that rather than avoiding multiple "territorial" proceedings, it creates and encourages them thereby impeding the creation of a universal bankruptcy scheme. This is contrary to settled notions of judicial economy. The ancillary proceedings, under section 306 of the Bankruptcy Code, allow a foreign party to appear for the ancillary proceedings without submitting itself to the jurisdiction of any other United

---

138 11 U.S.C. §306 (1988). §306 provides, in complete form, as follows:

**§306. Limited appearance**

An appearance in a bankruptcy court by a foreign representative in connection with a petition or request under section 303, 304, or 305 of this title does not submit such foreign representative to the jurisdiction of any court in the United States for any other purpose, but the bankruptcy court may condition any order under section 303, 304, or 305 of this title on compliance by such foreign representative with the orders of such bankruptcy court.
States' court. An ancillary proceeding, rather than commencing a full-scale bankruptcy proceeding only provides specific relief. Furthermore, they are limited to only certain circumstances. As a result, they are generally more efficient, flexible, and expeditious than a full-scale liquidation or reorganization proceeding. These benefits are certainly not to be dismissed because they “are the U.S. contribution toward creating a workable ‘universal’ bankruptcy scheme that avoids multiple ‘territorial’ proceedings if possible.” Yet, by granting discretion in the hands of judges, the interests of American creditors should not be dismissed simply for matters of judicial economy. This is disparaged because it cannot guarantee that waste of assets will be minimized because of the multiple proceedings.

Moreover, while costs of multiple proceedings are possibly saved under a discretionary approach because only a few claims (as opposed to all) are settled in the United States courts. It is certain that the rigid non-discretionary approach is invaluable to creditors because they generally make a bigger investment by lending money and/or credit to these corporate debtors. In addition, sometimes, a multiple proceeding may be unavoidable if assets are located in jurisdictions where principles of comity are not followed.

In addition, under a scheme where there is a general prohibition on discretion, there are many obstacles for the reorganization of a failing multinational enterprise or for coordinated asset sales particularly on a going concern basis. In the more common liquidation scenario, this approach prompts a race to national courthouses by creditors and produces unequal distributions among creditors depending upon the fortuity of the location of debtor assets.

### IV. RESOLUTION

#### A. Move towards the Dilution of 11 U.S.C. §304

In 2001, the Second Circuit expressed its preference for the secondary approach in its landmark opinion, *Bank of New York v. Treco*. In this case, the Second Circuit vacated decisions by a district court and a bankruptcy court that ordered the turnover to a foreign proceeding (Bahamas) of property alleged

---

139 Id.

140 See supra note 88 at 200. Ancillary proceedings allow the court to mold relief in almost unlimited form: (1) The court may enjoin the commencement or continuation of any action against the debtor with respect to property involved in the foreign proceeding or any action against such property. 11 U.S.C. §304(b)(1). (2) The court may order turnover of property, or its proceeds, belonging to the debtor's estate to the Foreign Representative. 11 U.S.C. §304(b)(2). (3) The court may abstain from adjudication of any matters, or suspend or dismiss all proceedings, relating to the foreign debtor and its property. 11 U.S.C. §305. (4) Examples of Other Appropriate Relief. 11 U.S.C. §304(b)(3). 141 See id.

142 See supra note 41 at 200.

143 Id.

to be subject to a security interest in the United States. The creditor holding the security interest argued that under the law of the foreign proceeding, its security interest would be subordinated to various statutory priorities, including administrative expenses, and that the distribution in the foreign proceeding would thus not be "substantially in accordance with the order prescribed" by the Code.\textsuperscript{145} The Second Circuit ruled that the district court had not properly applied section 304(c).\textsuperscript{146} The Second Circuit also said that while comity is the ultimate consideration in granting relief under section 304, it does not automatically override the other factors listed in section 304(c).\textsuperscript{147} This decision came down as Congress was already moving toward possible action on a new set of provisions to govern ancillary cases and other cross-border insolvency matters.\textsuperscript{148}

The Second Circuit analyzed the \textit{Treco} case based primarily on section 304(c)(4).\textsuperscript{149} In analyzing the language of section 304(c)(4), the Second Circuit also confirmed the commonly accepted view that the distribution rules of a foreign jurisdiction need not be identical to those of the United States to satisfy section 304(c)(4); the same foreign priority rules may be substantially in accordance with the United States laws.\textsuperscript{150} Under a non-discretionary approach, it makes sense that even if the laws of the competing jurisdictions are identical, or even "substantially similar," then we must look to accommodate American creditors' convenience.

The interpretation given to section 304(c)(4) by the Second Circuit recognizes that a foreign bankruptcy regime might be fair overall in its treatment of creditors, but significantly diverge from the Code in its treatment of any particular class of claim holders.\textsuperscript{151} Overall fairness is a necessary, but not sufficient condition for deference under section 304(c), if a particular class of actual United States' claim holders would be significantly disadvantaged by the distribution rules of the foreign proceeding.\textsuperscript{152}

\textbf{B. Proposed Chapter 15}

The United States Congress is currently reviewing a proposal by the House of Representatives\textsuperscript{153} which would seek to affect the way ancillary proceedings are initiated and conducted in United States courts. The versions of the bankruptcy reform legislation if passed by the Senate and the House provides for the addition of a new Chapter 15 to Title 11 of the United States

\textsuperscript{145} \textit{See supra} notes 52-53.
\textsuperscript{146} \textit{See Treco}, 240 F.3d at 151.
\textsuperscript{147} \textit{See id.} at 156.
\textsuperscript{148} \textit{See infra} Part IV. B.
\textsuperscript{149} \textit{See Treco}, 240 F.3d at 155 ("The primary dispute on appeal is whether the bankruptcy and district courts properly analyzed the factors under § 304(c) in deciding whether to grant turnover.").
\textsuperscript{150} \textit{See id.} at 158-59.
\textsuperscript{151} \textit{See id.}
\textsuperscript{152} \textit{Id.}
\textsuperscript{153} \textit{See supra} note 42.
Chapter 15 would govern the initiation and conduct of ancillary proceedings in substitution for the provisions currently contained in Section 304. As to ancillary proceedings, the provisions of Chapter 15 would build upon the provisions of section 304 but with clarifications and changes that will affect the conduct and perhaps the outcome of particular ancillary proceedings. Besides making revisions to the definitions already contained in the Code, Chapter 15 also adds its own list of defined terms for use in proceedings under the new Chapter. Among other things, this Chapter would also distinguish between a foreign main proceeding and a foreign non-main proceeding. It would also thereby introduce a level of complexity to the recognition process that is not readily apparent from the language of the initial sections of Chapter 15 that govern the recognition process. Section 1504 provides that an ancillary case is commenced under Chapter 15 by the filing of a petition for recognition of a foreign proceeding under Section 1515.

The distinction between a foreign main and non-main proceeding leads to another change: a mandatory recognition rule. Section 1517(a) would make recognition of a foreign proceeding mandatory if the foreign proceeding and foreign representative meet the definitional requirements of the Code and if the filing requirements of section 1515 are met. The bankruptcy court under the new Chapter 15 would not have the same freedom although there is a limited basis in section 1517(a) to deny recognition to a foreign proceeding. Section 1517 is expressly made subject to section 1506. Section 1506 provides that "[n]othing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States." Ultimately, if recognition of a foreign proceeding would be manifestly contrary to the public policy of the United States, a court could decline to enter an order recognizing the foreign proceeding.

Another significant change with the adoption of this new Chapter is that under Chapter 15, recognition of a foreign proceeding, as a foreign main proceeding will have automatic effects. This is a change in the operation of an ancillary proceeding from that under section 304 where there is no automatic stay and where all relief is discretionary and must be court ordered. The stakes for United States creditors in an ancillary proceeding under Chapter 15 will be significantly increased by virtue of the recognition of a foreign proceeding without regard for the section 304(c) factors. Although mandatory recognition

159 U.S.C. §1517(a).
161 Id.
means that a foreign main proceeding will be entitled to the benefits of an automatic stay even though the foreign proceeding might not satisfy the section 304(c) factors.

As it pertains to this new law, the non-discretionary regimen would not be impeded in any substantial way since most changes deal with definitions. The bill, in effect, would allow a foreign representative to file a petition directly with a court for recognition of a foreign proceeding. Another solution is that creditors should choose a debtor with the greatest interests within the preferred jurisdiction and/or obtain guarantees hopefully secured and properly authorized, from an entity with substantial interests within the preferred jurisdiction.

C. Alternative Remedy—A Happy Medium

Some critics and commentators might argue that this approach is too strong. However, even if this approach is found to be "too" absolute and a draconian measure to the narrow situation outlined in the Introduction above, the policies and concerns should not be dismissed.

A hypothetical is needed to illustrate the effects: A debtor corporation is incorporated in a foreign jurisdiction. It owns a piece of land in that foreign nation. In order to develop on the land, it borrows from a lender from that jurisdiction. During the term of the loan, the debtor, though solvent, files a bankruptcy proceeding in the foreign jurisdiction. In this situation, a bright-line rule would preclude American courts from considering the individual transaction to determine if the interests of the creditors in the United States (if any) are really being challenged. The non-discretionary regimen would probably be quite drastic.

For such situations, if Congress decides that the current state of Bankruptcy Law as it relates to ancillary proceedings, needs to be improved given the concerns mentioned in this Note, at the very least, a presumption-based system would be the best way to accomplish this improvement. Rebuttable presumptions, rather than bright lines, would provide greater guidance to the judge than the current guided discretionary system, and would thereby tend to reduce the risk of improper exercises of discretion. At the same time, rebuttable presumptions would preserve some discretion and thereby avoid the serious comparative justice consequences of a bright line rule. In the final analysis, a presumption-based system would help to achieve better results, or results that depend on the specific facts and circumstances of the foreign representative's case rather than on factors referenced in section 304(c) of the Code. This presumption strikes a balance between fixed rules and judicial discretion that errs on the side of caution. By giving bankruptcy judges a clear, "bright-line" rule, the potential for inconsistency, unpredictability, and inequity are minimized.
CONCLUSION

The ultimate relief available in an ancillary case, the turnover of property to the foreign representatives, would remain a discretionary exercise under the proposed Chapter 15 as it is under § 304. This power is found in U.S.C. §1521(b), which provides that:

Upon recognition of a foreign proceeding, whether main or nonmain, 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 or another person, including an examiner, authorized by the court, provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected.

Under a non-discretionary regimen, where there would be a general prohibition on a judge's discretion under section 304(b), instead of a statutory test for the turnover of assets, there would be a bright line rule conforming to the purposes and policies of bankruptcy law in the first place. The bright line rule would simply state that an American company filing a principal bankruptcy proceeding in a foreign jurisdiction will either have to file a companion "principal" full blown proceeding in the States or risk the American creditors attaching to assets located in the United States.