Richmond Journal of Global Law & Business

Volume 4 | Issue 1 Article 7

2004

Global Corporate Reorganization/ Global Corporate Governace: Imperfect Information and Credible Commitment

Bernhard Grossfield
University of Muenster

GLOBAL CORPORATE REORGANIZATION/GLOBAL CORPORATE GOVERNANCE: IMPERFECT INFORMATION AND CREDIBLE COMMITMENT[1]

Bernhard Grossfeld[2]

"Can the island of Tobago pass a law to bind the rights of the whole world?"[3]

I. THE ISSUE

Global corporate reorganizations are no longer the subject of overly zealous comparatists in corporate law and bankruptcy but an issue of increasing practical importance.[4] The Swiss Air collapse and the recent Enron debacle are examples of bankruptcy proceedings with thousands of creditors "in locations around the globe."[5] They have caused global ripple effects far beyond their "home states."

A. *Corporate Reorganizations*

Reorganization proceedings under Chapter 11 of the United States Bankruptcy Code are reserved for corporations trying to resurrect their business instead of auctioning off (liquidating) their assets to the highest bidder under Chapter 7. Chapter 11 keeps the future

---

[1] I borrowed the latter part of the title from Paul E. Fischer & Philip C. Stocken, *Imperfect Communication and Credible Commitment*, 39 J. OF ACCT. RES. 119 (2001).

[2] Professor of Law at the University of Muenster; Germany; LL.M. Yale 1963; Visiting International Professor T. C. Williams School of Law, University of Richmond, Fall 2001 & 2003.

[3] Lord Ellenborough, C. J., in: Buchanan v. Rucker, (1808) 9 East 192, 103 Eng. Rep. 546, 547 ; Hannah L. Busbaum, *Conflict of Economic Laws: From Sovereignty to Substance*, 42 VA. J. INT'L L. 931 (Summer 2002).

[4] *See also* VANESSA FINCH, CORPORATE INSOLVENCY LAW (Cambridge Univ. Press 2001); Hannah L. Busbaum, *Rethinking International Insolvency: The Neglected Role of Choice-of-Law, Rules and Theory*, 36 STAN. J. INT'L L. 23 (2000); Vanessa Finch, *Security, Insolvency and Risk: Who Pays the Price?*, 62 MOD. L. REV. 633 (1999); Richard Hynes, *Optimal Bankruptcy in a Non-Optimal World*, 44 B.C. L. REV. 1 (2002); Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696 (1999) [hereinafter *A Post-Universalist Approach*]; John Purcell, *International Insolvency Law at the Crossroads*, 13 AUSTL. L. REV. 304 (2002); Ulrik Rammeskow Bang-Pedersen, *Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests*, 73 AM. BANKR. L. J. 385 (1999).

[5] *See also* Lykes Bros. S.S. Co. v. Hanseatic (*In re* Lykes Bros. S.S. Co.), 207 B.R. 282 (Bankr. M.D. Fla. 1997).

open. Chapter 7 is the traditional – and now even more frequent – route for dead-end corporations. This article will first focus on the stellar rise of Delaware as a prominent place for these procedures. Second, the tendency to defend discharges on a global level, as expressed by *Hong Kong & Shanghai Banking Corp. v. Simon (In re* Simon).[6] We might find by putting the names "Delaware" and "Discharge" together that we will turn a new page in the "book" on "global corporate actors and global corporate governance."[7]

B. Corporate Governance

The term "corporate governance" is often used to define the ongoing social control over corporations from their incorporation through their life. As long as "bankruptcy" referred mainly to the liquidation of firms it was not seen as a corporate governance issue. This changed with the rise of reorganizations. Indeed, the correlation between corporate law and bankruptcy is no accident. Reorganization law is an extension of corporate law, as it is a kind of "revitalizing" of the otherwise moribund entity, it is similar to a "re-incorporation:" a re-structuring for a new future.[8] This affects creditors, shareholders and other stakeholders – a process distinctively corporate in nature[9]: "[f]or large firms, corporate bankruptcy looks a great deal like corporate law."[10]

Indeed, reorganization law *is* corporate law; it is federal corporate law and listing it under the name "bankruptcy" does not change its character (consider Shakespeare's "what's in a name"). This is a full circle back to the historical beginnings: corporate law can be understood as a frontrunner of and a buffer for bankruptcy law. This presents bankruptcy courts with conflict of law questions. The same interest groups that influence choice of law in corporate law in general (state of incorporation) will try to "color" reorganization proceedings under chapter 11 of the United States Bankruptcy Code (venue state for bankruptcy proceedings). Thus, it is a small wonder that the interests making Delaware the "queen" of U.S. corporate law also try to

---

6 153 F.3d 991 (9th Cir. 1998).

7 *Cf.* Bernhard Grossfeld, *Loss of Distance: Global Corporate Actors and Global Corporate Governance – Internet v. Geography*, 34 INT'L LAW. 963 (2000).

8 Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganizations of Large Publicly Held Companies*, 141 U. PA. L. REV. 669 (1993).

9 David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1325 (1998).

10 David A. Skeel, Jr., *Lockups and Delaware Venue in Corporate Law and Bankruptcy*, 68 U. CIN. L. REV. 1243, 1244 (2000).

catch the more or less subtle Delaware "influence" upon reorganizations[11].

II. DELAWARE

A. *The Old Story*[12]

The position of Delaware in corporate law needs little discussion. Delaware derives nearly twenty percent (20 %) of her state's income from franchise taxes and other corporate law fees. In addition, the corporate harbor policy generates strong impulses for her economy as a whole. Therefore, Delaware cannot afford to lose its corporate business. Since Brandeis' seminal dissent in *Louis K. Ligget Co. v. Lee*[13] and Cary's famous *Reflections upon Delaware*,[14] it has been discussed whether Delaware stands for a "race to the bottom" or for a "race to the top."[15] Even today, both views are held with equal fervor. Lucian Ayre Bebchuk and Allen Ferrell are rather skeptical,[16] whereas William T. Allen hails *The Pride and the Hope of Delaware Corporate*

---

11 David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1, 2-3 (1998) [hereinafter *Bankruptcy Judges*].

12 The idea of the race-to-the-bottom represents the "the old story." *See generally* Louis K. Ligget Co. v. Lee, 288 U.S. 517, 541-80 (1932) (Brandeis, J., dissenting) (discussing the states' need to protect public welfare from the practices of big corporations through corporate taxation); Christopher Grandy, *New Jersey Corporate Chartermongering, 1875-1929*, 49 J. ECON. HIST. 677 (1989) (discussing the rise and fall of New Jersey as chief "chartermonger" meaning the active solicitation of corporate charters for the purpose of bolstering state revenue and its replacement by Delaware).

13 288 U.S. at 541-80.

14 William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663 (1974) (discussing how Delaware courts in effect perpetuated the state's management friendly corporations statutes, thus illustrating the "race-to-the-bottom" theory). *Contra* Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908 (1998) (proposing that the "race" led by Delaware is based not on friendliness either management or shareholders but on indeterminacy, thus skewing the market for corporate law); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977) (concluding that state corporate laws are indeed shareholder friendly and that state regulation is, for the most part, preferable to federal regulation, thus illustrating the "race-to-the-top" theory).

15 *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993) (comparing and contrasting the different theories of William L. Cary and Ralph K. Winter, Jr. on whether corporation law is a "race-to-the-bottom" or a "race-to-the-top").

16 Lucian Ayre Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeover*, 99 COLUM. L. REV. 1168 (1999).

Law.[17] Robert Daines tells us that Delaware law increases stock market prices[18] - though, unfortunately, we do not know exactly whether the market prices for securities reflect the intrinsic value of firms. While the law and economics experts see the answer in market performances, others criticize their reliance on the underlying concept of efficiency[19] and question whether it is possible for markets to evaluate corporate laws.[20] There is no end to the debate in sight.[21]

B. *The New Story*

1. *Rise to the Top*

Delaware's position as a venue for reorganizations stems from Bankruptcy Code § 1408, which allows debtors seeking debt relief to file bankruptcy in the district of their domicile. "Domicile" has been construed to mean the corporation's "state of incorporation."[22] The rule is highly controversial, as it provides management with an opportunity for forum shopping and may thus be unfair to creditors.[23] As many large firms are incorporated in Delaware, the state has succeeded New York as corporate America's jurisdiction of choice for corporate reorganizations.[24]

---

[17] William T. Allen, *The Pride and the Hope of Delaware Corporate Law*, 25 DEL. J. CORP. L. 70, 71 (2000) ("It is certainly the nation's and indeed the world's leading organization law for large scale business enterprises.").

[18] Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. Fin. Econ. 525 (2001).

[19] *E.g.* Chris William Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 CORNELL L. REV. 1003 (2001) (criticizing the old concept of efficiency, supported by the law-and-economics approach, explaining a "new efficiency rationale").

[20] *E.g.* Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992); Bebchuk & Ferrell, *supra* note 16; Lynn M. LoPucki, *Can the Market Evaluate Legal Regimes? A Response to Professor Rasmussen, Thomas and Skeel*, 54 VAND. L. REV. 331 (2001) [hereinafter *A Response*].

[21] *See* Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1105 (2001). *Contra* Leo E. Strine, Jr., *Delaware's Corporation-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's "Price Discrimination in the Market for Corporate Law,"* 86 CORNELL L. REV. 1257 (2001).

[22] David A. Skeel, Jr., *Lockups and Delaware Venue in Corporate Law and Bankruptcy*, 68 U. CIN. L. REV. 1243 (2000) [hereinafter *Lockups*]; Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 Nw. U. L. REV. 1357 (2000).

[23] *In re* Abacus Broad. Corp., 154 B.R 682, 686 (1993); MICHAEL J. CRAMES ET AL., THE FUNDAMENTALS OF BANKRUPTCY AND CORPORATE REORGANIZATION 88 (1998).

[24] Theodore Eisenberg & Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 983 (1999).

The run to Delaware started in the early 1990s and today Delaware can boast that it is now by far the most popular venue for reorganizations. It is important to note, however, that corporations rarely have their headquarters or assets there. So called "brass plate" headquarters make Delaware the "home country." The "home" and thereby the venue can be easily achieved at any time by a "domestication" procedure under the auspices of the Revised Model Business Corporation Act.[25] Therefore, "large corporate debtors engage in rampant forum shopping among bankruptcy courts in the United States."[26] Over 60% of reorganizations of large public corporations are filed in Delaware bankruptcy court.[27] Reorganization law has been largely "Delawarized," not just as a matter of venue but also as a matter of substance.[28]

2. *Controversial Views*

The two concepts of incorporation and reorganization thus operate within an interrelated Delaware network. When incorporating in Delaware the various shareholders join webs of interests that see their advantage in Delaware and when seeking bankruptcy they join webs that favor reorganization there. The connecting link over time is the fact that in most cases the managers of the corporation, who remain in office as trustees, are rarely appointed.[29] It is no surprise that the old race to the bottom versus race to the top debate continues, this time in regards to reorganizations. Robert K. Rasmussen, Randall S. Thomas,[30] and David A. Skeel, Jr.[31] emphasize the speed, sophistication, and efficiency of Delaware. On the other side of the debate, Lynn M. LoPucki and Sara D. Kalin condemn the "forum shopping" and criticize the high re-filing rate (a practice that is not in line with Bankruptcy Code § 1129(a)(11)),[32] thus showing Delaware's inefficiency in bankruptcy reorganization.[33] The authors complain that Delaware

---

[25] *See* Lyman P.Q. Johnson, *Corporate and Business Law*, 35 U. RICH. L. REV. 499, 500 (2001).

[26] *See* LoPucki, *A Post-Universalist Approach*, *supra* note 4, at 720.

[27] Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom*, 54 VAND. L. REV. 231, 235 (2001).

[28] Robert K. Rasmussen & Randall S. Thomas, *Wither the Race? A Comment on the Effects of the Delewarization of Corporate Reorganizations*, 54 VAND. L. REV. 283 (2001).

[29] LoPucki & Kalin, *supra* note 27, at 233.

[30] Rasmussen & Thomas, *supra* note 28.

[31] David A. Skeel, Jr., *What's So Bad about Delaware?*, 54 VAND. L. REV. 309 (2001).

[32] LoPucki & Kalin, *supra* note 27, at 244.

[33] *Id.* at 347.

courts are not making informed decisions, but rather conforming to what the parties present.[34] Some commentators grumble that the run is not for bankruptcy courts, but for judges that might have "cultivated too cozy a relationship with debtors" ("judge shopping").[35] Others indicate their "displeasure with judges who might not be resistant to local legal culture."[36] Creditors worry that corporate insiders are positioning themselves for a final windfall. But even creditors are not beyond suspicion, as their most powerful supporters are expected to maneuver aggressively for control of the official creditor's committee. But who is most powerful before a Delaware court: foreign creditors or creditors from abroad?

In the meantime, the choice of law discussion has gone beyond Delaware. Some authors argue that a corporation should be able to choose its preferred bankruptcy system in its corporate charter.[37] The charter choice would then bind creditors. Others prefer to include the choice of bankruptcy venue in the lending agreement.[38] David A. Skeel, Jr. goes so far as to question whether firms should be *forced* to bring any reorganization petition in their state of incorporation.[39]

C. *Qualifications*

The parallels between incorporation and reorganization should not be overstated as crucial differences remain. Bankruptcy is regulated by federal law, rather than by state law, because the bankruptcy courts are a part of the federal district courts.[40] The judges therefore, are not appointed by Delaware constituencies. It is, however, controversial to the extent Delaware's influence is diminished by federal involvement. Bankruptcy courts often defer to the law of the state of incorporation on such issues as fiduciary duties of management or big shareholders and on matters concerning the internal affairs of the corporation. It is even an open question whether federal intervention in corporate affairs can avoid favoring Delaware.[41] Skeel argues, "Corporate charter competition and Delaware's corporate culture exert bene-

---

[34] *Id.* at 259. *But see In re* Abacus Broad. Corp., 154 B.R 682, 686 (1993).

[35] Skeel, *Lockups*, *supra* note 22 at 1274; *cf.* Eisenberg & LoPucki, *supra* note 24, at 972.

[36] LoPucki, *A Response*, *supra* note 20, at 354.

[37] Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT'L L. 1, 32 (1997).

[38] Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L. J. 1807 (1998).

[39] Skeel, *Lockups*, *supra* note 22, at 1275.

[40] 28 U.S.C. § 651, 1334.

[41] Lucian Arye Bebchuk & Allen Ferrel, *Federal Intervention to Enhance Shareholder Choice*, 87 VA. L. REV. 993 (2001); Stephen J. Choi & Andrew T. Guzman, *Choice and Federal Intervention in Corporate Law*, 87 VA. L. REV. 961 (2001).

ficial influence on Delaware bankruptcy practice."[42] Certainly, larger corporations tend to choose courts that they believe to be favorable to reorganizations.[43] But favorable to whom? If Delaware law was not advantageous to managers, many suspect that they would not flock to the state.

D. *Proposal for Reform*

Section 1408 of the Bankruptcy Code has come under fire as a result of the turn to Delaware.[44] Opponents wish to amend the section in order to eliminate the place of incorporation as a venue option.[45] In 1997, the National Bankruptcy Review Commission adopted such a proposal,[46] but so far that proposal has met with limited success.

III. UNDERLYING PREMISES

A. *Procedure*

The controversy over Delaware goes right into the heart of the public policy reasons for reorganization under Chapter 11 of the Bankruptcy Code. The fundamental philosophy underlying Chapter 11 is highly favored by U.S. legal culture and tradition. That legal culture and tradition is devoted to preserving the status quo and saving the corporation, even at the cost of creditor interests.

Following a long practice in reorganization proceedings, the debtor's management stays in control of the going concern. This gives leverage to the established management and to some extent to shareholder and worker interests. Though the reorganization plan should aim "to maximize value for the general benefit of all creditors,"[47] the *debtor* normally develops the plan for the reorganization. The debtor has a period of exclusivity (roughly six months) that is often extended by the court to give the debtor additional time to arrive at an agreement. Typically, the plan provides for a reduction or elimination of equity (often giving part or all of it to creditors or new investors), for reduced debt (discharge) and delayed repayment. The bankruptcy court will only confirm the plan for reorganization if there is a reasonable likelihood that the plan's promise will be fulfilled. There must be a sound expectation that the payments will be made as provided and

---

[42] Skeel, *Lockups*, *supra* note 22, at 1270 n.96.

[43] Lynn LoPucki & William Whiford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11 (1991).

[44] 28 U.S.C. § 1408.

[45] Crames, *supra* note 23.

[46] Skeel, *Bankruptcy Judges*, *supra* note 11.

[47] Lykes Bros. S.S. Co. v. Hanseatic (*In re* Lykes Bros. S.S. Co.), 207 B.R. 282, 284 (Bankr. M.D. Fla. 1997).

that the reorganized business will survive as an economically viable entity (feasibility). Majority creditors can outvote dissenting minority creditors.[48] The court can force a class of creditors to accept a plan to which they object if in the eyes of the court the plan is "fair and equitable" and consistent with legal priorities.[49]

B. *Discharges*

The confirmation of the debtor's plan by the bankruptcy court produces a complete discharge of all pre-confirmation debt except as provided in the plan.[50] This is the central feature in any reorganization proceeding. The estate property vested in the debtor corporation is free of all preexisting claims. It does not matter whether the creditor filed a proof of the claim, accepted the plan or the plan listed the debt.[51] Any right to payment, which arises prior to bankruptcy, is a pre-petition debt and is discharged, unless specifically excepted. The discharge constitutes a bar to any action against the debtor; it works like an injunction operating permanently to stay any attempt to hold the debtor personally liable for discharged debts.[52] The corporation gets a true "fresh start."

C. *Feasibility*

As a general rule, Bankruptcy Code § 1129(a)(11) requires a "feasibility" study by the court to find out that the "[c]onfirmation of the plan is not likely to be followed by the liquidation or the need for further financial reorganization, of the debtor." The purpose of this language is to prevent "visionary schemes."[53] The corporation has to show that "it has a fighting chance of surviving, even prospering, in the economic community in which it operates."[54] Therefore, "valuation is the most hotly contested and debated topic in the realm of corporate bankruptcy proceedings."[55] This brings us into general questions of

---

[48] INT'L STATEMENT OF U.S. BANKR. L. 59 (1997).

[49] 11 U.S.C. § 1129(b) (2003) (dictating how a court may accomplish such an act).

[50] 11 U.S.C. § 524 (2003).

[51] *In re* Chiles Power Supply Co., 264 B.R. 533, 542 (Bankr. D.W. Miss. 2001); Hobson v. Travelstead (*In re* Travelstead), 227 B.R. 638, 654 (Bankr. D. Md. 1998).

[52] River Place E. Hous. Corp. v. Rosenfeld (*In re* Rosenfeld), 23 F.3d 833 (4th Cir. 1994).

[53] *In re* Travelstead, 227 B.R. at 651.

[54] *In re* Abacus Broad. Corp., 154 B.R 682, 686 (1993).

[55] Barry E. Adler & Ian Ayres, *A Dilution Mechanism for Valuing Corporations in Bankruptcy*, 111 YALE L. J. 83 (2001). *Cf.* Bank of Am. Nat'l Trust & Sav. Ass'n. v. 203 North LaSalle St. P'ship, 526 U.S. 434 (1999).

accounting cosmetics[56] and corporate valuation and thus into a field that lawyers have shied away from far too long.[57] It leaves wide room for interested participants and their agents to maneuver.[58] In an international context, this gray zone (including foreign activities and foreign subsidiaries) is even larger, due to the widespread absence of experience with global accounting and global valuations. The implications of "accounting mathematics"[59] in different cultural contexts ("mathematics in context") are rarely discussed.[60]

This becomes even more apparent when looking into the challenges of reorganization.[61] It is an "educated guess" (call it "speculation") into a future that is dark by any definition. Determinations of whether the reorganized debtor will have future net earnings and sufficient cash flows to meet the restructured interests and to amortize the restructured debts, and whether it can pay the projected dividends must be made. The new capital structure, particularly the equity to debt relationship should be sound and newly issued securities should not be misleading in nature. Likewise, the general economic outlook, the abilities of management and other intangibles that might be "in the air" are of importance. A thorough valuation is a common necessity, specifically when members of a corporate group seek to reorganize. If the assets of the various corporations had been commingled, questions of fairness to the creditors of the individual members easily arise.[62]

The focus is on "expectation of income" because the reorganization value is the present worth of future anticipated earnings.[63] Since there is no single standard method to determine reorganization value, the particular valuation approach for defining and capitalizing earn-

---

[56] Claire A. Hill, *Why Financial Appearances Might Matter: An Explanation for "Dirty Pooling" and Some Other Types of Financial Cosmetics*, 22 DEL. J. CORP. L. 141 (1997)

[57] Bernhard Grossfeld, *Lawyers and Accountants: A Semiotic Competition*, 36 WAKE FOREST L. REV. 167 (2001); *see also* John B. Attanasio, *The Brave new World of Multidisciplinary Practice*, 50 J. LEGAL EDUC. 469 (2000).

[58] Jay W. Eisenhofer & John L. Reed, *Valuation Litigation*, 22 DEL. J. CORP. L 37, 95 (1997)

[59] Bernhard Grossfeld, *Global Accounting: Where Internet Meets Geography*, 48 AM. J. COMP. L. 261 (2000) [hereinafter *Global Accounting*].

[60] Bernhard Grossfeld, *Global Valuation: Geography and Semiotics*, 55 SMU L. REV. 197 (2002), forthcoming; Samuel C. Thompson, Jr., A Lawyers Guide to Modern Valuation Techniques in Mergers and Acquisitions, 21 Iowa J. Corporate L. 457 (1996).

[61] Eisenhofer & Reed, *supra* note 58, at 95.

[62] Consol. Rock Prod. Co. v. Du Bois, 312 U.S. 510 (1941).

[63] Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 442 n.20 (1968).

ings has not yet been definitely defined. The most common methods are the Comparable Company Analysis and the Discounted Cash Flow Analysis.[64] These methods may support each other, as every analysis needs additional information about comparables, to determine the cost of debt, for instance, the beta coefficient.[65] We also include data on acquisition prices of comparable corporations. But what is comparable? It goes without saying that "trustworthiness" of the experts and of the courts are at the core of this business. This poses particular problems for foreign participants, making the unevenness of information is then obvious: "lemons" are difficult to discover from abroad.

D. Lockups

Another problem involves how the bankruptcy courts will handle corporate lockups and which corporate law defines management's fiduciary duty or defines the contractual analysis.[66] Delaware seems to be lockup "friendly"[67] as it often upholds even large lockups affecting 20% of the target's stock.[68] Accordingly, lockups have become increasingly important in this context. The term "lockups" includes any termination fee, stock options or options to purchase assets granted by a target corporation to a particular bidder. They "float" somewhere between "bribe" and "deterrence." Target companies use lockups to entice or to deter a bidder, friendly or hostile – but always according to management's preference. It can either chill the bidding or favor a "white knight" (protecting management's policies and jobs).

A corporation undergoing reorganization is a kind of natural target. Therefore, lockups play a prominent role in many cases as they define, to a significant extent, the market value of the firm. Lockups are difficult to evaluate; the burgeoning literature criticizes and praises them in similar terms. Much depends on the circumstances, on the time perspective, and on the prospective bidders.[69] Their impact on reorganization is even more difficult to evaluate;[70] consequently, there exists a remarkable degree of confusion. Sometimes

---

[64] Peter V. Pantaleo & Barry W. Ridings, *Reorganization Value*, 51 BUS. LAW 419, 421 (1996); *see* Eisenhofer & Reed, *supra* note 58, at 112 (providing an overview of the valuation methods).
[65] *See* U.S. Inspect Inc. v. McGreevy, No. 160966, 2000 WL 33232337 (Va. Cir. Ct. Nov. 27, 2000).
[66] Skeel, *Lockups*, *supra* note 22, at 1264.
[67] *See* Brazen v. Bell Atl. Corp., 695 A.2d 43 (Del. 1997).
[68] Skeel, *Lockups*, *supra* note 22, at 1263.
[69] *See* Marcel Kahan & Michel Klausner, *Lockups and the Market for Corporate Control*, 48 STAN. L. REV. 1539 (1996); Paul L. Regan, *Great Expectation? A Contract Law Analysis for Preclusive Corporate Lockups*, 21 CARDOZO L. REV. 1 (1999).
[70] Kermit Roosevelt, *Understanding Lockups: Effects in Bankruptcy and the Market for Corporate Control*, 17 YALE J. ON REG. 93 (2000).

they are quite negatively classified. In *Calpine Corp. v. O'Brien Environmental Energy, Inc.*,[71] the plaintiff argued that the lockup "did not chill the bidding." The court answered:

> This is a logical fallacy. While it is true that bidding remained competitive in face of the uncertainty whether such fees would be awarded, the bidding might have been even more heated had the court definitively ruled that Calpine was not entitled to a break-up fee or expense earlier in the process.[72]

IV. GLOBAL REACH

A. *Bankruptcy Universalism*

The foregoing considerations are so important because of the core concept of universalism in U.S. bankruptcy theory and practice: a single court should have global control over the assets of a bankrupt multinational corporation.

The aim of bankruptcy universalism "is to prevent the debtor's estate from being picked to pieces by creditors," and to avoid "a chaotic and uncontrollable scramble for the debtor's assets in a variety of uncoordinated proceedings" in different countries.[73]

This tends to give domestic courts ultimate power over totally foreign relations and transactions and enable them to export their social and economic policies through bankruptcy proceedings. This might even happen even when all or most of the assets, like real estate or shares in subsidiaries, are located abroad. As national laws vary widely as to the appropriateness of bankruptcy actions, a severe clash is often inevitable.

B. *Location of Assets*

The clash between national laws is programmed by § 101(23) which asserts jurisdiction over a debtor's property "wherever located," thus claiming a worldwide jurisdiction over a debtor's assets.[74] In addition, § 541(a)(1) defines the bankruptcy estate as comprising all of the debtor's eligible property, "wherever located and by whoever held."

---

[71] Calpine Corp. v. O'Brien Envtl. Energy, Inc., 181 F.3d 527 (3d Cir. 1999).

[72] *Id.* at 537.

[73] Holtkamp v. Littlefield (*In re* Holtkamp), 669 F.2d 505, 508 (7th Cir. 1982); *see also* Underwood v. Hilliard, 98 F.3d 956, 961 (7th Cir. 1996); Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177 (2000).

[74] *In re* Chiles Power Supply Co., 264 B.R. 533, 542 (Bankr. D.W. Miss. 2001); *see also* INT'L STATEMENT OF U.S. BANKR. L. § III(C) (Tentative Draft 1997) [hereinafter INT'L STATEMENT].

Section 1334(e) adds that in a bankruptcy case the district court "shall have exclusive jurisdiction of all the property, wherever located." In the courts' eyes Bankruptcy Code § 524(a) creates a "fiction" that the property "regardless of any location" is legally located within the jurisdictional boundaries ("constructive possession"; "*custodia legis*"). "This includes property outside. . .the United States."[75] The courts argue that the efficacy of the bankruptcy proceedings depends on their ability to control and marshal the assets of the debtor "wherever located."[76]

These laws establish a global *in rem* jurisdiction for the proceeding over the debtor's property. Certainly, there is the often-mentioned presumption against the extraterritorial application of national law.[77] However, the presumption is rebuttable[78] and today's courts hold that in bankruptcy proceedings Congress intended an extraterritorial application to property outside the territorial limits of the United States.[79] Occasionally, even a judge does not see any extraterritorial implications: "[b]ankruptcy estate property is located within the bankruptcy court's jurisdiction."[80] Fiction = fact!

C. *Enforcement of Discharge*

The enforcement of discharges abroad is at the center stage of global reorganizations. It appears when creditors try to exercise their claims into the debtor's assets located abroad, be it in real estate or in shares of foreign subsidiaries.

A prime example is *In re Simon*.[81] There, the Court of Appeals for the Ninth Circuit had to decide whether a foreign creditor is bound by an individual debtor's discharge (Chapter 7) in a domestic bankruptcy proceeding with regard to assets in Hong Kong.

The "money trail" began with a loan that the Hong Kong and Shanghai Banking Corporation (incorporated at the time in Hong Kong) had extended to Odyssey International Holdings, Ltd. (incorpo-

---

[75] Hong Kong & Shanghai Banking Corp. v. Simon (*In re* Simon), 153 F.3d 991 (9th Cir. 1998).
[76] Underwood, 98 F.3d at 961.
[77] *See* E.E.O.C. v. Arabian Am. Oil Co., 499 U.S. 244 (1991).
[78] *In re* Chiles Power Supply Co., 264 B.R. at 542.
[79] *In re* Simon, 93 F.3d at 996; *In re* Chiles Power Supply Co., 264 B.R. at 542; Hobson v. Travelstead (*In re* Travelstead), 227 B.R. 638, 655 (Bankr. D. Md. 1998); Lykes Bros. S.S. Co. v. Hanseatic (*In re* Lykes Bros. S.S. Co.), 207 B.R. 282, 287 (Bankr. M.D. Fla. 1997); Nakash v. Zur (*In re* Nakash), 190 B.R. 763, 768 (Bankr. S.D.N.Y. 1996).
[80] *In re* Simon, 93 F.3d at 1000.
[81] *In re* Simon, 153 F.3d at 991; *cf.* Charles D. Booth & Philip St. J. Smart, *The New Avoidance Powers under Hong Kong Insolvency Law: A Move From Territoriality to Extraterritoriality*, 34 INT'L. LAW. 255 (2000).

rated in the British Virgin Islands). The defendant Simon was Odyssey's major shareholder. Simon lived in and operated the company from Hong Kong. He personally guaranteed the loan and agreed that it should be "construed and determined under and may be enforced in accordance with the laws of Hong Kong"[82] and that the courts in Hong Kong should have jurisdiction "over all disputes arising under the guaranty."[83] When Simon could not satisfy the loan in due course he fled (like in Homer's "Odyssey") to California and filed for personal bankruptcy under Chapter 7 of the U.S. Bankruptcy Code. He listed the guaranty to the bank on account of the loan as an obligation or liability.

Hong Kong and Shanghai Banking Corporation filed a proof of claim in the bankruptcy court on its behalf in a *separate* bank loan. It did not file a proof of claim for Simon's guaranty, nor did it object to the discharge of the debts. The bankruptcy court then granted Simon a discharge of all debts. Pursuant to § 524(a)(2) of the Bankruptcy Code the court issued the following injunction: "All creditors whose debt are discharged by this order . . . are enjoined from instituting or continuing any act to collect such debts as personal liabilities of the above-named debtor."[84]

Hong Kong and Shanghai Banking Corporation then sought a declaratory judgment that the discharge did not apply to enjoin the bank from enforcing the Simon guarantee in Hong Kong and that the bank would not be subject to sanctions in the United States if it chose to commence collection proceedings in Hong Kong. The bankruptcy court dismissed and noted that the discharge injunction was not directly enforceable in Hong Kong. It was enforceable, however, in the United States via the imposition of sanctions followed by appropriate collection proceeding against the bank's property located in the United States.[85] The court of appeals affirmed the bankruptcy court's decision.

The case indicates how the concept of extraterritoriality and of personal jurisdiction has changed recently. In 1997, the Transnational Insolvency Project stated, "[i]f the Discharge is granted by the United States as primary jurisdiction, it is highly likely that the United States would assert jurisdiction and intend that its Discharge would be honored elsewhere, but there is no substantial authority on point."[86]

This view has changed dramatically.

---

82 *In re Simon* 153 F.3d at 994.

83 *Id.*

84 *Id.*

85 *Id.* at 995.

86 INT'L STATEMENT, *supra* note 74, at 120.

V. PERSONAL JURISDICTION

A. *General Aspects*

Today, it seems clear that the United States does not sanction a foreign creditor not subject to U.S. jurisdiction when he exercises his rights abroad. This might then induce the bankruptcy court to permit other creditors to join the hunt for the assets abroad.[87] Even if the creditor subsequently files a claim, the claim will not have a retroactive effect.[88]

The automatic stay, however, can be enforced by an injunction if the U.S. court has personal (*in personam*) jurisdiction over the creditor.[89] In this way, when the creditor is a U.S. citizen, he may not exercise individual rights abroad without the permission of the bankruptcy court. Should the creditor act without the court's permission then sanctions may be levied. The creditor must accept the debtor's discharge.[90] The issue is different with foreign citizens. In cases of foreign citizens, personal jurisdiction will only be affirmed when the foreign citizen has consented to the U.S. proceeding[91] or is subject to U.S. jurisdiction on other grounds.[92] Should jurisdiction be affirmed, then the foreign citizen is restrained from taking actions in violation of the automatic stay against the debtor's assets wherever located – at home or abroad.[93]

A leading example is *In re Nakasch*[94] where the court held that a foreign receiver, subject to personal jurisdiction of a U.S. court, violated the automatic stay by instituting voluntary insolvency proceedings against a debtor abroad. There was some discussion whether this rule would extend to any "case" filed in the U.S. even when another

---

[87] *In re* McLean Industries, Inc., 74 B.R. 589 (Bankr. S.D.N.Y. 1987); *cf.* Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX. INT'L L. J. 27 (1998).

[88] INT'L STATEMENT, *supra* note 74, at 112; *see also* Fotochrome, Inc. v. Copal Co., 517 F.2d 512 (2d Cir. 1975).

[89] Fotochrome, 517 F.2d at 515; Nakash v. Zur (*In re* Nakash), 190 B.R. 763, 768 (Bankr. S.D.N.Y. 1996).

[90] Underwood v. Hilliard, 98 F.3d 956, 961 (7th Cir. 1996); *In re* McTague, 198 B.R. 428, 430 (Bankr. W.D.N.Y. 1996).

[91] Detroit Trust Co. v. Campbell River Timber Co., 98 F.2d 389 (9th Cir. 1938).

[92] *In re* Nakash, 190 B.R. at 768; Hobson v. Travelstead (*In re* Travelstead), 227 B.R. 638, 654 (Bankr. D. Md. 1998).

[93] *See* Hong Kong & Shanghai Banking Corp. v. Simon (*In re* Simon), 153 F.3d 991 (9th Cir. 1998); INT'L STATEMENT, *supra* note 74, at 111; Jeremy V. Richards, *The Long Arm of Canadian Insolvency Law and a Tale of Three Jurisdictions*, 17 AM. BANKR. INST. J. 12 (1998) (international complications).

[94] 190 B.R. at 767.

country has primary jurisdiction, "but there is no authority for that result."[95]

The chances for foreign creditors to escape are slim. Bankruptcy courts follow the "global" pattern of *in rem* jurisdiction when they discuss personal (*in personam*) jurisdiction. They have developed an "uncanny propensity" to exercise worldwide jurisdiction based on consent or on other grounds. Their leading idea is that allowing a foreign creditor to seize property of the bankruptcy estate located outside the territorial confines of the United States would affect the "very" ability of the court to fairly distribute the assets.[96]

It is, therefore decisive to know what constitutes "consent" and "jurisdiction."

B. Consent

It is not entirely clear what activity might constitute consent to jurisdiction. It is, however, generally accepted that filing a claim in the proceeding is sufficient for consent regarding this claim.[97] The question, however, is whether participation with one claim constitutes comprehensive consent for all others.

1. Surrender

This problem of comprehensive consent was crucial to *In re* Simon.[98] There, the court bypassed the "block" of personal jurisdiction by avoiding to "squarely address that question because Hong Kong -Shanghai fully participated in the Simon bankruptcy, thus surrendering to United States jurisdiction."[99] However, the matter was more complicated than these words indicate.

The creditor had offered a proof of claim for another bank loan, but had not filed a proof of claim for the loan secured by the guaranty nor for the guarantor. Therefore, the Bank disputed an extraterritorial jurisdiction effect. The court did not accept that view. It concluded "[f]urther, as the district court noted, *Langenkamp v. Culp* . . . suggests that filing a proof of claim to any debt is sufficient to subject a creditor to the general jurisdiction of the bankruptcy court."[100]

---

[95] INT'L STATEMENT, *supra* note 74, at 140 n.235; *cf.* Evan D. Flaschen, et al., *Foreign Representation in U.S. Chapter 11 Cases: Filling the Void in the Law of Multinational Insolvencies*, 17 CONN. J. INT'L L. 3 (2001).

[96] Lykes Bros. S.S. Co. v. Hanseatic (*In re* Lykes Bros. S.S. Co.), 207 B.R. 282, 287 (Bankr. M.D. Fla. 1997).

[97] *See* Langenkamp v. Culp., 498 U.S. 42, 45 (1990); *In re* Lykes Bros. S.S. Co., 207 B.R. at 286; INT'L STATEMENT, *supra* note 74, at 111-12, 140 n. 237.

[98] 153 F.3d 991 (9th Cir. 1998).

[99] *Id.* at 997.

[100] *Id.*

The court also noted that the bank did not use other opportunities to assert its position in the bankruptcy court. The guarantor had listed the guaranty on his bankruptcy schedules without objection by the bank. The bank also made no objection to the discharge of the guarantor's debt: "by acceding to bankruptcy court jurisdiction so that it might recover a portion of the money it was owed, Hong Kong-Shanghai forfeited any right it had to claim that the court lacked the power to enjoin Hong Kong-Shanghai from commencing a post-bankruptcy collection proceeding against the debtor."[101]

2. *Circumvention*

Once established by consent, jurisdiction cannot be circumvented by later activities. The *In re Lykes Bros. S.S. Co.* German creditor "Altonia" and the Singapore creditor "Andrea" had claims against a U.S. corporation "Lykes." "Andrea" had filed a proof of claim in the respective Chapter 11 proceeding in Florida. Five days after the beginning of the proceeding both creditors assigned their claims to the German "Hanseatic" that seemed to have been created a few days after the assignment. The assignment documents required confidentiality — particularly toward "Lykes." "Hanseatic" then procured the arrest of one of Lykes' ships in a court in Belgium in order to compel payment of the claims "purportedly" assigned to it.[102] Subsequently Hanseatic attempted to compel arbitration of its claims in the United Kingdom. The court concluded: "It is not unreasonable to infer that Hanseatic was created and the claims assigned to Hanseatic to avoid the automatic stay, and to that extent, violate the automatic stay and this Court's . . . Stay Order."[103]

C. *Other Grounds for Jurisdiction*

The majority in the Hong Kong and Shanghai case, *In re Simon*, saw a more difficult jurisdictional problem "if the creditor was not a party to the United States bankruptcy proceedings."[104] The present trend, however, is to overcome that hurdle.

1. In re Chiles Power Supply Co.[105]

This case stands for the tendency to considerably broaden the traditional concept of personal jurisdiction. It centered around a discharge that was secured by the announcement of a permanent channeling injunction (Bankruptcy Code § 105) against all released claims.

---

[101] *Id.*
[102] *In re* Lykes Bros. S.S. Co., 207 B.R. at 285.
[103] *Id.*
[104] *In re* Simon, 153 F.3d at 996-97.
[105] 264 B.R. 533 (Bankr. W.D. Mo. 2001).

It should prevent "a chaotic and uncontrolled scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts."[106] The Canadian creditors sought discovery from the debtor through a Canadian court. The creditors had notice of the U.S. bankruptcy proceeding but did not participate in any way. The court was of opinion that their actions in Canada satisfied the jurisdictional minimum contact requirements, arguing that the creditors' action in a foreign court "poses a direct threat to the bankruptcy estate if it threatens to deplete the estate."[107]

The court listed three actions that may satisfy the minimum contacts requirement:[108] "(1) transacting business in the United States; (2) doing an act in the United States; (3) having an effect in the United States by an act done elsewhere."[109] The court relied on the third action as the creditor had sought discovery from a debtor in a Canadian court:

> As discussed above the Defendants' actions against Heatway and the Carriers in the Canadian Litigation, without regard to this Court's Order of Confirmation containing a release of all claims against the Carriers, threatens to torpedo a confirmed Chapter 11 Plan. . . As such the Defendants' actions in Canada not only satisfy the minimum contacts requirement, but have a profound effect in the United States where the estate res is located. I find, therefore, that this Court has personal jurisdiction over the Defendants, and that their actions are in violation of the automatic stay and the channeling injunction.[110]

2. In re Lykes Bros. S.S. Co.[111]

The court in *In re Lykes Bros. S.S. Co.* used the criteria delineated in *In re Chiles Power Supply Co.* to the fullest extent. The court asserted jurisdiction over a German firm, "Altonia," on the ground that the firm had transacted business in the United States by entering into a charter with Lykes, "a U.S. citizen," for the "foreign commerce of the United States with other citizens of the United States."[112] Among other factors, the court mentioned that the vessel had to be delivered

---

106 *Id.* at 540 (quoting Underwood v. Hilliard, 98 F.3d 956, 961 (7th Cir. 1996)).
107 *Id.* at 541.
108 *Id.* at 543.
109 *Id.* (citing Lykes Bros. S.S. Co. v. Hanseatic (*In re* Lykes Bros. S.S. Co.), 207 B.R. 282, 286 (Bankr. M.D. Fla. 1997)).
110 *Id.* at 543-44.
111 207 B.R. 282 (Bankr. M.D. Fla. 1997).
112 *Id.* at 286.

and redelivered in New York and that all bills of lading under the charter were subject to the Carriage of Goods by Sea Act[113] of the United States. However, the application of these general standards to discharges is not clear. Jurisdiction over the Singapore firm, "Andrea," was based on "consent," as the firm had "voluntarily filed its proof of claim"[114] in the present reorganization, and thus "purposefully submitted itself to this Court's jurisdiction."[115]

With regard to "Hanseatic," the court concluded: "nothing in the record warrants the conclusion that Hanseatic is subject to the personal jurisdiction of this Court." The court continued, asserting that it has "jurisdiction over all property of the estate where so ever located", even in Belgium.[116] Consequently, the court entered an injunction against "Hanseatic," arguing that the firm's actions were in willful violation of the jurisdiction of the bankruptcy court and the automatic stay. The effects doctrine gave the more general basis:

> Hanseatic has taken an action that it clearly knew or reasonably should have foreseen would have an effect in the United States. The clear intent of the seizure was to compel payment by a Chapter 11 debtor of the assigned claims. The actions clearly have effects in the United States inasmuch as they disrupt the Debtor's business with customers around the globe and also disrupt this Court's administration of this estate. The action also clearly affects the commerce of the United States and its citizens. Hanseatic knew or reasonably should have known that its conduct in seizing the M/V STELLA LYKES would have an effect in the United States. Consequently, this Court finds that the exercise of jurisdiction over Hanseatic does not violate traditional notions of fair play and substantial justice.[117]

D. Comity

Bankruptcy courts may be required by international comity "to abstain from exercising [their personal] jurisdiction where conflicts exist with foreign law."[118] Comity, as "the mutual respect of sovereigns,"[119] is a matter of practice, convenience, and expediency "rather

[113] 46 U.S.C. app. § 1300 *et seq.* (2000).
[114] *Id.* at 284.
[115] *Id.*
[116] *Id.* at 287.
[117] *Id.* at 288.
[118] Hobson v. Travelstead (*In re* Travelstead), 227 B.R. 638, 655 (Bankr. D. Md. 1998).
[119] Underwood v. Hilliard, 98 F.3d 956, 963 (7th Cir. 1996).

than law."[120] *In re Simon* argued that this principle of comity required "deference to the courts of Hong Kong."[121] The Bank argued that international bankruptcy was "territorial" in nature and that courts in each national jurisdiction are responsible for seizing and controlling assets within their geographic reach.[122] The debtor argued a "universalist" philosophy, with one transnational proceeding governing the administration of assets worldwide.[123]

The court, however, preferred a flexible approach dependent upon the circumstances in the particular case. Preference should be given to the country where the primary insolvency proceeding is located. In cases of multiple proceedings the courts will defer to where the center of gravity is, if it can be ascertained. As there was no competing bankruptcy proceeding going on in Hong Kong, the court saw no conflict between Hong Kong and U.S. laws. Following *Hartford Fire Ins. Co. v. California*,[124] the court concluded that comity is limited to cases in which "'there is in fact a true conflict between domestic and foreign law.'"[125] Other courts follow this precedent as well.[126] They will, for instance, take into consideration whether foreign "penalty payments" will be forfeited.[127]

E. *Act of State*

The comity aspect may gain strength through the act of state doctrine.[128] The act of state doctrine is implicated when a foreign receiver seeking to enforce a claim has a government status abroad (e.g. representing the Ministry of Justice). The *In re Nakash* court could not find "such acts to be those which a sovereign would undertake in fulfilling its duty to supervise bankruptcies. Rather, they are acts similar to those private creditors would undertake in a commercial role."[129] The court also mentioned that the receiver's personal liability for breach of his duties "is not consistent with sovereignty."[130] Such

---

[120] *See* Societe Nationale Industrielle Aerospatiale v. U.S., 482 U.S. 522, 543 (1987).
[121] Hong Kong & Shanghai Banking Corp. v. Simon (*In re* Simon), 153 F.3d 991 (9th Cir. 1998).
[122] *Id.*
[123] *Id.*
[124] Hartford Fire Ins. Co. v. California, 509 U.S. 764, 798 (1993).
[125] *Id.* at 797.
[126] *See In re* Simon, 153 F.3d at 991; Nakash v. Zur (*In re* Nakash), 190 B.R. 763, 770 (Bankr. S.D.N.Y. 1996).
[127] Hobson v. Travelstead (*In re* Travelstead), 227 B.R. 638, 657 (Bankr. D. Md. 1998).
[128] Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 417 (1964).
[129] *In re* Nakesh, 190 B.R. at 769.
[130] *Id.* at 770.

conflicts would not rise to the level of "imperiling relations between governments" or "embarrassing the U.S. executive branch in its conduct of foreign relations."[131]

VI. CRITICAL VIEWS

The present situation leaves room for discussion with regard to some of the underlying assumptions.

A. *Geography*

1. *Order of Orders*

If we take for granted that matters of legal sovereignty first have to do with location,[132] then assets located abroad are closer to the most affected territorial legal orders. Therefore, geography is the basis of all human ordering and of all Law. Also, if sovereignty means first physical control over assets and over how they are disposed of, then again the countries of location are closer to the issue. In *Watkins v. Holman* the Supreme Court stated: "[a]nd no principle is better established that the disposition of real estate, whether by deed, descent or by any other mode, must be governed by the law of the State where the land is situated."[133]

"It is well settled that where rights to real property are in issue, the law of the situs of the property controls."[134] This is the result of fundamental and universal interests analysis. Therefore, regulating the fate of assets located in another state is not to be taken lightly.

2. *Cross-border Fictions*

Cross-border fictions seems to be a clear concept among sister states and even more among sovereign states. Courts, however, do not have great regard for the territory of a foreign state. International and domestic cases have equal footing. For instance, the *In re Simon* creditor was in Hong Kong; Odyssey International Holding Ltd, though incorporated in the Virgin Islands, maintained offices and was operated in Hong Kong; and the debtor of the guaranty lived in Hong Kong.[135] The collection action commenced in Hong Kong against real estate

---

[131] *Id.*

[132] *See* Grossfeld, *Global Accounting*, *supra* note 59; Bernhard Grossfeld, *Geography and Law*, 82 MICH. L. REV. 1510 (1984).

[133] Watkins v. Holman's Lessee, 41 U.S. 25, 57 (1842).

[134] El Cid, Ltd. v. New Jersey Zink Co., 575 F.Supp. 1513, 1517 (S.D.N.Y 1983) (citing Carrolton Assoc. v. Abrams, 293 N.Y.S.2d 159 (1968)).

[135] Hong Kong & Shanghai Banking Corp. v. Simon (*In re* Simon), 153 F.3d 991 (9th Cir. 1998).

property located there.[136] It would not be farfetched to assume that given all these circumstances the "fiction of [U.S. location] should yield to the totality of [Hong Kong] contacts."[137]

The court won over reality by referring to the words "constructive possession" and "*custodia legis*." The first term is taken from *Katchen v. Landy*[138], where there was no international background.[139] The second term was used in *Commodities Futures Trading Comm'n v. Co Petro Marketing Group*[140] likewise without an international setting.

This is not simply a matter of transferring language within an international frame as fictions change their nature when going across borders.[141] *Bank of Augusta v. Earl*[142] told us long ago with regard to a corporation as an "artificial" being that a fiction "exists only in contemplation of law, and by force of law; and where that law ceases to operate, and is no longer obligatory, the corporation can have no existence."[143] Do U.S. fictions exist abroad where they are not protected by the Full Faith and Credit Clause[144] as they are within the United States? The Constitution's Full Faith and Credit Clause "substituted a command for the earlier principles of comity and thus basically altered the status of the States as independent sovereigns."[145] Federal law, such as the Bankruptcy Code, leads to the same result. According to the *Nottebohm* case of the International Court of Justice, "fictions" cannot be used unilaterally to govern the relation between sovereign states.[146]

3. *Strength of Precedents*

As to the inclusion of "property outside the territorial jurisdiction of the United States" the *Stegeman*[147] court came to a different conclusion from *Nottebohm*. However, the difference in the factual

---

[136] *Id.*
[137] Western Airlines Inc. v. Sobieski, 191 Cal.App.2d 399, 403 (1961).
[138] Katchen v. Landy, 382 U.S. 323, 327 (1966).
[139] *See also* Thompson v. Magnolia Petroleum Co., 309 U.S. 478, 481 (1939)
[140] 700 F.2d 1279, 1282 (9th Cir. 1983).
[141] Note, What We Talk About When We Talk About Persons: The Language of a Legal Fiction, 114 HARV. L. REV. 1745, 1750 (2001).
[142] 38 U.S. 519, 588 (1839).
[143] *See also* Case 81/87, Regina v. H.M. Treasury & Comm'r of Inland Revenue *ex parte* Daily Mail & Gen. Trust, 1988 E.C.R. 5483, [1988] 3 C.M.L.R. 713, 725 (1988).
[144] U.S. CONST. art. IV, § 1.
[145] Baker v. Gen. Motors Corp., 522 U.S. 222, 232 (1998) (quoting from Estin v. Estin, 334 U.S. 541, 546 (1948)).
[146] The Nottebohm Case (Liech. v. Guat.), 1955 I.C.J. 4 (Apr. 6).
[147] 425 F.2d 984, 986 (1970).

background is dramatic. In *Stegeman v. U.S.* the situation was reversed from *Nottebohm*: the debtor had "fraudulently transferred property from the District of Oregon to Canada."[148] The language was directed against "a large immunity for fraud as easily committed by citizens on the high seas and in foreign countries as at home."[149] Circumvention and concealment were the issues. The *In re Simon* debtor, however, disappeared from Hong Kong: "[i]nstead, facing personal debts of over 200 million, he traveled to the United States and filed a personal bankruptcy"[150] – leaving the assets behind.

Underwood v. Hilliard[151] also does not fully support the court's view. There the emphasis was that "the efficacy of the bankruptcy proceedings depends on the court's ability to control and marshal the assets of a debtor wherever located (see sect. 541 (a))."[152] National fictions do not give such control over assets abroad.

B. *Domestic v. Extraterritorial Effects*

The cases *In re Chiles Power Supply Co.*[153] and *In re Lykes*[154] tell another strange lesson. They change the traditional concept of domestic effects and of extraterritoriality.

1. *"Domestic Globality"*

Due to the fictitious location of assets in the United States, activities abroad that conflict with an extraterritorial fiction were held to have domestic effects in the United States. The whole world thus becomes globally "domestic;" fiction prevails over fact. Effects are no longer seen as being physical in nature. It is enough that they conflict somewhere in the world with a legal network that pretends globality. Extraterritorial reach has domestic effects. It would be more honest than that which the *In re Simon* dissent had proposed: there is no question of extraterritoriality, because for reorganizations purposes all matters are domestic as this fiction 'domesticates' them *there*![155]

2. *Loss of Focus*

In the two cases just mentioned, *In re Chiles Power Supply Co.* and *In re Lykes*, the terms "domestic" and "extraterritorial" lose their

---

[148] *Id.* at 985.
[149] *Id.* at 986.
[150] Hong Kong & Shanghai Banking Corp. v. Simon (*In re* Simon), 153 F.3d 991, 994 (9th Cir. 1998).
[151] 98 F.3d 956 (7th Cir. 1996).
[152] *Id.* at 961.
[153] 264 B.R. 533, 542 (Bankr. D.W. Miss. 2001).
[154] 207 B.R. 282, 287 (Bankr. M.D. Fla. 1997).
[155] *In re* Simon, 153 F.3d at 1000.

focus. If we look at it closer, we see immediately that "domestic," in terms of time, applies first to Canada and Belgium and then to the United States. Similarly, the term "extraterritorial" becomes ambiguous. Both terms backfire toward each other, constantly changing between domestic and extraterritorial effects. The distinctions in geography are made senseless through verbal fictions.

But the basic facts remain unchanged: the primary territorial and social effects are where the assets are located; the effects outside this location are secondary. They have to cross a nonphysical bridge built unilaterally cross-border into Canadian or Belgian territory. Domestic turns into extraterritorial and vice versa due to the power of words!

C. Comity

The trouble is that the abstract term "comity," as taken from *Hartford Fire Insurance Co. v. California*,[156] seems to have been applied to different facts and circumstances. In *Hartford Fire Insurance*, English reinsurance companies had "conspired in violation of sect. 1 Sherman Act to restrict the terms of coverage of commercial general liability . . . insurance available in the United States."[157] The *Hartford Fire Insurance* defendants tried to take value out of the United States. In *Hong Kong & Shanghai* and similar cases, the issue was whether the "fiction of possession" over real estate outside the United States could be turned into "something" more real, channeling the monetary value of the assets to participants in a U.S. proceeding – a proceeding tainted by U.S. interests.[158] In *Sterling Drug Incorporated v. Bayer AG*[159] the Court of Appeals for the Second Circuit came closer to the second view. It held that *Hartford Fire Insurance* was "not automatically transferable to the trademark context:"[160]

> It is one thing for the British reinsurers in Hartford Fire to be barred under United States law from boycotting activity that they might be free to engage in without violating British law. But it is quite a different thing for the holder of rights in a mark under German law to be ordered by a United States court to refrain from uses of that mark protected by German law.[161]

The court also quoted from the Restatement of Law of Unfair Competition: "[i]n establishing the parameters of injunctive relief in the case of

[156] 509 U.S. 764, 798 (1993).
[157] *Id.* at 770.
[158] *In re* Simon, 153 F.3d at 991.
[159] Sterling Drug Inc. v. Bayer AG, 14 F.3d 733 (2d Cir. 1994).
[160] *Id.* at 746.
[161] *Id.* at 747.

lawful concurrent users, a court must take account of the realities of the market place."[162]

D. *Full Faith and Credit Clause*[163]*—Analogy*

When bankruptcy courts inhibit the execution of claims in foreign real estate they control the disposition of part of the foreign territory and effectively prevent the exertion of foreign legal rules. There seems to be little doubt that, in the first place, it is the foreign country's matter to enforce a domestic creditor's claim against a domestic piece of land. This comes close to the general territorial principle of execution that the U.S. Supreme Court only recently affirmed in *Baker v. Gen. Motors Co.*:

> Full faith and credit, however, does not mean that States must adopt the practices of other States regarding the time, manner, and mechanisms for enforcing judgments. Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the evenhanded control of forum law.[164]

The Court referred to the Restatement (Second) of Conflict of Laws: "the local law of the forum determines the methods by which a judgment of another state is enforced."[165]

Given these views, injunctions against foreign creditors, which prohibit enforcement of their claims against assets abroad, will remain controversial. They put the local assets under a foreign country's control, thus bringing its monetary value into foreign coffers.

E. *Creditors' Interests*

1. *Domestic Enforcement Chances*

From the foreign creditors' point of view foreign states cannot be treated as being on the same level with sister states. Sister state cases "live" under the common umbrella of Federal bankruptcy law whereas international cases occur under different national bankruptcy laws with different rules. This causes a lot of concern: if creditors are prevented from attachments in their home countries, somebody else clever enough not to be regarded as bound by U.S. law or not subject to U.S. sanctions, may take advantage of it. As a practical result, credi-

---

[162] *Id.* (quoting RESTATEMENT OF THE LAWS OF UNFAIR COMPETITION § 35 (Tentative Draft No. 3, 1991)).
[163] U.S. CONST. art. IV, § 1.
[164] Baker v. Gen. Motors Co., 522 U.S. 222, 235 (1998).
[165] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 99 (1969).

tors have to leave the assets in which they put their trust and which reflect local interest rates to a wide range of other creditors which the bankruptcy court cannot prevent from pursuing their interest.

This leads us to the question, whether reorganizations can be argued without regard to the assumptions of where the debtor's assets are located. *Cole v. Cunningham*[166] told us long ago, that injunctions against an out of state attachment "evade" the laws of the proper jurisdiction (defined by "domicile" in that case). The *In re Simon* bank had its domicile in Hong Kong where the debtor had been domiciled and the assets were located when he gave the guaranty.[167] The loan was given on the reasonable expectation that the risk could be evaluated under the debtor's conditions in Hong Kong. There were no "foreign risks" in the contemplation of the parties. Very probably this affected the interest rate for the loan, (no "foreign risks – factor" added) and thereby the price of the transaction. All of a sudden the security became a "foreign" asset through the debtor's unilateral action. By "traveling" to the United States the debtor effectively "expropriated" the domestic creditor to an unpredictable extent. Should courts use fictions to protect such behavior?

2. *Change of Risks*

The loss of chances to enforce claims domestically might even considerably change positions of substantive law. That starts with currency fluctuations and with possibly different priorities for the creditor[168] and might burden him with risks that were not within the expectation of the parties when they agreed on the price for the debt. The creditor might have to share the debtor's estate with creditors that would have had no chances to share with him under domestic bankruptcy rules. Examples include creditors from punitive damage claims,[169] from more liberal or newly invented "piercing the corporate veil rules,"[170] or from attorneys' contingency fees. We can also take for granted that the creditor has much less influence over foreign proceedings than over a domestic proceeding.

---

166 *See* 133 U.S. 107 (1890).

167 Hong Kong & Shanghai Banking Corp. v. Simon (*In re* Simon), 153 F.3d 991, 994 (9th Cir. 1998).

168 *See* discussion *infra* Part V.G.

169 Steven Garber, *Punitive Damages and Deterrence of Efficiency: A Problem Without a Solution*, 52 STAN. L. REV. 1809 (2000).

170 *Cf.* U.S. v. Bestfood, 524 U.S. 51 (1998); Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999); Damien Considine, *The Real Barriers to Regulation of Corporate Groups*, 3 ASIA PAC. L. REV. 37 (1994); Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory – Chinese Private Perspective*, 52 STAN. L. REV. 1599 (2000).

Bankruptcy venues are more than just a matter of procedure. These venues are risk relevant – as the high Delaware refiling rate clearly indicates – and they exert a deep impact on issues of substantial law. Therefore they are also price relevant and will become an important factor when "rating" a corporation's credit standing for creditors from abroad.

F. Comprehensive Surrender

This leads us into similar doubts with regard to the comprehensive "surrender" concept. As venue is risk and price relevant, creditors might have sound reasons not to be too "liberal" towards foreign bankruptcy proceedings. In addition, the authorities normally referred to for the "lump-surrender" approach are weak. *Langenkamp v. Culp* differs on the facts, "[r]espondents filed claims against the bankruptcy estate, thereby bringing themselves within the equitable jurisdiction of the [b]ankruptcy [c]ourt. Consequently they were not entitled to a jury-trial on the trustee's performance action."[171] Again, there was no international implication.

There may also be difficulties with the concept of surrender if the creditor and debtor expressly agree on enforcement in a particular country and exclude others. Paragraph 15 of the *In re Simon* debtor's guaranty provided that, it should be "construed and determined under and may be enforced in accordance with the laws of Hong Kong."[172] Such a clause could be interpreted as excluding any other forum. Is this meaningless, given the fact that the debtor has wide opportunities to choose the bankruptcy venue?

G. Public Interest (Political Economy)

But there is also a strong public interest involved when an injunction from abroad limits the free disposition of domestic assets. The power to regulate what assets, in particular real estate and corporate shares, can be freely disposed of is *the* core question of every economic balance and is a central issue of sovereign regulatory power. An injunction by a foreign court is a harsh interference by that sovereign into the domestic flow of assets and privilege to decide who should acquire them. Injunctions from abroad put these assets under foreign control and use the foreign creditor as a private instrument for implementing foreign public policy goals whose "credibility" is often difficult to evaluate.

Another concern is that all unilaterally imposed cross-border movements of valuable assets have an important characteristic: their

---

171 *Id.* at 45.
172 153 F.3d at 991.

monetary value is largely "sipped away" from the domestic economic circle and transferred into the economic circle of another country – often never to return. This again distinguishes international transfers from sister state transfers within the United States. In the latter case the value of the assets remains within the U.S. economy.

VII. FOREIGN REACTIONS

A. *Global Implications*

So far, Delaware and reorganization are mainly subjects for discussions within the United States. Critiques of Delaware reorganization law are of little practical consequences as they do not affect the validity of Delaware incorporations or reorganizations within the United States. For incorporations entities, the Constitution's Full Faith and Credit Clause[173] forms a protective shield, as it provides for the recognition of most judicial proceedings of every State of the Union.[174] It "substituted a command for the earlier principles of comity and thus basically altered the status of the States as independent sovereigns."[175] We could also explain it as creating a taboo to questioning the basis for "full faith" and the intrinsic "fairness" of the procedure. For reorganizations the result is the same because bankruptcy law is federal law and, therefore, applicable everywhere in the United States.

These defensive taboos cannot be used against foreign states. Giving the critical arguments raised within the United States, Delaware has a remaining credibility problem. As long as foreign states are not bound by comity or international treaty obligations, they will ask whether they may grant full faith and credit (call it "comity" in trans-border cases) to Delaware reorganizations. The controversial status of Delaware within the United States causes the classic "lemons" story outside the United States.[176] States have learned from experience that other states are both willing and able (call it "diplomacy") to mask an unflattering picture with verbal cosmetics and to "get a facelift" (making "face to face" recognition even more difficult).[177] The term "imperfect information and credible communica-

---

[173] U.S. CONST. art. IV, § 1.

[174] Baker v. Gen. Motors Co., 522 U.S. 222 (1998); *see* Mark Strasser, *Baker and Some Recipients for Disaster: On DOMA, Covenant Marriages, and Full Faith and Credit Jurisprudence*, 64 BROOK. L. REV. 307 (1998).

[175] Estin v. Estin, 334 U.S. 541, 546 (1948).

[176] George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

[177] Claire A. Hill, *Why Financial Appearances Might Matter: An Explanation for "Dirty Pooling" and Some Other Types of Financial Cosmetics*, 22 DEL. J. CORP. L. 141, 142 (1997).

tion"[178] describes the issue perfectly – or should we talk of the "lemon" approach in international relations? Whatever the name, we have to analyze the communication game between a sender and a receiver with misaligned incentives and, therefore, a possible lack of equilibrium in global reorganizations.

B. Territory v. Fiction "Nottebohm"

The traditional skepticism against trans-border effects of fictions will be the first line of defense. This skepticism, as expressed in *Bank of Augusta*, is supported by the *Nottebohm* case[179] and shared in other jurisdictions. A famous example is the language of the European Court of Justice in the *Daily Mail & Gen. Trust* case:

> In that regard it should be borne in mind that, unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning.[180]

Here the purpose was to secure national control over domestic corporations. We may take for granted that the sentiment is even stronger, when fictions are used to make domestic real estate a foreign asset. What counts are not fictions but effects. Are fictions "genuine links" for real estate?[181] Probably not.

C. Economic Effects - "Fruehauf"

The international test is still the *Fruehauf* case that pitched France against the United States.[182] The case turned around the extraterritorial effects of the U.S. Trading with the Enemy Act[183] that caused defensive actions by the French courts[184] - with international applause.[185] Here, the detrimental effects on the foreign economy and on its concept of distribution of risk are most easily recognizable when

---

[178] *See* Fischer & Stocken, *supra* note 1.

[179] The Nottebohm Case (Liech. v. Guat.), 1955 I.C.J. 4 (Apr. 6).

[180] Case 81/87, Regina v. H.M. Treasury & Comm'r of Inland Revenue *ex parte* Daily Mail & Gen. Trust, 1988 E.C.R. 5483, [1988] 3 C.M.L.R. 713, 725 (1988).

[181] *See* The Nottebohm Case (Liech. v. Guat.), 1955 I.C.J. 4 (Apr. 6) (discussing what constitutes a real link between the naturalized person and the naturalizing nation).

[182] Societe Fruehaf-France v. Massardy, CA Paris, 14e ch., May 22, 1965, J.C.P. 1965, II, 14247 (France), 5 I.L.M. 476 (1966).

[183] 50 App. U.S.C.A. § 1 *et seq.* (2004).

[184] RECUEIL DALLOZ-SIREY, JURISPRUDENCE 147 (1968).

[185] *See* Andrea Bianchi, *Extraterritoriality and Export Controls*, 35 GER. Y. INT'L L. 365 (1992); William Laurence Craig, *Application of the Trading with the Enemy*

the foreign creditor enforces a secured debt in a foreign asset serving as security. The order of priority as the basis for the interests charged might be quite different under U.S. bankruptcy rules.[186] Also, receiving shares in a Delaware corporation might not be regarded by foreign creditors as a proper investment. An enforced reliance on Delaware's internal affairs rules might bring foreigners into a situation that they are unable to control at reasonable costs.

D. Credible Commitment

Negative foreign reactions might also be driven by a rising distrust in U.S. courts. This starts with skepticism toward local influences on U.S. judges. Popular election contests sponsored by lawyers[187] are a constant matter of concern for foreign claimants and defendants.[188] The following words of Judge Richard Neely from the West Virginia Supreme Court of Appeals are often quoted:

> As long as I am allowed to redistribute wealth from out-of-state companies to injured in-state plaintiffs, I shall continue to do so. Not only is my sleep enhanced when I give someone else's money away, but so is my job security, because the in-state plaintiffs, their families, and their friends will reelect me.[189]

And even where judges are appointed (as in federal courts) such legal "melodies" are remembered when U.S. authors allude to "judge shopping"[190] or indicate their displeasure with judges who might not be resistant to local legal culture.[191]

E. Friendly "Fire"?

This cross-border atmospheric environment might be important though "friendly fire" can also be harmful. But even below the level of "fire," all individual injunctions to secure the global reach of Delaware reorganizations might be futile, if the foreign state is not

Act to Foreign Corporations Owned by Americans: Reflections on Fruehauf v. Massardy, 83 HARV. L. REV. 579 (1970).

[186] *Cf.* The Bank of New York & JCPL Leasing Corp. v. Treco (*In re* Treco), 240 F.3d 148, 156 (2d Cir. 2001) (discussing the reverse situation).

[187] Alexander Tabarrok & Eric Helland, *Court Politics: The Political Economy of Tort Awards*, 42 J.L. & ECON. 157 (1999).

[188] Rolf A. Schuetze, *Richterwahlsponsoring: Ueberlegungen zur Ordre Public-Widrigkeit von Urteilen US-Amerikanischer Staatsgerichte*, 100 ZEITSCHRIFT FUER VERGLEICHENDE RECHTSWISSENSCHAFT 464 (2001).

[189] RICHARD NEELY, THE PRODUCT LIABILITY MESS 4 (1988).

[190] *See* Eisenberg & LoPucki, *supra* note 24, at 972; Skeel, *Lockups*, *supra* note 22 at 1274.

[191] *See* LoPucki, *A Response*, *supra* note 20, at 354.

willing to go along with it or if it is not offering a willingness not to interfere. But the motivation to grant international comity needs constant "watering" and should not be taken for granted. Otherwise, anti-injunctions[192] and claw back statutes[193] hang in the air and might lead to unexpected reactions. Remember "*Fruehauf*"![194]

VIII. "REVERSE SITUATION"—TEST

To test the inherent cross-border fairness of the U.S. concept of comity in bankruptcy proceedings it is advisable to discuss the issue in a reverse situation. How would U.S. courts react in the following situation: a foreign state – similar in size and in reputation to Delaware and with reorganization proceedings similar to the U.S. law[195] – would enjoin U.S. creditors (not parties to the foreign proceeding) from enforcing their claims against U.S. debtors in the debtors' real estate located somewhere in the United States? How would U.S. courts react if the foreign state applied similar standards of "comity" towards the United States? Would U.S. courts be willing to give that which they are willing to take? Let us imagine a hypothetical case where a bankruptcy court in Liechtenstein (the European Delaware) issues such an injunction. How would Liechtenstein fare in the United States given the fact that its status as a corporate home away from home was as controversial as Delaware's?[196]

A. *U.S. Domestic Control*

The general answer is that in final analysis the U.S. controls the extraterritorial effects of foreign reorganizations. Bankruptcy Code § 304 represents a "modified universalism."[197] The intent is "to deal . . .with the legal effect the United States courts will give to foreign bankruptcy proceedings"[198] as defined in the Bankruptcy Code § 101(23). The overriding purpose is to prevent piecemeal distribution

---

192 *Cf.* Airbus Industries GIE v. Patel, 2 All E.R. 257 (H.L. 1998); British Airways Bd. v. Laker Airways Ltd., 1 A.C. 58 (H.L. 1985); Bernhard Grossfeld & C. Paul Rogers, *A Shared Values Approach to Jurisdictional Conflicts in International Economic Law*, 32 INT'L & COMP. L.Q. 931 (1983).

193 *Cf.* Protection of Trading Interests Act, 1980, c. 11 (Eng.).

194 *In re* McTague, 198 B.R. 428, 430 (Bankr. W.D.N.Y. 1996).

195 *Cf.* Yoder v. Yoder, 330 A.2d 825, 826 (1974).

196 *See In re* Bank of Credit & Commerce, S.A., 4 All E.R. 796 (Q.B. 1966) (describing the U.K. proceedings in the BCCI case); E. Bruce Leonard, *The International Year in Review*, 19 AM. BANKR. INST. J. 24 (2001) (describing the Canadian scene); LoPucki, *A Post-Universalist Approach*, *supra* note 4, at 718.

197 Jay Lawrence Westbrook, *International Insolvencies: The Lessons of Maxwell Communication*, 64 FORDHAM L. REV. 2531, 2533 (1996).

198 Cunard S.S. Co. v. Salen Reefer Serv. AB, 773 F.2d 452, 454 (2d Cir. 1985).

of a debtor's estate. But it is not an unconditional giving way. Section 304 *authorizes*, but does *not require*, action by the bankruptcy court to protect the assets of the foreign estate against creditors and to order turnover to the foreign proceeding. It reserves "to local courts discretion to evaluate the fairness of home country procedures and to protect the interests of local creditors."[199] Therefore, the interest of "local creditors" reigns supreme. Creditors remain free to proceed with their claims against the debtor, and liquidate the debtor's U.S. assets, if the bankruptcy courts abstain from action.[200]

Consequently, the U.S. bankruptcy courts are the final arbiters to exert control over the assets of a foreign estate and, thus, retain domestic authority over the liquidation of such assets within U.S. territories.

The bankruptcy court will evaluate the foreign bankruptcy system. Section 304(c)(4) mandates that the distribution of proceeds of such estate is "substantially in accordance with the order prescribed by this title."[201] This indicates that the United States wants to keep final control over the issue of who distributes the proceeds to whom. A

---

[199] Maxwell Communication Corp. v. Barclays Bank (*In re* Maxwell Communication Corp.), 170 B.R. 800, 816 (Bankr. S.D.N.Y. 1994).

[200] LoPucki, *A Post-Universalist Approach*, *supra* note 4, at 727.

[201] In 2001, the House and Senate approved chapter 15 of the Bankruptcy Code, which covers ancillary and other cross-border cases. It currently awaits reconciliation. Proposed § 1507(b) is the new version of § 304(c) and is substantially modeled on § 304(c). The proposed text of the House and Senates versions § 1507(b) are identical and read as follows:

> 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 proceedings concerns.

bankruptcy court's decision not to yield to a foreign proceeding is reviewed on appeal only for abuse of discretion.[202]

B. Comity

Certainly, comity should be a "two-way street."[203] But the problem is whether we apply the same "comity" both ways: as limits to *our* extraterritorial ambitions and to the extraterritorial ambitions of *others*. Section 304(c)(5) also refers to comity[204] "as the ultimate consideration in determining whether to provide relief under section 304."[205] The general standard of comity applied towards foreign reorganizations is taken from *Hilton v. Guyot*:

> Comity, in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will upon the other. But it is the recognition one nation allows within its territory to the legislative, executive and judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protections of its laws[206]

The Court gave the following list of requirements for comity. It required the opportunity for a full and fair trial abroad before a court of competent jurisdiction, a regular proceeding after due citation or voluntary appearance of the defendant, an impartial administration of justice between the citizens of country and those of other countries. In addition, there must be an absence of prejudice in the court or in the system of law under which the court is sitting; there should be no fraud in procuring the judgment.

C. Foreign Debtor/Foreign Assets

The outcome is often clear when the debtor is a foreign corporation and when its principal assets are located abroad. "American courts have consistently recognized the interest of foreign courts in liquidating or winding up the affairs of their own domestic business entities."[207] But location of the assets seems to have reigned supreme.

---

[202] Hobson v. Travelstead (*In re* Travelstead), 227 B.R. 638, 656 (Bankr. D. Md. 1998).
[203] *Id.* at 657.
[204] *See* Finanz AG Zuerich v. Banco Economico S.A., 192 F.3d 240 (2d Cir. 1999).
[205] The Bank of New York & JCPL Leasing Corp. v. Treco (*In re* Treco), 240 F.3d 148, 156 (2d Cir. 2001).
[206] 159 U.S. 113 (1895); *cf.* *In re* Travelstead, 227 B.R. at 655.
[207] *In re* Spanish Cay Co., 161 B.R. 715, 725 (Bankr. S.D. Fla. 1993) (quoting Cunard S.S. Co. v. Salen Reefer Serv. AB, 773 F.2d 452, 454 (2d Cir. 1985)).

The *In re Spanish Cay Co.* court put the primary focus on comity and location and stated:

> The Debtor is a Bahamian corporation, its principal asset a Bahamian island. The Island has been pledged to creditors under debentures which were executed under Bahamian law and which provided for the rights of the parties to be determined under Bahamian law. Furthermore, the expert witness on Bahamian law . . . stated that the laws of the Bahamas regulating the sale of real estate would not be preempted by the exercise of jurisdiction over the Debtor by a United States Bankruptcy Court. Based upon these considerations, the Court concluded that the principle of comity required that it respect the paramount interests of the Commonwealth of the Bahamas and its laws governing both the insolvency of its domestic corporations and rights with respect to real property located in the Bahamas.[208]

Apparently the real property aspect weighed heavily on the court:

> While the Court could have attempted to fashion relief in the United States bankruptcy proceedings through personal jurisdiction over [Canadian Imperial Bank of Commerce] and other creditors, and its ability to order those subject to its jurisdiction to take certain actions in the Bahamas, the Court deemed it inappropriate to attempt to accomplish indirectly that which it could not do directly because on the limitations on its jurisdiction over Bahamian real property.[209]

This issue was elaborated at length in the Supplemental Opinion:

> Applying the principle of comity and deferring to the Bahamian courts and Bahamian law to govern any insolvency proceeding with respect to this Debtor is appropriate here since (1) the Debtor is a Bahamian Company and (2) the Debtor's principal asset is real property located in the Bahamas. These facts weigh heavily in favor of abstention and dismissal of these proceedings. The courts of the Bahamas have the greatest interest in liquidating the assets of the Debtor. Moreover, it is a basic tenet of international law that real property should

---

[208] *Id.*

[209] *Id.*

> be governed by the laws of the country in which the property is located.[210]

The court also considered, under the comity analysis, the rights of all persons who are under the protection of the laws of the United States:

> As a matter of law, creditors dealing with the Debtor knew or should have known that they were dealing with a Bahamian company and that they would be bound by the laws of the Bahamas. The law is clear that "every person who deals with a foreign corporation impliedly subjects himself to such laws of the foreign government, affecting the powers and obligations of the corporation with which he voluntarily contracts as the known and established policy of that government authorizes.
>
> In this case both the Debtor and its creditors reasonably expected that Bahamian insolvency law would govern. In loan documents between the Debtor and CIBC, the parties specifically contracted for Bahamian law to apply. . . . In negotiating the mortgage the Debtor advised P. B. Davis in writing that the mortgage must provide for venue in the Bahamas and for Bahamian law to apply in any litigation. Thus, both the Debtor and its major creditors expected that Bahamian law would govern any insolvency proceeding of this Debtor.[211]

The court did not accept the argument that Bahamian law did not provide for reorganization:

> The potential for a successful Chapter 11 reorganization in this case is questionable, at best, since certain orders of this court this Court may be given no effect in the Bahamas. . . . This Court could not prevent Bahamian citizens and the Bahamian governmental agencies from proceeding with their claims against the Debtor during the pendency of this bankruptcy case.[212]

---

[210] *Id.* (quoting El Cid, Ltd. v. New Jersey Zink Co., 575 F.Supp. 1513 (S.D.N.Y 1983) (stating "It is well settled that where rights to real property are in issue, the law of the *situs* of the property controls.").

[211] *Id.* (quoting Matter of Culmer, 25 B.R. 621, 632 (Bankr. S.D.N.Y. 1982)).

[212] *Id.*

D. *Foreign Debtor / U.S. Assets*

The location of the assets in the United States was decisive in *Underwood v. Hilliard.*[213] This case dealt with a corporation incorporated in the Federation of Saint Christopher and Nevis, a Commonwealth Caribbean island ("Horatio Nelson, later Admiral Lord Nelson, was married in Nevis").[214] The court considered that "all of Rimsat's assets (save a bank account with only $1,700 in it), creditors and shareholders are located outside of Nevis."[215] Therefore Nevis may be an "inconvenient forum" to be "still another reason not to abstain in favor of it."[216]

The court concluded:

> Given the location of the debtor's headquarters and financial assets, the uncertainty concerning the exact nature of the Nevis receivership, and in the absence of any indication that U.S. bankruptcy law requires a resolution of the disputes among the debtor's shareholders and creditors that would offend the principles that Nevis would apply . . . it is evident that the bankruptcy court in Fort Wayne provides a more suitable and convenient forum for the resolution of these disputes than the court in Nevis.[217]

E. *U.S. Creditors / U.S. Assets*

The case most on point for our discussion is *In re Treco* where the court discussed § 304(c)(4) in view of a bankruptcy proceeding in the Bahamas.[218] A secured U.S. creditor (secured on assets in the United States) held a claim that was subject to diminution by administrative expenses in the Bahamas but not in the United States. The court discussed the matter "in light of all the circumstances"[219] and came to the conclusion that violating the "order of priority accorded to various types of creditors" would be inconsistent with U.S. standards for the special protected status of secured creditors.[220]

The court distinguished between the "macro systematic concepts" of the first three factors of the Bankruptcy Code § 304(c)(1-4) (just treatment of all claimholders; prejudices or inconveniences for

---

213 Underwood v. Hilliard, 98 F.3d 956, 961 (7th Cir. 1996).
214 *Id.* at 959.
215 *Id.* at 964.
216 *Id.* at 962.
217 *Id.* at 963.
218 The Bank of New York & JCPL Leasing Corp. v. Treco (*In re* Treco), 240 F.3d 148, 158-60 (2d Cir. 2001).
219 *Id.* at 156.
220 *Id.*

U.S. claimholders; inadequate protection against the risks of preferential or fraudulent dispositions[221]) from the fourth factor.[222] This fourth factor requires U.S. courts to consider differences of law "in determining whether affording comity will be repugnant to American public policies."[223]

The court emphasized that it was not creating a presumption against affording comity to Bahamian bankruptcy proceedings.[224] It did refer to the Fifth Amendment's Takings Clause that prohibits the taking of "private property. . .for public use, without just compensation."[225] If the claim were secured, then § 304 took care of the matter; if it were unsecured, then it would not be "property" for purposes of the takings clause.[226] The court also held that a forum selection clause does not preclude a court from granting comity where it is otherwise warranted.[227]

However, the consequence of *In re Treco* seems to be far reaching. It gives bankruptcy courts greater discretion to protect creditors and it opens up more "gray areas." How much disparate treatment will be tolerated? Ronald J. Silverman describes the outlook as follows:

> Treco . . .indicates that any significant difference in ordering is susceptible to attack in an ancillary proceeding. The court's broad language might also allow for the application of the principles enunciated in Treco to unsecured creditors as well. Seemingly, any significant departure from the ordering scheme set forth in the Bankruptcy Code may now be vulnerable to attack in an ancillary proceeding brought in the United States.[228]

F. Fundamental Fairness

In addition, courts look for fundamental fairness. The question comes up when the transfer to a foreign proceeding places the risk of

---

221 *See* Finanz AG Zuerich v. Banco Economico S.A., 192 F.3d 240, 249 (2d Cir. 1999) (discussing factors of procedural fairness).
222 *In re Treco*, 240 F.3d at 158.
223 *Id.*
224 *Id.* at 161.
225 U.S. CONST. amend. V.
226 *In re Treco*, 240 F.3d at 161 (referring to Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 602 (1935), finding that government action which took the "property of individuals mortgages in order to relieve the necessities of individual morgagors" to be a compensable taking).
227 *Id.* at 163.
228 Ronald J. Silverman & Helder P. Pereira, *The International Scene: Second Circuit Explores Parameters of Ancillary Jurisdiction*, 20 AM. BANKR. INST. J. 14 (May 2001).

currency fluctuations on the creditor. This danger occurs when the claim will be converted into the currency of the foreign state. However, courts take into account that Bankruptcy Code § 502(b) also determines the amount "in lawful currency of the United States."[229] There is, however, a proviso: it might be fundamentally unfair if the early conversion of a creditor's claim into foreign currency would render the debt unenforceable or valueless.[230]

G. *Foreign Discharges*

There is presently no case concerning the recognition of foreign discharges in the United States. The Transnational Insolvency Project discussed this absence in U.S. jurisprudence:

> There is no significant authority in the United States as to United States recognition of a foreign discharge when the United States was the primary insolvency jurisdiction. In general, it would seem that modified universalism would look to the primary jurisdiction for a centralized Discharge, but it is difficult to anticipate the circumstances that would raise the question if the United States was the primary jurisdiction and the discharge was granted elsewhere.[231]

H. *Full Faith and Credit—Analogy*

Additional insights into the probability of negative U.S. reactions might be derived from the Full Faith and Credit Clause.[232] In *Baker v. Gen. Motors Corp.*[233] the U.S. Supreme Court considered such a case. There, the parties had agreed to a permanent injunction barring one of them from testifying as a witness in any later litigation between them. A Michigan county court accordingly entered the injunction. Afterwards, plaintiffs who were not involved in the Michigan case subpoenaed the concerned party to testify before a Missouri court. The U.S. Supreme Court held that the party could testify in the Missouri action without offending the Full Faith and Credit Clause.[234]

The Court argued that orders commanding action or inaction were not enforceable in a "sister State" when they purported to accom-

---

229 Finanz AG Zuerich v. Banco Economico S.A., 192 F.3d 240, 250 (2d Cir. 1999) (quoting 11 U.S.C. § 502 (2003)).
230 *See id.*; Pravin Banker Assocs., Ltd. v. Banco Popular del Peru, 109 F.3d 850, 853-54 (2d Cir. 1997).
231 INT'L STATEMENT, *supra* note 74, at § III(C)(6).
232 U.S. CONST. art. IV, § 1.
233 Baker, 522 U.S. 222 (1998).
234 U.S. CONST. art. IV, § 1.

plish "an official act within the exclusive province of that other State."[235] It should be noted, however, that the Court added the proviso: "such a decree may indeed preclusively adjudicate the rights and obligations running between the *parties* to the foreign litigation."[236] The Court also held that a court in one State, "in a proper case, could compel a defendant before it to convey property situated in another State."[237] For a "proper case," we have to look into the cases quoted by the court, in particular *Fall v. Eastin.*[238] There, the Supreme Court held that a decree is ineffective to transfer title in another state.[239] With regard to injunctions, however, the Court said, "[t]he territorial limitation of the jurisdiction of courts of a State over the property in another State has a limited exception. . .but it is an exception well defined."[240] *Robertson v. Howard,*[241] also alluded to "a proper case," and in *Cole v. Cunningham*[242] we find the definition of the exception. The Supreme Court came to the conclusion that a Massachusetts court could issue a decree "restraining citizens of that Commonwealth from the prosecution of attachments suits in New York brought by them for the purpose of evading the laws of their domicile."[243]

The Supreme Court's decision brings us back to what we heard before: evasion is the decisive point of view.[244] Outside this aspect, courts of one state should refrain from interfering with the regulation of assets located in another state against creditors that are not parties to the reorganization proceedings.

I. Drapery of Illusion

Overall, U.S. courts are not likely to welcome foreign injunctions that are contrary to policies or prejudicial to interests of the United States.[245] Not only is this unfriendliness a response to major

---

[235] Baker, 522 U.S. at 235.

[236] *Id.*

[237] *Id.* at 236 (quoting Robertson v. Howard, 229 U.S. 254 (1913)).

[238] 215 U.S. 1 (1909).

[239] *Id.* at 8 (quoting Watts v. Waddle, 31 U.S. 389, 400 (1838))

[240] *Id.*

[241] Robertson, 229 U.S. at 26 (indicating the ability of a court in equity, in a proper case, to compel a defendant to convey property located in another state).

[242] Cole v. Cunningham, 133 U.S. 107 (1890).

[243] *Id* at 111.

[244] *See id.*; *see also* Richard W. Raushenbush, Note, *Antisuit Injunctions and International Comity*, 71 Va. L. Rev. 1039, 1049 n.60 (1985).

[245] Pravin Banker Assocs., Ltd. v. Banco Popular del Peru, 109 F.3d 850, 855 (2d Cir. 1997) (stating two main interests of the United States are encouraging participation in debt resolution processes and ensuring that debts owed to the United States are enforceable).

differences, but also to "relatively minor differences."[246] As understood in *Hartford Fire*, a "conflict" with U.S. law is a violation of an express prohibition by U.S. law and such a sharp contrast is not required. Comity, then, is a dual standard concept. In reality it often serves only as a "drapery of illusion" that "disguises the protectionism lurking beneath."[247] The different concepts of comity undermine the universalist paradigms on which the cross-border concept of reorganization is based.[248]

IX. CONCLUSION

This article does not suggest that somebody has to be blamed. Life is not yet as global, and interests in reorganization proceedings are not yet as homogeneous, as some "universalists" might want us to believe. Global fictions meet local geography: they have not yet reached a balance. Due to the continuing inconsistencies it is almost inevitable that comity often has two widely different faces. One face looks suspiciously at foreign courts' activities, while the other face looks more leniently at the actions of domestic courts. It is a perfect example that the same abstract notion is filled with different pictures taken from different geographical positions. The legal formats controlling the hermeneutics work silently and are normally undisclosed—sometimes even taboo.[249] With terms that are "chameleons" by necessity, we are completely "lost in translation." A fair compromise is hardly possible in international reorganizations where imperfect information and credible commitment are still difficult to match. Consequently, we wait to learn whether international treaties will settle these problems in the near future.[250]

---

246 LoPucki, *A Post-Universalist Approach*, *supra* note 4, at 730.

247 Mary Elain Knecht, *The "Drapery of Illusion" of Section 34 – What Lurks Beneath: Territoriality in the Judicial Application of Section 304 of the Bankruptcy Code*, 13 U. PA. J. INT'L BUS. L. 287, 288 (1992).

248 *Id.*, (recognizing protectionist motivation behind the usurpation of international comity).

249 *Cf.* Bernhard Grossfeld, *Comparative Law as a Comprehensive Approach. A European Tribute to Professor Jack A. Hiller*, 1 RICH. J. GLOBAL L. & BUS. 1, 14 (2000) (describing the importance of analyzing the unwritten and unspoken).

250 Bernhard Grossfeld, *Loss of Distance: Global Corporate Actors and Global Corporate Governance – Internet v. Geography*, 34 INT. LAW. 963, 985-86 (2000); *see also* PRINCIPLES OF COOPERATION IN TRANSNATIONAL INSOLVENCY CASES AMONG THE MEMBERS OF THE NORTH AMERICAN FREE TRADE AGREEMENT (Tentative Draft, April 14, 2000).