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Relief Under Section 304 of the Bankruptcy Code: Clarifying the Principal Role of Comity in Transnational Insolvencies

Cover Page Footnote
Mr. Krause is a partner and Messrs. Janovsky and Lebowitz are associates at Zeichner Ellman & Krause.
RELIEF UNDER SECTION 304 OF THE
BANKRUPTCY CODE: CLARIFYING THE
PRINCIPAL ROLE OF COMITY IN
TRANSNATIONAL INSOLVENCIES

Stuart A. Krause, Peter Janovsky, and Marc A. Lebowitz*

INTRODUCTION

CONSIDER the following scenario: A multinational company is being liquidated or reorganized under insolvency laws of a foreign jurisdiction. Although the multinational company has significant assets and creditors in the United States, it has filed a petition under § 304 of the United States Bankruptcy Code and asked the United States Bankruptcy Court to defer to the foreign proceeding. This would relegate United States creditors to pursuing their claims in the foreign jurisdiction under that country's laws. Section 304 requires a bankruptcy court to apply a multipart test to determine whether local creditors may exercise their rights against the multinational company's assets under United States law, or allow the foreign jurisdiction to administer the United States-based assets, leaving United States creditors with only their claim in the foreign jurisdiction.

This Article begins with a discussion of the historical approaches to transnational insolvencies prior to the enactment of § 304 of the Bankruptcy Code and a description of the relatively complex procedures followed under that section. The discussion then follows the evolution of § 304 through case law interpreting the critical issue of comity, culminating in an analysis of a recent Southern District of New York case dealing with a Jordanian bank liquidation. Finally, this Article suggests an amendment to § 304 that clarifies some of the issues case law raises under the existing section.

I. APPROACHES TO TRANSNATIONAL INSOLVENCIES

Historically, United States federal courts have applied two divergent philosophies in addressing transnational insolvencies. The universality approach stresses deference to the foreign proceeding, while the territoriality approach emphasizes the rights of local, United States creditors. Thus, the universality approach favors a single, unified distribution of assets in the foreign jurisdiction, while the territo-

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rality approach favors protection of local creditors from the prejudice that might occur if they were forced to pursue their claims in the foreign jurisdiction. While some commentators substitute the terms comity for universality and creditors' rights for territoriality, this choice of terms is imprecise because a true comity analysis balances considerations of universality and territoriality. Indeed, the central issue in transnational insolvency cases is almost always whether to extend comity to a foreign proceeding, and a court's universalist or territorial orientation conditions the issue's determination. The use of the terms comity and local creditor's rights as labels for these approaches is by nature result based.

A. Pre-1978 Approaches: Hilton v. Guyot and the 1898 Bankruptcy Act

Prior to 1978, when considering whether to defer to a foreign insolvency, courts almost always undertook an analysis that stressed the rights of the United States creditors. Because these local creditors might be prejudiced if the local assets were to become the subject of a proceeding in the foreign jurisdiction, courts tilted the balance away from the universality approach, the principle of international duty and convenience, and a predisposition to recognize valid foreign laws.

In 1895, in *Hilton v. Guyot*, the Supreme Court defined the concept of comity as follows:

"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 which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.

This definition included the seeds of both the universality approach—"due regard to international duty and convenience"—and the territoriality approach—"due regard . . . to the rights of its own citizens"—to transnational insolvencies. In this case, however, the court refused to afford comity to a French judgment because, according to the court, France did not afford such comity to judgments in the United States and other countries. In the Bankruptcy Act of 1898 (the "Act"), Congress tried to refine the inquiry courts should make when faced

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4. 159 U.S. 113 (1895).

5. *Id.* at 163-64.


with foreign bankruptcy issues. Bankruptcy Rule 119 and section 2(a)(22) of the Act set out the framework for the analysis. Bankruptcy Rule 119 read:

When a proceeding for the purpose of the liquidation or rehabilitation of his estate has been commenced by or against a bankrupt in a court of competent jurisdiction without the United States, the court of bankruptcy may, after hearing on notice to the petitioner or petitioners and such other persons as it may direct, having regard to the rights and convenience of local creditors and other relevant circumstances, dismiss a case or suspend the proceedings therein under such terms as may be appropriate.

By focusing on the rights of local creditors, the language of the rule and section 2(a)(22) of the Act clearly embraced the territorial approach to transnational insolvencies.

The Supreme Court reinforced this limited approach to comity in 1908 in *Disconto Gesellschaft v. Umbreit* by following the result in *Hilton* and declining to recognize a German insolvency proceeding, primarily because the proceeding would have prejudiced United States creditors. In 1916, the Southern District of New York again applied this territoriality-based analysis in *In re Berthoud*. The court found jurisdiction in the United States under the Act, predicated solely on property of the debtor in this country. The narrow *Disconto* approach favoring protection of local creditors rights reigned supreme for decades; indeed, into the 1970s.

Commentators agree that it was the 1974 failure of the German bank, Bankhaus I.D. Herstatt ("Herstatt") that illuminated the inadequacies of the Rule 119-section 2(a)(22) framework in dealing with modern transnational insolvencies. When Herstatt failed, Chase Manhattan Bank froze more than $50 million that it was to deliver to Herstatt. A scramble ensued as the German liquidator stayed out of the United States to avoid being subject to personal jurisdiction, and withering pretrial discovery followed. Although the parties in the

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10. Pub. L. No. 87-681, § 2, 76 Stat. 570 (1962) (amending 11 U.S.C. § 11(a)(22) (1958)). The amendment provided that a court may "[e]xercise, withhold, or suspend the exercise of jurisdiction, having regard to the rights or convenience of local creditors and to all other relevant circumstances, where a bankrupt has been adjudged bankrupt by a court of competent jurisdiction without the United States." *Id.*
13. *Id.* at 579-80.
14. 231 F. 529 (S.D.N.Y.), appeal dismissed, 238 F. 797 (2d Cir. 1916).
16. The court did not reach the issue of whether the attachment would have been unconstitutional under the Supreme Court standard in Fuentes v. Shevin, 407 U.S. 67 (1972).
Herstätt proceeding settled without a decision, it left the perception that the system surrounding transnational insolvencies needed reform.

B. Post-1978 Approaches to Transnational Insolvencies: Section 304

Congress overhauled the United States bankruptcy system in 1978 with the Bankruptcy Reform Act of 1978 (the "Code"). It specifically addressed transnational insolvencies in § 304 by providing factors courts should evaluate when considering whether to defer to a foreign proceeding. The Code further outlined filing procedures for commencing a case ancillary to a foreign proceeding.

1. The Legislative History

The Commission on Bankruptcy Laws initially proposed five factors for courts to consider when examining a foreign representative's petition to have a United States court defer and to have a foreign proceeding administer assets. These factors were (i) just treatment of all holders of claims, (ii) protection of United States claim holders against prejudice and inconvenience, (iii) prevention of fraudulent dispositions of property, (iv) distribution in substantial accordance with the United States Bankruptcy Code, and (v) the opportunity for a fresh start for the debtor. The commission intended these five factors to provide more specific guidelines for the general comity balancing test outlined in the 1898 Act and *Hilton v. Guyot* and its progeny. In essence, the factors were an attempt to isolate the most significant policy considerations of the United States Bankruptcy Code as a touchstone for comparison with a foreign proceeding.

Just prior to enactment of § 304, the commission added a sixth factor, comity, to the § 304(c) factors. This addition appears to be superfluous because the five factors themselves all address whether United States courts should extend comity to a foreign proceeding. Nevertheless, the addition may also be interpreted as an expression of

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The question of whether a foreign bank not doing business in the United States could be the subject of a bankruptcy proceeding under the Act, in light of the exclusion of foreign banks from the jurisdiction of the Act, was ultimately resolved by § 109(b)(3) of the Code, which provides that a person may be a debtor only if such person is not "a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such business in the United States." 11 U.S.C. § 109(b)(3) (1994).

20. See infra notes 21-26 and accompanying text.
21. This addition was the codification of the legislative statement directing that "Section 304(c) is modified to indicate that the court shall be guided by considerations of comity in addition to the other factors specified therein." 124 Cong. Rec. 32,394 (1978) [hereinafter Legislative Statement].
congressional intent encouraging courts to lean toward a universality approach by giving greater deference to the foreign proceeding.

Other legislative history supports this conclusion. The House and Senate committee reports focused on flexibility in the guidelines, stating that "Principles of international comity and respect for the judgments and laws of other nations suggest that the court be permitted to make the appropriate orders under all of the circumstances of each case, rather than being provided with inflexible rules." Both reports also state that the policy behind § 304 is to provide for "an economical and expeditious administration of the estate;" Congress ultimately included this language in the text of § 304(c). Thus, these pronouncements signaled a shift toward a universality-based approach


25. The full text of 11 U.S.C. § 304 provides:

§ 304. Cases ancillary to foreign proceedings
(a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative. (b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may—

(1) enjoin the commencement or continuation of—
(A) any action against—
(i) a debtor with respect to property involved in such foreign proceeding; or
(ii) such property; or
(B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
(2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
(3) order other appropriate relief.
(c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—

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

that favors extending comity to foreign proceedings. Granting a § 304 petition was seen as a way to prevent "dismemberment by local creditors of assets located here." 26

Ironically, the insertion of comity as an additional factor has caused some courts to diminish its importance. For example, the court in In re Papeleras Reunidas S.A. 27 viewed comity as merely one factor that could be outweighed by the others. 28

2. Applicable Procedural Rules

The procedural rules governing § 304 generally follow the rules regarding the filing of an involuntary bankruptcy petition under § 303 of the Code. 29 Bankruptcy Rule 1010 provides that on the filing of a § 304 petition the clerk shall issue a summons, 30 and also provides rules for the service of the summons, pursuant to the Federal Rules of Civil Procedure 4(g) and (h) ("FRCP"), and petition on "the parties against whom relief is sought" and any other parties as the court may direct. 31 Bankruptcy Rule 1011 allows any "party in interest" to a § 304 petition to contest the petition. 32 Rule 1011 further specifies that "objections to the petition shall be presented in the manner prescribed by Rule 12 F.R. Civ. P. [sic]." 33 The rules permit no other pleadings, although the court may order a reply to an answer. 34 Rule 1018 provides that once a petition commencing an ancillary case is contested, most rules found in part VII of the Bankruptcy Rules governing adversary proceedings apply, including the rules addressing pleading, parties, discovery, and summary judgment. 35 After a petition is contested, the bankruptcy court must analyze the factors outlined in § 304(c) to determine whether to grant or dismiss the petition. 36 Thus, a threshold summary judgment determination often arises shortly after a § 304 petition is contested. If, on their face, the insolvency procedures of a foreign jurisdiction do not meet the section's standards, a court may then deny the petition. 37 Even a facially just foreign system may require an inquiry into whether it actually

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28. Id. at 594.
31. Id.
36. See supra part I.B.1.
applies procedures in conformity with the protections of United States law.\textsuperscript{38}

II. RECENT CASE LAW

The recent case law interpreting § 304 falls into two general categories, cases granting comity and those not granting comity. While the majority of cases follow the universality approach and grant comity, the outcome is by no means certain. Some courts continue to exhibit a territoriality bent, and even a court with a universality view will not automatically grant comity.

A. Cases Granting Comity to Foreign Proceedings

Perhaps the leading case adopting the "universality" approach and granting comity to a foreign proceeding is \textit{In re Culmer}.\textsuperscript{39} In \textit{Culmer} the United States bankruptcy proceeding was ancillary to the liquidation of Banco Ambrosiano Overseas Limited ("BAOL"), a banking company organized under the laws of the Bahamas. BAOL did not conduct business in the United States, but maintained deposit accounts in United States banks and financial institutions. The § 304 petition sought to enjoin creditors from commencing or continuing proceedings in the United States against BAOL assets. The petition also sought to direct all claimants to turn over United States-based assets to the Bahamian liquidation.\textsuperscript{40} In reaching its decision, the \textit{Culmer} court first examined the legislative history of § 304(c). According to this history, § 304(c)'s factors were designed to give courts "maximum flexibility" and that principles of "international comity and respect for the judgments and laws of other nations suggest that the court be permitted to make the appropriate orders."\textsuperscript{41} The court then concluded that, based on the policy enunciated in the legislative history, the analysis under § 304(c) entails determining "whether the relief petitioners seek will afford equality of distribution of the avail-


\textsuperscript{39} 25 B.R. 621 (Bankr. S.D.N.Y. 1982). \textit{Culmer} and its importance vis-à-vis § 304 case law and the universality approach are discussed in detail in \textit{Booth}, \textit{supra} note 2, at 172-84, and \textit{Rimel}, \textit{supra} note 2, at 464-70.

\textsuperscript{40} \textit{Culmer}, 25 B.R. at 623.

\textsuperscript{41} \textit{Id.} at 628.
able assets." The court stated that courts should generally accord comity to foreign decisions unless judicial enforcement of such foreign-based rights "would be the approval of a transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense." Having set the general standard for comity, the court applied it to the other five factors in § 304(c). The court considered this standard not as a separate sixth factor but as a thread that runs through all the factors in the ancillary proceeding analysis. Based upon its review of each factor, the court concluded that exercising comity and deferring to the Bahamanian proceeding was appropriate. Accordingly, it granted the relief requested in the petition.

United States courts have widely followed the principles outlined in Culmer. Indeed, the vast majority of § 304 cases have deferred to the foreign proceedings' law. In most of these cases, the courts concluded that the foreign proceedings' substantial similarity to that of the United States validated deference. For example, the Second Cir-
cuit recognized that the level of scrutiny appropriately increases when the foreign liquidation procedures being assessed are not in "a sister common law jurisdiction" and when the United States courts lack experience with the foreign liquidation scheme.\textsuperscript{47} In any event, any foreign proceeding would have to be egregiously harmful to the rights of creditors to fall short of the \textit{Culmer} court's comity standard.\textsuperscript{48} The Second Circuit emphasized the central status of comity in \textit{Cunard Steamship Co. v. Salen Reefer Services}\textsuperscript{49} and \textit{Victrix Steamship Co. v. Salen Dry Cargo},\textsuperscript{50} two 1980s cases involving the same Swedish bankruptcy.\textsuperscript{51} In \textit{Cunard}, a creditor obtained an order of attachment in New York against certain assets of a Swedish entity.\textsuperscript{52} The court affirmed the district court's vacatur of the order based upon principles of international comity.\textsuperscript{53} Although the \textit{Cunard} court did not specifically discuss each of the § 304 criteria, it engaged in a similar analysis. The court initially found that the principles of Swedish bankruptcy law were "not dissimilar" to those of the United States as to creditors' meetings, notice, and other protections of creditors' rights.\textsuperscript{54} The court further noted that there was no indication that participating in the Swedish proceedings would prejudice \textit{Cunard}.\textsuperscript{55} Finally, the court found that proof of Sweden's reciprocity in a similar situation, while possibly relevant, was not essential in this case.\textsuperscript{56} In \textit{Victrix}, the Second Circuit also affirmed the granting of comity to the same Swedish proceeding, relying initially on \textit{Cunard}'s holding that Swedish law was substantially similar to United States law.\textsuperscript{57} Nevertheless, because the \textit{Victrix} creditor had obtained both a foreign arbitration award and a foreign judgment, the court also analyzed whether a court under New York law would extend comity to the foreign proceeding by denying

\textsuperscript{47} See \textit{Drexel Burnham Lambert Group Inc. v. Galadari}, 777 F.2d 877, 881 (2d Cir. 1985).
\textsuperscript{48} See supra note 43 and accompanying text.
\textsuperscript{49} 773 F.2d 452 (2d Cir. 1985) (granting comity to a Swedish bankruptcy proceeding and vacating an attachment in the United States).
\textsuperscript{50} 825 F.2d 709 (2d Cir. 1987) (recognizing Swedish bankruptcy proceedings).
\textsuperscript{51} These cases were initiated in the district court and were not first decided in a § 304 ancillary proceeding in bankruptcy court. The \textit{Cunard} court held that although such an ancillary proceeding would have been a preferred remedy, it would not reverse the district court for deciding the matter without having referred the case to the bankruptcy court. \textit{Cunard}, 773 F.2d at 455. In any case, the courts, particularly in \textit{Cunard}, applied a comity analysis similar to that of § 304. See \textit{id.} at 456-60; \textit{Victrix}, 825 F.2d at 713-16.
\textsuperscript{52} \textit{Cunard}, 773 F.2d at 454.
\textsuperscript{53} \textit{id.}
\textsuperscript{54} \textit{id.} at 459.
\textsuperscript{55} \textit{id.}
\textsuperscript{56} \textit{id.} at 460. The court found that evidence was inconclusive as to whether Sweden would grant comity to a United States proceeding. \textit{id.}
\textsuperscript{57} \textit{Victrix S.S. Co. v. Salen Dry Cargo}, 825 F.2d 709, 714 (2d Cir. 1987).
enforcement of the foreign judgment in New York.\textsuperscript{58} The court held that New York would extend comity because such an extension would not impair local creditors' rights and because the creditor had voluntarily submitted to the Swedish proceeding and had an ample opportunity to pursue its claim in that proceeding.\textsuperscript{59} The court in \textit{In re Brierley}\textsuperscript{60} also strongly emphasized the comity factor in granting § 304 relief in a British bankruptcy. According to the \textit{Brierley} court, "chaos" would lurk in all transnational bankruptcies if courts "ignore the importance of comity."\textsuperscript{61} The court then undertook a detailed analysis of the British insolvency statutes and found them substantially similar to United States laws.\textsuperscript{62} Adopting a standard almost identical to \textit{Culmer}'s, the \textit{Brierley} court held that a foreign proceeding need not be a carbon copy of United States law; rather, it merely "must not be repugnant to American laws and policies."\textsuperscript{63} In \textit{In re Koreag, Controle et Revision S.A.},\textsuperscript{64} the Southern District reaffirmed \textit{Culmer}'s emphasis on comity as the most significant factor in deciding a case under § 304, because, according to the court, the other factors in the section "are inherently taken into account when considering comity."\textsuperscript{65} The court noted that comity is important not merely because of respect for the laws of a foreign government, but also to assure that liquidation will be carried out in an orderly and systematic manner, rather than in a "haphazard, erratic or piecemeal fashion."\textsuperscript{66} Analyzing Swiss law, the \textit{Koreag} court found that its distribution scheme was not violative or repugnant to United States standards of fairness and thus ordered turnover of certain funds held in the United States.\textsuperscript{67} Although, on appeal, the Second Circuit agreed with the district court that turnover was appropriate, it noted that lower courts in this circuit had disparate views as to the weight they should accord to comity.\textsuperscript{68} In particular, the court noted the difference between the Southern District courts that, following \textit{Culmer}, give paramount importance to comity and the courts that hold that comity merits only

\textsuperscript{58} Id. at 714-15. According to the court, N.Y. Civ. Practice L. & R. § 5304(b)(4) would permit denial of enforcement of the foreign judgment because it would conflict with the public policy of deference to foreign proceedings. \textit{Id.} at 715.

\textsuperscript{59} Id.

\textsuperscript{60} 145 B.R. 151 (Bankr. S.D.N.Y 1992).

\textsuperscript{61} Id. at 164.

\textsuperscript{62} Id. at 164-66.

\textsuperscript{63} Id. at 166.


\textsuperscript{65} Id. at 712.

\textsuperscript{66} Id. at 713 (citing Cunard S.S. Co. v. Salen Reefer Servs., 773 F.2d 452, 458 (2d Cir. 1985)); \textit{see also} Victrix S.S. Co. v. Salen Dry Cargo, 825 F.2d 709, 714 (2d Cir. 1987) (noting public policy for orderly distribution of assets in foreign bankruptcies).

\textsuperscript{67} Koreag; 130 B.R. at 716.

equal weight with the other factors. The court saw no need, however, to resolve the matter because under either view turnover was appropriate under § 304.

B. Cases Not Granting Comity to Foreign Proceedings

In recent cases only a few courts have declined to defer to a foreign proceeding by adopting a territoriality-based approach to a § 304 petition. Although some of these courts acknowledged the importance of comity in their holdings, each considered it as only one factor in the analysis, rather than as the controlling factor.

In *In re Lineas Areas de Nicaragua*, the court had previously granted § 304 relief and ordered the turnover of assets to a foreign representative from Nicaragua. A United States creditor moved for the appointment of an independent trustee in this country to determine whether any value could be obtained from the debtor's remaining asset—a certificate from the Civil Aeronautics Board to operate in the United States. The court granted the motion chiefly because of the § 304(c)(2) factor of prejudice to local creditors. The *Lineas* court concluded that forcing United States creditors to look to Nicaragua for payment was "an alternative to be avoided if possible under § 304(c)(2)." The decision did not discuss any other factors and therefore has been construed as a territoriality case. In *In re Toga Manufacturing*, the bankruptcy court noted that "Section 304 . . . embodies the universal theory of conflicts of laws with some qualifications." The *Toga* court, however, appeared merely to pay lip service

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69. Id.; see infra part II.B (discussing recent cases that treat comity as only a sixth, equal factor for § 304 analysis).
70. Koreag, 961 F.2d at 359. The court noted that the creditor opposing § 304 relief would be an unsecured creditor in the Swiss proceeding. Thus, it would not be deprived of any rights enjoyed by secured creditors in the United States that might be absent in Switzerland. Accordingly, because no party contested the fundamental fairness of Swiss insolvency laws, it would be proper to extend comity. Id.
73. In *re Lineas Aereas S.A.*, 10 B.R. 790, 791 (Bankr. S.D. Fla. 1981). This turnover was extremely limited, however, perhaps not even a turnover at all, because it prohibited the Nicaraguan representative from "encumbering, assigning or abandoning the debtor's known assets located in the United States . . . as well as any additional assets discovered in this country." Id.
75. See *id.* at 780-81.
76. Id.
77. See *Booth*, supra note 2, at 190-92.
79. Id. at 167-68.
to concepts of universality.\textsuperscript{80} In applying its territoriality disposition, the \textit{Toga} court relied on the local creditor's status as a perfected lien creditor in Michigan.\textsuperscript{81} Under § 507 of the Bankruptcy Code\textsuperscript{82} the local creditor would be one of the first paid,\textsuperscript{83} while under Canadian law, the local creditor would likely be an ordinary creditor and the claim would have a lower priority.\textsuperscript{84} Thus, the \textit{Toga} court concluded that Canadian law did not meet the requirement of § 304(c)(4)—distribution in conformity with the Bankruptcy Code—compelling the court to apply United States bankruptcy law to protect the local creditor's claim.\textsuperscript{85} Although each prong of § 304(c) is not a requirement, but rather a factor to be considered in determining whether to permit the foreign proceeding to administer assets in the United States,\textsuperscript{86} the court did not apply the section that way. Thus, by appearing to treat the § 304(c) factors as independent grounds for denying relief to the foreign representative, rather than weighing all the factors in a balancing test, the \textit{Toga} court revealed its territoriality perspective. The \textit{Toga} court further justified denial of comity on the basis that the United States and Canada did not have a treaty for the recognition of each other's bankruptcy laws.\textsuperscript{87} Finally, the court concluded that it "must protect United States citizens' claims against foreign judgments inconsistent with this country's well-defined and accepted policies."\textsuperscript{88} The \textit{In re Papeleras Reunidas, S.A.}\textsuperscript{89} court specifically rejected the notion held by other bankruptcy courts that comity should be "the focal point" of a § 304 analysis.\textsuperscript{90} In particular, the court criticized the view of the \textit{In re Culmer}\textsuperscript{91} and \textit{Universal Casualty & Surety Co. v. Gee (In re Gee)}\textsuperscript{92} courts, which stated that the other five § 304 factors are solely for the purpose of aiding a court's comity analysis.\textsuperscript{93} According to the \textit{Papeleras} court, the consideration of the comity factor "requires . . . an analysis of the effect that the recognition of a foreign proceeding has upon the laws, public policies and the rights of citizens of the United States."\textsuperscript{94} The court in \textit{Interpool, Ltd. v. Certain Freights of M/
V Venture Star noted that comity has been considered the most significant of the § 304 factors. Nevertheless, it denied comity and dismissed a foreign proceeding because an Australian proceeding lacked the procedural and substantive safeguards of United States bankruptcy law. In particular, the court noted that Australian bankruptcies gave insufficient notice to creditors and lacked the remedy of equitable subordination. One commentator found Interpool to be the most significant rejection of Culmer's approach to § 304 since Toga and warned that such an approach endangered cooperation in cross-border insolvencies. It is noteworthy, however, that the Southern District of New York, where many § 304 petitions are brought because of its location as an international financial center, has explicitly rejected Lineas Areas, Toga, and Papeleras. As case law indicates, however, even the Southern District is not a "rubber stamp" for § 304 petitions. At this point, the territoriality-based protectionist approach to comity is out of favor. A party seeking to defeat a petition will have to establish that a foreign proceeding is offensive to United States notions of justice. Nevertheless, under certain circumstances even a court following the deferential, universality-based approach to comity will not defer to a foreign proceeding.

C. The Petra Bank Case

In the bankruptcy of Petra Bank, the Bankruptcy Court for the Southern District of New York refused to grant comity to a Jordanian bank insolvency proceeding despite that court's general adherence to

1. Booth, supra note 2, at 212.

Zeichner Ellman & Krause represented A.I. Trade in the Southern District of New York Action and in related litigation arising out of the forfaiting transaction described below.
the universality approach to § 304. The case is therefore of particular interest because it illustrates the limits of comity under the section. In addition, the case involved multiple questions of comparative law involving four sets of statutes: The United States Bankruptcy Code, United States banking statutes, the Jordanian Companies Law (that country's normal procedure for liquidations), and special resolutions written specifically for the liquidation of Petra Bank.

1. The Facts in Petra Bank I

In November 1989, A.I. Trade Finance, Inc. ("AI Trade") sued Petra Bank in the United States District Court for the Southern District of New York ("Petra Bank I"). Petra Bank I arose out of Petra Bank's aval, or guarantee, on certain promissory notes that AI Trade had purchased in a forfaiting transaction. AI Trade obtained an ex parte order of attachment and levied against approximately $4 million of Petra Bank's funds in the United States (the "Funds"). The district court granted Petra Bank's motion to dismiss based on lack of personal jurisdiction and vacated the attachment. The Second Circuit reversed, holding that a foreign bank's aval, payable in New York, subjects the guarantor bank to personal jurisdiction in New York.

Jordanian banks, which are public shareholder companies, are formed pursuant to Jordanian Companies Law No. 12 (1964) and are liquidated pursuant to Chapter XIII of the Companies Law No. 1 (the "Companies Liquidation Law"). Nevertheless, it is not uncommon for a bank liquidation in Jordan to be carried out with the assistance of special resolutions. On July 15, 1990, the Jordanian Economic Security Committee, part of the martial law regime established in 1967, ordered the liquidation of Petra Bank. The Petra Bank liquidation was pursuant to special legislation styled as special resolutions (the "Special Resolutions"). The committee promulgated the Special Resolutions solely to provide for Petra Bank's liquidation. In contrast with other bank liquidations in Jordan, where the special resolutions specifically incorporated procedural and substantive provisions of the Companies Liquidation Law, the Petra Bank Special Resolutions specifically excluded application of the Companies Liquidation Law.

104. Id. at 70.
105. Id. at 64-66.
107. For a detailed discussion of forfaiting transactions and the legal effect of a bank's "aval," see id. at *1.
108. Id.; Hourani, 180 B.R. at 61.
110. A.I. Trade Finance, Inc. v. Petra Bank, 989 F.2d 76, 81 (2d Cir. 1993).
111. Hourani, 180 B.R. at 62.
113. Id.
114. The Special Resolutions provide in pertinent part:
Soon thereafter the Governor of the Central Bank of Jordan appointed the Liquidation Committee to liquidate Petra Bank, and Jordanian public law subsequently incorporated the Special Resolutions.\textsuperscript{115} Shortly after the Second Circuit's decision that New York had jurisdiction over Petra Bank,\textsuperscript{116} the Liquidation Committee filed a petition (the "Petition") pursuant to § 304 in the Southern District seeking, inter alia, to assume dominion and control over the Funds, to direct turnover of the Funds, and to stay all action against Petra Bank in the United States.\textsuperscript{117} The Liquidation Committee moved for summary judgment to grant the relief the Petition requested, and thus afford comity to the Special Resolutions. AI Trade opposed the Liquidation Committee's motion and cross-moved for summary judgment to dismiss the Petition, and thus deny comity to the Special Resolutions.

2. Petra Bank II: The Decision

In the case of In re Hourani\textsuperscript{118} ("Petra Bank II"), Chief Judge Lifland of the United States Bankruptcy Court for the Southern District of New York noted that his court leaned toward a universality approach in § 304 cases, rather than the territoriality or "grab rule" approach.\textsuperscript{119} He recognized the trend toward universality in recent cases involving § 304 and in other cases involving the issue of deference to a foreign proceeding.\textsuperscript{120} This comports with Judge Lifland's position as the author of Culmer,\textsuperscript{121} the leading universality case.\textsuperscript{122} He took a

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Notwithstanding the provisions of the Companies Law and any other law or regulation:

(7) A lawsuit for declaring the bankruptcy or insolvency of Petra Bank shall not be considered and the provisions of bankruptcy or insolvency provided for under the Commercial Law or Civil Law or any other law shall not be applicable thereto.

\textit{Id.} at 71.

115. \textit{Id.} at 62.


117. The full relief sought by the Committee requested an order (1) approving of the petition recognizing the Liquidation Committee as a "foreign representative" within the meaning of the Code, and recognizing the Jordanian Liquidation as a "foreign proceeding" within the meaning of 11 U.S.C. §§ 101(23) and 304(a) of the Bankruptcy Code; (2) authorizing the Liquidation Committee to "assume dominion and control" of the Funds, "for the purposes of administering and disposing of Petra Bank's assets"; (3) directing the turnover of the Funds; (4) enjoining anyone from exerting "control or dominion" over the Funds; and (5) staying all other proceedings against Petra Bank. See Petition in a Case Ancillary to a Foreign Proceeding at 11-12, \textit{In re Hourani}, 180 B.R. 58 (Bankr. S.D.N.Y. 1995) (No. 93-B-43765) (July 21, 1993).


119. \textit{Id.} at 63 & n.9.

120. \textit{Id.} at 63-64 & n.10.


broad view of the court's power in the *Petra Bank II* case to fashion appropriate relief under § 304 to avoid turmoil if local creditors seek to gain advantages under local law, despite the impact on other creditors. Thus, citing *Culmer*, he stated that § 304 gives courts the power to "broadly mold appropriate relief in near blank check fashion." He stressed, however, that while this approach generally leads to deference to other nation's insolvency laws, a court should limit such deference to proceedings providing "a reasonable degree of certainty that the consideration of all parties' rights will be fair and impartial," and that absent an international treaty addressing what is fair, courts should apply the § 304 factors and case law in each case. A threshold issue in *Petra Bank II* was the determination of which United States law the court would compare to the Jordanian procedures. The Jordanian proceeding was a bank liquidation. Accordingly, the Liquidation Committee argued that the provisions of the Financial Institutions Reform Recovery and Enforcement Act ("FIRREA") and the Federal Deposit Insurance Act ("FDIA")—the United States banking law—should apply as the basis for comparison rather than the Bankruptcy Code, notwithstanding the language of § 304 referring to distribution of proceeds in accordance with "this title." This determination could have been critical, because FIRREA extends less protection to creditors than the Bankruptcy Code. The court agreed with the Liquidation Committee and used FIRREA as its first point of reference. Nevertheless, the court also compared the Jordanian proceeding to the Bankruptcy Code, thus employing a somewhat holistic approach to § 304 analysis by concluding that

v. Togut (*In re Axona Int'l Credit & Commerce*), 924 F.2d 31 (2d Cir. 1991); Finister, *supra* note 15, at 358.


124. *Id*. The court also noted that there exists a modified universality approach with characteristics of both regimes. *Id*.

125. *Id*.

126. *Id*. at 64-65.

127. *Id*. at 65.


129. For example, the Bankruptcy Code and Bankruptcy Rules have extensive notice provisions for many different stages of a bankruptcy case. See 11 U.S.C. §§ 362(d), 363(b), 364(b), 502(b), 503(b), 1112(b) (1994); Fed. R. Bankr. P. 2002. FIRREA's notice provisions, however, are primarily limited to notice by mail and publication for the filing of claims. See 12 U.S.C. § 212(s)(3)(B) (1994). Further, the Bankruptcy Code requires a meeting of creditors, see 11 U.S.C. § 341, under FIRREA, that determination is first made by the FDIC, see 12 U.S.C. § 1821(d)(11)(B)(iii). Only after an FDIA determination may a creditor seek judicial review. See *id*.; 12 U.S.C. § 1821(d)(7).

130. The court noted that "it would be ironic if section 304 were interpreted to refuse comity to another country's liquidation of a bank under provisions identical to FIRREA. It would be akin to finding that FIRREA is repugnant to this country's notions of justice." *Hourani*, 180 B.R. at 65 n.12.
neither FIRREA nor the Bankruptcy Code are paramount.\textsuperscript{131} Rather, the foreign proceeding must not "be repugnant to this nation’s general principles of justice, regardless of the form in which those principles are manifested."\textsuperscript{132} The Petra Bank II court then applied the § 304 test and concluded that it could not defer to the Jordanian proceeding because there was "little to ensure integrity and fairness in the liquidation process embodied in the Resolutions."\textsuperscript{133} As to the § 304(c)(1) requirement of "just treatment of all . . . claims,"\textsuperscript{134} the court found that the Liquidation Committee's procedures deprived creditors of important due process rights, including the right of access to information and the opportunity to be heard.\textsuperscript{135} Under the Special Resolutions, a Jordanian court could deny creditors' claims without giving any reason for the denial, unlike the proceeding in Culmer that required grounds for rejection.\textsuperscript{136} The court noted that United States banking laws included provisions for the fair treatment of creditors that were absent under the Special Resolutions, including provisions governing the disposition of assets, the recovery of fraudulent transfers, and equitable subordination.\textsuperscript{137} As to the § 304(c)(2) requirement of "protection of claim holders . . . against prejudice and inconvenience in the processing of claims,"\textsuperscript{138} the court also found that the Special Resolutions violated United States standards of procedural fairness as to notice to creditors.\textsuperscript{139} They permitted notice of the bar date for filing claims by publication only. The court stressed that the notice provisions of the FDIA and the Bankruptcy Code prohibit notice by publication alone and require mailing to all known creditors.\textsuperscript{140} In its discussion of § 304(c)(3)\textsuperscript{141} the court revealed what may have been its central concern with the procedures in the Special Resolutions: They gave virtually unlimited discretion to the Liquidation Committee.\textsuperscript{142} The Companies Liquidation Law has specific provisions for the recovery of fraudulent transfers, which are absent in the Special Resolutions.\textsuperscript{143} The Liquidation Committee argued that under the Special Resolutions, the Committee has the discretion to incorporate this provision of the Companies Laws.\textsuperscript{144} The

\begin{itemize}
  \item \textsuperscript{131} \textit{Id.} at 65.
  \item \textsuperscript{132} \textit{Id.}
  \item \textsuperscript{133} \textit{Id.} at 66.
  \item \textsuperscript{134} 11 U.S.C. § 304(c)(1) (1994).
  \item \textsuperscript{135} \textit{Hourani}, 180 B.R. at 65.
  \item \textsuperscript{136} \textit{In re} Culmer, 25 B.R. 621, 630 (Bankr. S.D.N.Y. 1982).
  \item \textsuperscript{137} \textit{Hourani}, 180 B.R. at 67.
  \item \textsuperscript{138} 11 U.S.C. § 304(c)(1) (1994).
  \item \textsuperscript{139} \textit{Hourani}, 180 B.R. at 68.
  \item \textsuperscript{140} \textit{Id.}
  \item \textsuperscript{141} 11 U.S.C. § 304(c)(3) (1994) (requiring consideration of the "prevention of preferential or fraudulent transfers").
  \item \textsuperscript{142} \textit{Hourani} 180 B.R. at 65-66.
  \item \textsuperscript{143} \textit{Id.} at 69.
  \item \textsuperscript{144} \textit{Id.}
Special Resolutions, however, include a specific preemption provision stating that the Companies Law or any other bankruptcy or insolvency law shall not be applicable to the Petra liquidation.145 The Petra Bank II court contrasted two other Jordanian bank liquidations with the Petra Bank liquidation. The previous two liquidations specifically incorporated the provisions of the Companies Liquidation Law,146 thereby making those liquidations more predictable and disciplined. In the Petra Bank liquidation, however, the Liquidation Committee had the power to virtually make up its procedures as it went along.147 Accordingly, the court found that the Special Resolutions fail to "provide the certainty and safeguards that section 304 contemplates."148

Considering § 304(c)(4),149 the court noted that the Special Resolutions include no differentiation between secured and unsecured creditors. While the court did not require a differentiation identical to that under United States laws, it found the Petra Bank liquidation's lack of any distinction clearly suspect.150

The court's final analysis was of the § 304(c)(5) comity factor. According to the court, comity should be extended based upon an analysis of whether the foreign bankruptcy "comports with American notions of fairness and due process."151 The Petra Bank liquidation failed this test because the Special Resolutions, on their face, prevent creditors from knowing whether the proceedings are fair. The Liquidation Committee's virtual blank check to implement rules as it goes along justified denying comity in this case.152 The Petra Bank II court's comity discussion illustrates that courts should not treat comity as merely one of the § 304 factors; it is the cornerstone of the entire section analysis. The intent of the framers of the 1978 Code was that courts should extend comity to foreign proceedings provided that the procedures comport with the guidelines in § 304.153 Interestingly, the Petra Bank II court did not make a specific finding that the Petra Bank liquidation satisfied the "inherently vicious, wicked or immoral, and shocking to the prevailing moral sense" standard set by the Culmer court.154 Nevertheless, the court reached the same result by

145. Id. at 71.
146. Id. at 69.
147. Id. at 68-69 (citing paragraph 19 of the Special Resolutions, which give the Liquidation Committee discretion to supplement the Special Resolutions as it "deems fit").
148. Id. at 69.
149. 11 U.S.C. § 304(c)(4) (1994) (listing "distribution of proceeds ... substantially in accordance with the order prescribed by this title" as a relevant factor in determining whether to defer to a foreign jurisdiction).
150. Hourani, 180 B.R. at 69.
151. Id. at 70.
152. Id.
153. See supra part I.B.1 (discussing the legislative history of § 304).
denying comity because of the Special Resolutions’ denial of fundamental due process.  

III. SUGGESTED AMENDMENT TO SECTION 304

The debate over whether comity should be of equal or greater weight than the other § 304 factors in considering ancillary bankruptcy proceedings misses the point. While in reality, comity is the overriding concern of § 304, the section’s structure creates ambiguity as to comity’s role. A more clearly worded section would emphasize its central role in § 304 and its relationship to the five other factors in the section. Indeed, the section directs each of the other factors toward determining whether, given the facts of a foreign proceeding, comity should be extended to that proceeding.

The actual language of decisions on § 304 petitions betrays the true nature of the inquiry courts make. In In re Culmer, the Southern District of New York Bankruptcy Court noted that all criteria set forth in § 304(c) “have historically been considered within a court’s determination whether to afford comity to a proceeding in a foreign nation.”155 Chief Judge Lifland remarked that denying a § 304 petition is “refus[ing] comity.”157 In Cunard Steamship Co. v. Salen Reefer Services AB,158 the Second Circuit described deference to a foreign proceeding as the “granting of comity to a foreign bankruptcy proceeding.”159 In Interpool Ltd. v. Certain Freights of the M/V Venture Star,160 the District Court for the District of New Jersey held that in ruling on a § 304 petition it is deciding “whether to grant comity to the actions of [a foreign liquidator].”161 Finally, in In re Axona International Credit & Commerce Ltd.,162 the court concluded that comity

155. Hourani, 180 B.R. at 69-70. As United States courts have developed a body of case law addressing the issues transnational insolvencies raise, the International Bar Association has drafted the Cross-Border Insolvency Concordat, “a framework for harmonizing cross-border insolvency proceedings.” Cross-Border Insolvency Concordat 1 (Draft, Int’l Bar Assoc. Sept. 1995). The Concordat is a set of 10 principles that embrace universality. Id. at 5-8. Although its practical utility may be limited, the Concordat’s real significance is its codification of the principle of universality by a respected organization of international insolvency professionals. It will prove useful if courts widely adopt its principles, or if it leads to an international treaty drafted in the same spirit. Indeed, at least one published United States opinion has mentioned the Concordat. See In re Hackett, 184 B.R. 656, 658 & n.3 (Bankr. S.D.N.Y. 1995) (noting that the case’s holding is not inconsistent with the principles of the Concordat, but not relying on it as authority).
156. Culmer, 25 B.R. at 629 (emphasis added).
158. 773 F.2d 452 (2d Cir. 1985).
159. Id. at 458 (emphasis added).
161. Id. at 377 (emphasis added).
should be accorded to a foreign proceeding. In fact, within the Supreme Court's definition of comity, one finds the seeds of both the territoriality and universality approaches, to wit: "international duty and convenience" and "rights of [a nation's] own citizens."

Commentators are imprecise when they use the terms comity and universality interchangeably to describe a single approach to analyzing a § 304 petition. In reality, courts that embrace universality focus on the international duty and convenience aspect of the comity analysis, while courts embracing territoriality focus on the rights of a nation's own citizens aspect of the comity analysis. Courts should acknowledge, therefore, that § 304 requires a determination as to whether to extend comity to the foreign bankruptcy proceeding. Treating comity as merely one in the list of factors leads to inappropriate analysis. In retrospect, it appears that Congress intended the original five factors in § 304(c) to temper a court's decision as to whether to afford comity to a foreign proceeding. It is entirely appropriate to include comity as the determining factor under § 304 because, by definition, the section involves foreign proceedings. In recognition of this fact, § 304 should be amended as follows:

§ 304. Cases ancillary to foreign proceedings
(a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.
(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may extend comity to the foreign proceeding by
   (1) enjoining the commencement or continuation of—
      (A) any action against—
         (i) a debtor with respect to property involved in such foreign proceeding; or
         (ii) such property; or
      (B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
   (2) ordering turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
   (3) ordering other appropriate relief.

163. Id. at 609.
165. See, e.g., Rimel, supra note 2, at 461-62, 464-66 (using comity and universality as interchangeable terms).
166. See supra part I.B.1 (discussing legislative history of § 304(c)); see also H.R. Rep. No. 595, supra note 23, at 6281 (focusing on comity and flexibility in the § 304 analysis); S. Rep. No. 989, supra note 23, at 5821 (same).
167. In this proposed amendment underlined language is an addition and bracketed language is a deletion. See supra note 25 (giving full text of 11 U.S.C. § 304 (1994)).
(c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with principles of comity, considering all of the following—

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

This proposed section would be consistent with the legislative history of § 304, which emphasized the centrality of comity. At the same time, it would not prevent a court from denying comity to a foreign proceeding if the proceeding did not meet the tests in the remaining five factors.

Conclusion

The complex nature of modern international transactions makes it untenable for any nation to erect a territorial wall. On the other hand, United States bankruptcy law should not subject United States creditors to foreign proceedings that are repugnant to United States insolvency laws and fair treatment of creditors. The suggested amendment to § 304 clarifies that courts should undertake an analysis of the fairness of foreign proceedings with the principle of comity always in mind.

168. See discussion supra part I.B.1 (discussing the legislative history of § 304(c)).