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

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GLOBAL CORPORATE REORGANIZATION/GLOBAL CORPORATE GOVERNANCE: IMPERFECT INFORMATION AND CREDIBLE COMMITMENT

Bernhard Grossfeld

“Can the island of Tobago pass a law to bind the rights of the whole world?”

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. The Swiss Air collapse and the recent Enron debacle are examples of bankruptcy proceedings with thousands of creditors “in locations around the globe.” 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

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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.
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). 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.”

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. This affects creditors, shareholders and other stakeholders – a process distinctively corporate in nature: “[f]or large firms, corporate bankruptcy looks a great deal like corporate law.”

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).
catch the more or less subtle Delaware “influence” upon reorganizations.\(^\text{11}\)

II. DELAWARE

A. The Old Story\(^\text{12}\)

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*\(^\text{13}\) and Cary’s famous *Reflections upon Delaware*,\(^\text{14}\) it has been discussed whether Delaware stands for a “race to the bottom” or for a “race to the top.”\(^\text{15}\) Even today, both views are held with equal fervor. Lucian Ayre Bebchuk and Allen Ferrell are rather skeptical,\(^\text{16}\) whereas William T. Allen hails *The Pride and the Hope of Delaware Corporate*
Law.\textsuperscript{17} Robert Daines tells us that Delaware law increases stock market prices\textsuperscript{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\textsuperscript{19} and question whether it is possible for markets to evaluate corporate laws.\textsuperscript{20} There is no end to the debate in sight.\textsuperscript{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."\textsuperscript{22} The rule is highly controversial, as it provides management with an opportunity for forum shopping and may thus be unfair to creditors.\textsuperscript{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.\textsuperscript{24}

\textsuperscript{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.").


\textsuperscript{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").

\textsuperscript{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].


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. Therefore, “large corporate debtors engage in rampant forum shopping among bankruptcy courts in the United States.” Over 60% of reorganizations of large public corporations are filed in Delaware bankruptcy court. Reorganization law has been largely “Delawarized,” not just as a matter of venue but also as a matter of substance.

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. 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, and David A. Skeel, Jr. 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)), thus showing Delaware’s inefficiency in bankruptcy reorganization. The authors complain that Delaware

26 See LoPucki, A Post-Universalist Approach, supra note 4, at 720.
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.\textsuperscript{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”).\textsuperscript{35} Others indicate their “displeasure with judges who might not be resistant to local legal culture.”\textsuperscript{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.\textsuperscript{37} The charter choice would then bind creditors. Others prefer to include the choice of bankruptcy venue in the lending agreement.\textsuperscript{38} David A. Skeel, Jr. goes so far as to question whether firms should be \textit{forced} to bring any reorganization petition in their state of incorporation.\textsuperscript{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.\textsuperscript{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.\textsuperscript{41} Skeel argues, “Corporate charter competition and Delaware’s corporate culture exert bene-

\textsuperscript{34} \textit{Id.} at 259. \textit{But see In re Abacus Broad. Corp.}, 154 B.R 682, 686 (1993).
\textsuperscript{35} Skeel, \textit{Lockups}, supra note 22 at 1274; cf. Eisenberg & LoPucki, \textit{supra} note 24, at 972.
\textsuperscript{36} LoPucki, \textit{A Response}, supra note 20, at 354.
\textsuperscript{39} Skeel, \textit{Lockups}, \textit{supra} note 22, at 1275.
\textsuperscript{40} 28 U.S.C. § 651, 1334.
ficial influence on Delaware bankruptcy practice.”

Certainly, larger corporations tend to choose courts that they believe to be favorable to reorganizations. 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. Opponents wish to amend the section in order to eliminate the place of incorporation as a venue option. In 1997, the National Bankruptcy Review Commission adopted such a proposal, 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,” 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

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42 Skeel, Lockups, supra note 22, at 1270 n.96.
45 Cramers, supra note 23.
46 Skeel, Bankruptcy Judges, supra note 11.
that the reorganized business will survive as an economically viable entity (feasibility). Majority creditors can outvote dissenting minority creditors. 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.

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. 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. 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. 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.” The corporation has to show that “it has a fighting chance of surviving, even prospering, in the economic community in which it operates.” Therefore, “valuation is the most hotly contested and debated topic in the realm of corporate bankruptcy proceedings.” This brings us into general questions of

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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.
accounting cosmetics\textsuperscript{56} and corporate valuation and thus into a field that lawyers have shied away from far too long.\textsuperscript{57} It leaves wide room for interested participants and their agents to maneuver.\textsuperscript{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”\textsuperscript{59} in different cultural contexts (“mathematics in context”) are rarely discussed.\textsuperscript{60}

This becomes even more apparent when looking into the challenges of reorganization.\textsuperscript{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.\textsuperscript{62}

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

\textsuperscript{58} Jay W. Eisenhofer & John L. Reed, Valuation Litigation, 22 Del. J. Corp. L 37, 95 (1997)
\textsuperscript{61} Eisenhofer & Reed, supra note 58, at 95.
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).
66 Skeel, Lockups, supra note 22, at 1264.
68 Skeel, Lockups, supra note 22, at 1263.
they are quite negatively classified. In *Calpine Corp. v. O'Brien Environmental Energy, Inc.*\(^7\) 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.\(^7\)

### 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.\(^7\)

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.\(^7\) In addition, § 541(a)(1) defines the bankruptcy estate as comprising all of the debtor’s eligible property, “wherever located and by whoever held.”

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\(^7\) Id. at 537.

\(^7\) 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).

\(^7\) *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.” 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. However, the presumption is rebuttable and today’s courts hold that in bankruptcy proceedings Congress intended an extraterritorial application to property outside the territorial limits of the United States. Occasionally, even a judge does not see any extraterritorial implications: “[b]ankruptcy estate property is located within the bankruptcy court’s jurisdiction.” 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. 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. (incorporated at the time in Hong Kong) and was guaranteed by several subsidiaries of OST. The guarantors included Lykes Bros. S.S. Co. (In re Lykes Bros. S.S. Co.), which was incorporated in the United States. Under the jurisdictional assumptions of Chapter 1334(e), the court of the United States retained exclusive jurisdiction to determine the validity of the guarantee (In re New York Screw Corp., 859 F.2d 788 (2d Cir. 1988)).

In the Ninth Circuit, the court has held that the guarantees are contracts made outside the United States (In re Inverline Steamship Co., 52 F.3d 358 (9th Cir. 1995)) and therefore were subject to the territorial limits of the United States. Consequently, the court held the guarantees to be void under section 1334(e), which the Ninth Circuit had previously held applicable to foreign law contracts (In re S. S. Chiles Power Supply Co., 264 B.R. at 542).


In re Simon, 93 F.3d at 1000.

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" and that the courts in Hong Kong should have jurisdiction "over all disputes arising under the guaranty." 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.

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52 In re Simon 153 F.3d at 994.
53 Id.
54 Id.
55 Id. at 995.
56 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.\(^\text{87}\) Even if the creditor subsequently files a claim, the claim will not have a retroactive effect.\(^\text{88}\)

The automatic stay, however, can be enforced by an injunction if the U.S. court has personal (in personam) jurisdiction over the creditor.\(^\text{89}\) 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.\(^\text{90}\) 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\(^\text{91}\) or is subject to U.S. jurisdiction on other grounds.\(^\text{92}\) 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.\(^\text{93}\)

A leading example is *In re Nakash*,\(^\text{94}\) 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


\(^{88}\) *Int’l Statement*, supra note 74, at 112; see also Fotochrome, Inc. v. Copal Co., 517 F.2d 512 (2d Cir. 1975).


\(^{91}\) Detroit Trust Co. v. Campbell River Timber Co., 98 F.2d 389 (9th Cir. 1938).


\(^{94}\) 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

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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.

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\(^{101}\) *Id.*


\(^{103}\) *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." 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.
^110 Id. at 543-44.
^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\textsuperscript{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”\textsuperscript{114} in the present reorganization, and thus “purposefully submitted itself to this Court’s jurisdiction.”\textsuperscript{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.\textsuperscript{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.\textsuperscript{117}

\textbf{D. Comity}

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

\textsuperscript{113} 46 U.S.C. app. § 1300 et seq. (2000).
\textsuperscript{114} Id. at 284.
\textsuperscript{115} Id.
\textsuperscript{116} Id. at 287.
\textsuperscript{117} Id. at 288.
\textsuperscript{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

121 Hong Kong & Shanghai Banking Corp. v. Simon (In re Simon), 153 F.3d 991 (9th Cir. 1998).
122 Id.
123 Id.
125 Id. at 797.
129 In re Nakash, 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.”\textsuperscript{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,\textsuperscript{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.”\textsuperscript{133}

“It is well settled that where rights to real property are in issue, the law of the situs of the property controls.”\textsuperscript{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.\textsuperscript{135} The collection action commenced in Hong Kong against real estate

\textsuperscript{131} Id.
\textsuperscript{133} Watkins v. Holman’s Lessee, 41 U.S. 25, 57 (1842).
\textsuperscript{135} Hong Kong & Shanghai Banking Corp. v. Simon (In re Simon), 153 F.3d 991 (9th Cir. 1998).
property located there.\textsuperscript{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."\textsuperscript{137}

The court won over reality by referring to the words "constructive possession" and "custodia legis." The first term is taken from \textit{Katchen v. Landy}\textsuperscript{138}, where there was no international background.\textsuperscript{139} The second term was used in \textit{Commodities Futures Trading Comm'n v. Co Petro Marketing Group}\textsuperscript{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.\textsuperscript{141} \textit{Bank of Augusta v. Earl}\textsuperscript{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."\textsuperscript{143} Do U.S. fictions exist abroad where they are not protected by the Full Faith and Credit Clause\textsuperscript{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."\textsuperscript{145} Federal law, such as the Bankruptcy Code, leads to the same result. According to the \textit{Nottebohm} case of the International Court of Justice, "fictions" cannot be used unilaterally to govern the relation between sovereign states.\textsuperscript{146}

3. \textit{Strength of Precedents}

As to the inclusion of "property outside the territorial jurisdiction of the United States" the \textit{Stegeman}\textsuperscript{147} court came to a different conclusion from \textit{Nottebohm}. However, the difference in the factual

\begin{flushleft}
\textsuperscript{136} \textit{Id.}
\textsuperscript{137} Western Airlines Inc. v. Sobieski, 191 Cal.App.2d 399, 403 (1961).
\textsuperscript{138} Katchen v. Landy, 382 U.S. 323, 327 (1966).
\textsuperscript{139} \textit{See also} Thompson v. Magnolia Petroleum Co., 309 U.S. 478, 481 (1939)
\textsuperscript{140} 700 F.2d 1279, 1282 (9th Cir. 1983).
\textsuperscript{142} 38 U.S. 519, 588 (1839).
\textsuperscript{144} U.S. \textit{CONST.} art. IV, § 1.
\textsuperscript{146} The \textit{Nottebohm} Case (Liec. v. Guat.), 1955 I.C.J. 4 (Apr. 6).
\textsuperscript{147} 425 F.2d 984, 986 (1970).
\end{flushleft}
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. Hilliard151 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 Lykes154 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.
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,\textsuperscript{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.”\textsuperscript{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.\textsuperscript{158} In Sterling Drug Incorporated v. Bayer AG\textsuperscript{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.”\textsuperscript{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.\textsuperscript{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

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\textsuperscript{156} 509 U.S. 764, 798 (1993).
\textsuperscript{157} Id. at 770.
\textsuperscript{158} In re Simon, 153 F.3d at 991.
\textsuperscript{159} Sterling Drug Inc. v. Bayer AG, 14 F.3d 733 (2d Cir. 1994).
\textsuperscript{160} Id. at 746.
\textsuperscript{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 Clause163—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.
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. Cunningham166 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 creditor168 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).
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-

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\(^{173}\) U.S. Const. art. IV, § 1.


\(^{175}\) Estin v. Estin, 334 U.S. 541, 546 (1948).


tion” 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 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.

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? Probably not.

C. Economic Effects - “Fruehauf”

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

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178 See Fischer & Stocken, supra note 1.
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. 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 are a constant matter of concern for foreign claimants and defendants. 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.

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

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

186 Cf. The Bank of New York & JCP Leasing Corp. v. Treco (In re Treco), 240 F.3d 148, 156 (2d Cir. 2001) (discussing the reverse situation).
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 and claw back statutes hang in the air and might lead to unexpected reactions. Remember “Fruehauf”!

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 – 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?

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.” The intent is “to deal with the legal effect the United States courts will give to foreign bankruptcy proceedings” as defined in the Bankruptcy Code § 101(23). The overriding purpose is to prevent piecemeal distribution

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193 Cf. Protection of Trading Interests Act, 1980, c. 11 (Eng.).
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.”\textsuperscript{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.\textsuperscript{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.”\textsuperscript{201} This indicates that the United States wants to keep final control over the issue of who distributes the proceeds to whom. A


\textsuperscript{200} LoPucki, \textit{A Post-Universalist Approach}, supra note 4, at 727.

\textsuperscript{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.


\(^{203}\) 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.\footnote{208}{Id.}

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.\footnote{209}{Id.}

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

\footnote{208}{Id.}
\footnote{209}{Id.}
be governed by the laws of the country in which the property is located.\textsuperscript{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.\textsuperscript{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.\textsuperscript{212}

\textsuperscript{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.").

\textsuperscript{211} Id. (quoting Matter of Culmer, 25 B.R. 621, 632 (Bankr. S.D.N.Y. 1982)).

\textsuperscript{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

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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. This fourth factor requires U.S. courts to consider differences of law “in determining whether affording comity will be repugnant to American public policies.”

The court emphasized that it was not creating a presumption against affording comity to Bahamian bankruptcy proceedings. It did refer to the Fifth Amendment’s Takings Clause that prohibits the taking of “private property. . .for public use, without just compensation.” 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. The court also held that a forum selection clause does not preclude a court from granting comity where it is otherwise warranted.

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.

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

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 mortgagees” to be a compensable taking).
227 Id. at 163.
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." 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.

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.

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. In *Baker v. Gen. Motors Corp.*, 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.

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

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230 See *id.*; Pravin Banker Assocs., Ltd. v. Banco Popular del Peru, 109 F.3d 850, 853-54 (2d Cir. 1997).
231 *INTERNATIONAL STATEMENT*, *supra* note 74, at § III(C)(6).
232 U.S. CONST. art. IV, § 1.
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)).
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).
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.
248 Id., (recognizing protectionist motivation behind the usurpation of international comity).