11 U.S.C. 1506: U.S. COURTS KEEP A TIGHT REIN ON THE PUBLIC POLICY EXCEPTION, BUT THE POTENTIAL TO UNDERMINE INTERNATIONAL COOPERATION IN INSOLVENCY PROCEEDINGS REMAINS

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Chapter 15 of the Bankruptcy Abuse and Consumer Protection Act ("BAPCPA") generally requires American courts to cooperate with foreign insolvency proceedings.[1] Section 1506 permits noncooperation where doing so would be "manifestly contrary to the public policy of the United States." The trend among American courts is to construe the public policy exception very narrowly, as intended by the United Nations commission that created the Model Law on which Chapter 15 was based. The commission hoped that exceptions would be limited to express statutes, treaties, or constitutional provisions that would prohibit a court's action in a particular proceeding.

Sound statutory interpretation, efficiency, and predictability in the international economy, as well as the spirit of comity with foreign courts, all support the narrow interpretation of the public policy exception followed by American courts. Where debtors attempt to avoid responsibilities by forum-shopping, courts have looked to other sections of Chapter 15 to ensure that the interests of American creditors and debtors are given proper consideration in foreign proceedings. This is proper where insolvency proceedings are filed in overseas jurisdictions for the sole purpose of avoiding U.S. bankruptcy law, but courts should be wary of creditors who urge them to give minimal effect to foreign proceedings.

Part One of this note describes the most comprehensive attempt to deal with international insolvency to date: the Model Law on Cross-Border Insolvency. Part Two focuses on the public policy exception in Article 6 of the Model Law and gives a survey of the application of the

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[1] The Bankruptcy Code defines a foreign proceeding as "a collective judicial or administrative proceeding in a foreign country. . .under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation." 11 U.S.C. § 101 *23).

public policy exception among some adopting countries. Part Three discusses provisions in the Model Law and Chapter 15 of the U.S. Bankruptcy Code that grant considerable discretion to courts. Using this discretion to protect domestic creditors, courts might undermine the purpose of the Model Law, even without an expansive interpretation of the public policy exception. American bankruptcy courts ought therefore to consider the spirit of the Model Law—the spirit of comity—even as they guard American interests in due process and fundamental fairness in foreign proceedings.

I. INTRODUCTION AND BACKGROUND

A. PRIORITIES AND FORUM-SHOPPING

1. QUESTION OF PRIORITIES AND POWERS

A captain stands on the bridge of a luxury liner steamship, looking ahead to the distant horizon, wondering how long the fair weather will hold out. His thoughts are interrupted by an officer of the watch: an iceberg has just scraped the side of the ship, cutting an irreparable gash in the hull, and water is filling the hold. The captain breaks into a cold sweat; he has important decisions to make. When a ship sinks, there may be no winners, but some will certainly lose more than others. If the captain's first priority is the financial health of the company for which he works, he may load the life rafts with the most valuable fixtures belonging to the company. If his loyalty is to customers who have entrusted cargo, he will put that on the life rafts in hopes it will get to its owners. If the captain's fidelity is to his crew, those who have loyally served under him for years, they will be told to get on the life rafts. And then, there are the passengers, who can only hope there are enough life rafts. A nearby Coast Guard vessel may have different priorities for the ship, and so may nearby pirates.

A corporation in bankruptcy (called "insolvency" in most English-speaking countries) has much in common with a sinking ship. It assesses its financial damage to determine whether the damage is reparable. It estimates how much time is left before the ship is completely under water. To the extent permitted by law, it decides who or what will be rescued and conversely, who or what will be lost forever.

In international bankruptcy, like the "law of the sea,"[2] the jurisdiction overseeing the demise or restructuring of an entity controls many decisions about who is saved and what is lost. Intricate bankruptcy laws become more complicated when the insolvent entity is a multinational corporation. Author Neil Desai compares the multinational firm to an octopus that can strategically spread its tentacles and conduct business through its subsidiaries.[3] Subsidiaries are located around the world to accumulate market share, generate revenue, target demographics, develop product lines, and gain brand recognition.[4] With the added layer of e-commerce, multinationals and their subsidiaries are operating in a global arena that collapses commerce into one marketplace.[5]

2. FORUM-SHOPPING

Natural persons reside at one place at a time. Corporations, however, can "reside" in many places at once: They can be registered in one country, be managed from another country, own assets in another country, and conduct the bulk of their business in yet another country. It is possible for a corporation's directors, sensing the end is near, to re-register in a venue perceived to be more friendly to management or to favored creditors. This practice is often criticized by commentators as improper forum-shopping.[6] However, by the time a company considers forum-shopping, criticism from academics is not among the directors' biggest fears. Forum-shopping is one way for an insolvent debtor to exercise control over the bankruptcy process, and it comes at the expense of those who are owed money.

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[2] For an extended analogy of insolvency jurisdiction to the law of a ship's flag, see John J. Chung, *The Retrogressive Flaw of Chapter 15 of the Bankruptcy Code: A Lesson from Maritime Law*, 17 DUKE J. COMP. & INT'L L. 253 (2007).

[3] Neil Desai, *How Insolvent Multinational Businesses Should Adjust to Congress's Creation: Chapter 15*, 7 HOUS. BUS. & TAX L.J. 138, 139-40 (2006).

[4] *Id*.

[5] *Id.*

[6] *See* LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS 200 (2005), *reprinted in* Lynn LoPucki, *Global and Out of Control?*, 79 AM. BANKR. L.J. 79, 79 (2005), ("The potential for economic harm from international forum-shopping is greater than the potential for harm from domestic shopping."). *See also In re* SPhinX, Ltd., 351 B.R. 103, 121 (Bkrtcy S.D.N.Y. 2006) (citing *In re* Rimsat, Ltd., 98 F.3d 956, 962 (7th Cir. 1996) ("noting similar 'strategic conduct that is not to be encouraged' by deferral to foreign proceeding."). *But cf.* John A.E. Pottow, *The Myth (and Realities) of Forum-shopping in Transnational Insolvency*, 32 BROOKLYN J. INT'L L. 785, 814-16 (2007) (questioning whether forum-shopping has a negative impact on the market).

Creditors of one Bear Stearns hedge fund were alarmed when in 2007 it filed for bankruptcy not in the United States, where it did practically all its business, but in the Cayman Islands, where the fund was nominally registered.[7] Commentator Daniel Glosband speculates that the fund filed offshore in order to avoid publicity, to save expenses, and to avoid litigation.[8] These are pragmatic reasons for filing abroad, but – as a matter of policy – should they be enabled? Until national insolvency laws are uniform, there will be an incentive for debtors to forum-shop.[9] To the degree directors and officers have discretion to do this, they arguably have a fiduciary duty to shareholders to forum-shop.[10]

B. PROTOCOLS AND PRELUDES TO THE MODEL LAW

For hundreds of years, treaties between nations and protocols have provided for a fairly orderly and predictable disposition of assets owned by a single debtor doing business in multiple countries. Later examples include the Montevideo treaties on international commercial law of 1889, the Convention on Private International Law of 1928, the Convention regarding Bankruptcy between Nordic States of 1933, and the European Council Regulation No. 1346/2000 in insolvency proceedings of 2000.[11]

Contributions of nongovernmental organizations have also been important. The International Bar Association's Section on Business Law produced the Model International Insolvency Cooperation Act and its Cross-Border Insolvency Concordat, both of which were influential on later standards.[12] The latter put forth several general principles in 1995

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[7] *In re* Bear Stearns High-Grade Structured Credit Strategies Master Fund, 374 B.R. 122 (Bankr. S.D.N.Y 2007), discussed *infra* note 202. This author did not find a single indication in the 124-page 2005 Bear Stearns Annual Report that any of its funds were registered outside the United States.

[8] Daniel Glosband, *Bankruptcy Court Rejects Cayman Proceedings of Bear Stearns Hedge Funds*, 26-8 AM. BANKR. INST. J. 38, 64 (2007).

[9] Evelyn Biery et al., *A Look at Transnational Insolvencies and Chapter 15 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 47 B.C. L. REV. 23, 57 (2005).

[10] MODEL BUSINESS CORPORATION ACT §§ 8.30(a); 8.42(a) (1984). Directors and officers also have a fiduciary duty to creditors. Cohen v. UN-Ltd. Holdings, Inc. (*In re* Nelco, Ltd.), 264 B.R. 790, 811 (Bankr. E.D. Va. 1999) ("When a corporation becomes insolvent and files bankruptcy, the duty of the officers and directors shifts from the shareholders to creditors.")

[11] UNCITRAL, LEGISLATIVE GUIDE ON INSOLVENCY LAW 311 (2005).

[12] *Id.*

that could be a framework for harmonizing cross-border insolvency proceedings.[13] Principle 2 captures the spirit of the Concordat:

> Where there is one main forum:
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> a) Administration and collection of assets should be co-ordinated by the main forum.
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> b) After payment of secured claims and privileged claims, as determined by local law, assets in any forum other than in the main forum shall be turned over to the main forum for distribution.
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> c) Common claims are filed in and distributions are made by the main forum. Common creditors not in the main forum must file claims in the main forum . . . with no formalities other than required under their local insolvency law.
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> d) The main forum may not discriminate against non-local creditors.
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> e) Filing a claim in the main forum does not subject a creditor to jurisdiction for any purpose, except for claims administration . . . .
>
> f) A discharge granted by the main forum should be recognised in any forum.[14]

Principle 2 embodies the practical recognition that a single, appropriate jurisdiction should take charge of the asset distribution of a bankrupt multinational corporation. It also assigns to the main jurisdiction a duty to be fair in its treatment of foreign creditors. Acceptance of these tenets would seem necessary if an orderly cross-border insolvency is to be administered.[15]

C. THE MODEL LAW

Recognizing that most countries are not willing to overhaul their substantive insolvency laws for the sake of fiscal efficiency in the global marketplace, the United Nations Commission on International Trade

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[13] INTERNATIONAL BAR ASSOCIATION, CROSS-BORDER INSOLVENCY CONCORDAT (1995), *available at* http://www.ibanet.org.

[14] *Id*. For a more detailed summary and discussion of the impact of such protocols, see ALAN RESNICK AND HENRY SOMMER, COLLIER ON BANKRUPTCY. Vol. 11, sec. [3](c) (15th ed., rev. vol. 2008) (monograph).

[15] *See* THE WORLD BANK, CREDITOR RIGHTS AND INSOLVENCY STANDARD (Draft), *passim* (2005) (creditors are to be treated equally regardless of whether they are domestic or foreign).

Law (UNCITRAL) decided to foster cooperation in insolvency procedure, as individual treaties and protocols had done for decades.[16] In 1995, a working group began drafting a procedural framework of legislation that could be adopted by all countries.[17] In May 1997, UNCITRAL adopted the Model Law on Cross-Border Insolvency ("the Model Law"), and the General Assembly officially expressed its appreciation in December of that year.[18]

With the text of the Model Law complete, UNCITRAL knew its work was not finished. The remaining challenge was to convince UN member states to adopt the Model Law. UNCITRAL created a guide to explain to lawmakers the history, purpose, and practical workings of the legislation they were being asked to consider.[19] In 1999 UNCITRAL continued its work on international insolvency matters, particularly corporate insolvency.[20] The result was the *Legislative Guide on Insolvency Law*, a nearly 400-page document that drew on principles developed by the International Bar Association and others.[21]

Nongovernmental organizations involved in international finance generally had good things to say about the Model Law. The International Monetary Fund said that adoption of the law would be an effective way to deal with difficult cross-border insolvency issues.[22] The World Bank went further, calling adoption "[t]he most effective and expeditious way

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[16] *Cf.* James H.M. Sprayregen, *Strategies for Success When Dealing with Multinational Insolvencies in a Changing North American Regulatory Landscape – Chapter 15,* __. ABI 24th Annual Spring Meeting (Apr. 20-23, 2006).

[17] UNCITRAL, GUIDE TO ENACTMENT OF THE UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY ¶ 8.

[18] *Id.* The Preamble to the Model Law sets forth its purpose:

> The purpose of this Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of: *(a)* Cooperation between the courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency; *(b)* Greater legal certainty for trade and investment; *(c)* Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor; *(d)* Protection and maximization of the value of the debtor's assets; and *(e)* Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

Id. at 7.

[19] UNCITRAL, LEGISLATIVE GUIDE TO ENACTMENT ¶ 9 (2000).

[20] UNCITRAL, LEGISLATIVE GUIDE ON INSOLVENCY LAW, *supra* note 11, at iii.

[21] *Id.*

[22] INTERNATIONAL MONETARY FUND, ORDERLY AND EFFECTIVE INSOLVENCY PROCEDURES: KEY ISSUES 82 (1999), *available at* http://www.imf.org/external/pubs/ft/orderly/index.htm.

to achieve" rules governing jurisdiction and recognition, cooperation, and assistance.[23]

Not all who monitored the drafting of the Model Law or its Legislative Guide liked what they saw. Of the nongovernmental organizations that commented on the draft, perhaps none was as critical as the International Labor Organization (ILO). The ILO disagreed with one of the key objectives of the Model Law: that "to the greatest extent possible . . . priorities should be based upon commercial bargains and not reflect social and political concerns that have the potential to distort the outcome of insolvency."[24]

The ILO maintained that this objective runs contrary to a basic tenet of labor law that workers should not have to share an employer's business risk.[25] The organization felt that adoption of the Model Law by any of the 95 countries that had endorsed the ILO's Protection of Wages Convention, 1949 (No. 95),[26] would constitute a repudiation of that Convention.[27] The ILO noted that the Model Law does not deal with the significant problem posed by jurisdictions where workers "enjoy a 'super-privilege' ranking ahead of all other claims, including secured claims."[28] The ILO attributed these perceived defects as coming from a small number of countries of the common law tradition, and it expressed confidence that such principles are not widely accepted among most nations.[29]

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[23] THE WORLD BANK, PRINCIPLES AND GUIDELINES FOR EFFECTIVE INSOLVENCY AND CREDITOR RIGHTS SYSTEMS 53 (2001), *available at* http://www.worldbank.org/ifa/ipg_eng.pdf.

[24] The Secretariat, *Draft UNCITRAL Legislative Guide on Insolvency Law: Compilation of Comments by International Organizations*, at 5, *delivered to the U.N. Comm'n. on Int'l Trade Law*, U.N. Doc. A/CN.9/558 (Apr. 27, 2004).

[25] *Id.* at 6. *Cf.* INTERNATIONAL LABOUR OFFICE, *The Protection of Wages: Chapter V*, *The Preferential Treatment of Workers' Wage Claims in Case of Employer's Bankruptcy*, Report III, Convention C095, Document 252003G07, ¶ 346 (Business risk is the collective responsibility of the community of entrepreneurs).

[26] Article 11 of the Convention requires signatories to treat workers as privileged creditors in the event of bankruptcy. In fact, the United States does assign some priority to employees who are owed wages. 11 U.S.C. § 507(a)(4)(A) (2007). Nevertheless, secured creditors hold the highest claim to property in the possession of the debtor. 11 U.S.C. §§ 506, 521(a), 522(c)(2) (2007). *See* UNCITRAL, LEGISLATIVE GUIDE ON INSOLVENCY LAW 287-88 (2005) (highlighting treatment of secured creditors in insolvency proceedings under the Model Law).

[27] Secretariat, *supra* note 24, at 6.

[28] *Id.* at 6-7.

[29] *Id.* at 7. The World Bank subsequently included in its draft CREDITOR RIGHTS AND INSOLVENCY STANDARD 48 (2005) an exception to the principle that the forum state should apply its own law in determining creditor priority: "[t]he effects of insolvency proceedings on rejection, continuation and modification of labour contracts may be governed by the law applicable to the contract." Even this probably does not go as far as the ILO would demand.

1. ADOPTION HISTORY

Sixteen countries have adopted the Model Law in some form.[30] Most of Europe declined to adopt the Model Law.[31] The European Union (EU) opted instead to adopt its own law, Council Regulation on Insolvency Proceedings (EC) No. 1346/2000 ("Council Regulation"), on which it had been working for over forty years.[32] The EU law, like the Model Law, puts a premium on cross-border cooperation where forum-shopping might otherwise become commonplace for debtors.[33] European states considered cooperation in insolvency proceedings a necessity if their economies were to work together.[34] Like the Model Law, the Council Regulation is a procedural framework rather than a body of substantive law.[35] Unlike the Model Law, the EU Council Regulation applies only in cases where a debtor has its Center of Main Interests ("COMI") in an EU member state; each state must rely on its own laws in regard to international insolvency not involving a fellow EU member state.[36]

II. THE PUBLIC POLICY EXCEPTION

A. REASON FOR INCLUSION IN THE MODEL LAW

Venezuela's nationalization of its oil industry in recent years led to bitter disputes over what was fair compensation for the assets seized from companies.[37] What if, in addition to seizing equipment and real property, Venezuela also appropriated "illegal profits" of the companies involved, levied "windfall taxes" on them, and commenced involuntary bankruptcy actions against them? Imagine further that in these actions, foreign creditors were excluded from showing evidence of their

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[30] UNCITRAL, http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html (last accessed Feb. 20, 2009).

[31] *See id.*

[32] *See* BOB WESSELS, INTERNATIONAL INSOLVENCY LAW 229-34 (2007).

[33] *See* Council Regulation (EC) No 1346/2000 on Insolvency Proceedings, L 160/1 (May 29 2000); Wessels, *supra* note 32, at 227-28.

[34] *Id.*

[35] Wessels, *supra* note 32, at 229, 235.

[36] *Id.* at 235.

[37] Russell Gold, Raul Gallegos & Chad Bray, *Exxon Wins Asset Freeze in Fight With Venezuela*, WALL ST. J., Feb. 8, 2008, at A3; Russell Gold & Erica Herrero-Martinez, *Exxon Loses U.K. Ruling In Fight With Venezuela*, WALL ST. J., Mar. 19, 2008, at A11.

legitimate claims. Would bankruptcy courts in jurisdictions that had adopted the Model Law be compelled to recognize and assist the Venezuelan government in seizing and repatriating the assets of the newly nationalized companies? Such a scenario is far from unlikely in some countries.[38] If adoption of the Model Law would force a country to cooperate, few would adopt it, with the fear of occasional abuses outweighing the hope of economic benefits to the adopting country and its citizens.

The Model Law on Cross-Border Insolvency ostensibly does not touch substantive insolvency law of the nations that adopt it. That would have made adoption politically unpalatable in many countries.[39] Rather, the Model Law provides a mechanism for courts to recognize foreign insolvency proceedings and to cooperate with them when the debtor owns assets in the court's jurisdiction.[40] Recognizing that procedural law can affect a party's substantive rights, the Model Law includes the public policy exception to reassure adopting countries that the Model Law would not undermine their law in a way repugnant to those countries' fundamental principles.[41] However, proponents of the Model Law urge courts not to construe the exception too broadly, so as to undermine the international cooperation envisioned.[42]

B. POTENTIAL TO UNDERMINE THE PURPOSE OF THE MODEL LAW

Without a transnational authority to administer a universal system of insolvency law, one can see a need for a public policy exception as a safety valve to prevent egregious cases from being foisted upon each nation. Should courts be able to refuse to cooperate with a foreign proceeding that is not obviously unjust? Local courts that have adopted the Model Law do not have to cooperate with a foreign main proceeding if doing so would be contrary to the nation's public policy.[43]

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[38] *See, e.g.,* Thomas Catan & John Lyons, *Spain's Bets Sour in Latin America*, WALL ST. J., Dec. 4, 2008, at A13 (Spanish investments in Latin America being seized by populist governments).

[39] James H.M. Sprayregen, *Strategies for Success When Dealing with Multinational Insolvencies in a Changing North American Regulatory Landscape – Chapter 15*, American Bankruptcy Institute 24th Annual Spring Meeting (Apr. 20-23, 2006).

[40] UNCITRAL, LEGISLATIVE GUIDE ON INSOLVENCY LAW, *supra* note 11, *passim*.

[41] *Id.* at 326. *Cf.* Burlington N. R.R. v. Woods, 480 U.S. 1,5 (1987) (In the context of U.S. federal jurisdiction as over against that of the states, state procedural "rules which incidentally affect litigants' substantive rights" may be followed, despite an aversion to forum-shopping as a matter of law and policy, "if reasonably necessary to maintain the integrity of that system of rules.")

[42] UNCITRAL, LEGISLATIVE GUIDE ON INSOLVENCY LAW, *supra* note 11, at 326.

[43] 11 U.S.C. § 1506 (2007).

Even if it is not simply a truism, it is at least possible that local interests will bias a court deciding whether to recognize a foreign proceeding. Public policy has long been an important tool in judicial activism.[44] Unrestrained judicial discretion can be a dangerous thing.[45] If courts can manufacture public policy to advantage local creditors or debtors, the public policy exception could overwhelm the Model Law's *raison d'être*: to foster international cooperation in insolvency proceedings.[46]

The ILO's argument against the text of the Model Law, discussed above, could be obviated by the public policy exception.[47] A jurisdiction that has submitted to the Protection of Wages Convention may be asked to cooperate in the sale of assets of an insolvent corporation and the discharge of its debts.[48] In that case, the public policy exception could be invoked to ensure that employees are paid back wages before other creditors, even secured creditors.[49]

If the public policy exception were broadly interpreted by adopting countries, then the Model Law's benefit of predictability and market efficiency is lost. Multinational corporations may have to learn the traditions of every country with which they do business to get a sense of those countries' public policies in order to predict whether their debts will be discharged through insolvency.[50] Author Justin Luna suggests that Americans who take freedom of speech for granted may be surprised by limitations on that freedom in Europe, including limitations in business contexts.[51] A European insolvency court, he hypothesizes, may well refuse to recognize a discharge of a debtor dealing in Nazi memorabilia.[52] The result is predictable only by one familiar with

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[44] Judicial activism is defined as a "philosophy of judicial decision-making whereby judges allow their personal views about public policy, among other factors, to guide their decisions, usu[ally] with the suggestion that adherents of this philosophy tend to find constitutional violations and are willing to ignore precedent." BLACK'S LAW DICTIONARY, "Judicial Activism" (8th Ed. 2004).

[45] *See* Rogers v. Tennessee, 532 U.S. 451, 477 (2001) (quoting MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW: 1780-1860 14 (1977) (relating Zepheniah Swift's warning about lack of legislatively-prescribed sentences)).

[46] Jennifer Greene, *Recognizing Foreign Proceedings in Cross-Border Insolvencies*, 30 BROOKLYN J. INT'L L. 685, 717 (2005).

[47] *See* Justin Luna, Thinking Globally, Filing Locally, 19 FLA. J. INT'L L. 671, 694 (2007).

[48] *Id.*

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

German history and German proscriptions on certain kinds of speech and business.

The *Legislative Guide on Insolvency Law* itself uses the phrase "public policy" in broad and narrow ways: For example, it suggests that exceptions to the automatic stay[53] include actions to protect public policy interests.[54] Here public policy interests include policies to prevent environmental damage and activities detrimental to public health and safety.[55] A nation's public policy might lead it to exclude certain claims from insolvency proceedings, including foreign tax claims, claims relating to personal injury, negligence, or gambling debts.[56] Many countries give a broad meaning to this phrase in connection with domestic affairs, so public policy in those contexts includes any "mandatory rule of national law."[57] In connection with the public policy exception of the Model Law's Article 6, however, the drafters clearly indicate that they expect a more restrictive understanding of "public policy" to be applied to international insolvency cooperation.[58] A narrow interpretation is one "restricted to fundamental principles of law, in particular constitutional guarantees."[59] Only where a foreign judicial decision contravenes such principles would the public policy exception apply.[60] The *Guide* expects that the exception will be invoked only under exceptional circumstances, and consequently will rarely be used.[61]

C. THE PUBLIC POLICY EXCEPTION AS IMPLEMENTED IN FOREIGN JURISDICTIONS

Of the countries that have adopted the Model Law, perhaps South Africa is most confident that it will not need to rely on a public policy exception to avoid cooperation with nations whose laws are

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[53] An "automatic stay" is imposed at the filing of the bankruptcy petition, preventing creditors from taking any action against the debtor or property claimed by the debtor. Claims will then be resolved through the bankruptcy court. 11 U.S.C. § 362.

[54] UNCITRAL, LEGISLATIVE GUIDE ON INSOLVENCY LAW, *supra* note 11, at 86.

[55] *Id.*

[56] *Id.* at 251.

[57] *Id.* at 326.

[58] *Id.* at 326.

[59] *Id.*

[60] *Id.*

[61] *Id.* at 311, 326.

repugnant to its own.[62] South Africa's version of the Model Law is applicable only to countries officially designated by the South African parliament.[63] As of April 2005, no countries had been so designated.[64] Other countries requiring reciprocity before applying their versions of the Model Law to a foreign proceeding are Argentina, Mexico,[65] Romania, and to a lesser extent, the British Virgin Islands.[66] The UNCITRAL rejected adding a reciprocity component to the Model Law.[67]

As noted above, the European Union has declined to adopt the UN Model Law as its own.[68] However, its approach to public policy exceptions is consistent with the intentions of the Model Law.[69] The insolvency case of *Eurofood IFSC, Ltd.* tested the EU's understanding of limits on national determinations of "public policy" to refuse recognition of foreign judgments. [70] Following the collapse of food conglomerate Parmalat in 2003, insolvency proceedings commenced in Italy.[71] About the same time, Parmalat's Eurofoods division was subjected to insolvency proceedings in Ireland.[72] Creditors claimed that they were not being given an opportunity to make their claims in the Italian court overseeing the bankruptcy of the parent company.[73] They petitioned the Irish court to conduct an insolvency proceeding independent of the Italian one.[74]

The legal justification for an independent proceeding could be found in Article 26 of the Insolvency Proceedings Regulation of the European Union ("the Regulation," based on the E.U. Convention on Insolvency Proceedings), which reads: "Any Member State may refuse to

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[62] UNCITRAL, Secretariat, *IAIR Recognition Reciprocity Report 2006 – Uncitral 2005 Addendum*, ¶14, U.N. Doc. A/CN.9/580 (Apr. 14, 2005), (citing South Africa's Cross-Border Insolvency Act 42, Art. 34 (2000) [hereinafter *IAIR Recognition Reciprocity Report*].

[63] *Id.*

[64] *Id.*

[65] Ley de Concursos Mercantiles, Chapter I, Article 280 (2000).

[66] The BVI statute requires "designation by notice in an official publication," *IAIR Recognition Reciprocity Report* at ¶14 (discussing BVI's Insolvency Act 2003).

[67] *Id.*

[68] UNCITRAL, *supra* note 30.

[69] 2006 E.C.R. I-03813, 2005 ECJ CELEX LEXIS 630, ¶ 18 (Sept. 27, 2005) (hereinafter "*Eurofood*").

[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *Id.*

[74] *Id.*

recognise insolvency proceedings opened in another Member State or to enforce a judgment handed down in the context of such proceedings where the effects of such recognition or enforcement would be manifestly contrary to that State's public policy, in particular its fundamental principles or the constitutional rights and liberties of the individual."[75]

Faced with this option, but understanding its potential to undermine the framework of EU mutual recognition of member state judgments, the Supreme Court of Ireland turned to the European Court of Justice (ECJ).[76] Ireland asked whether it was obligated to subordinate its sovereign public policy concerns to its obligation as an EU member state to recognize a foreign (Italian) proceeding.[77] The Virgos-Schmit Report, a respected commentary on the Regulation, made it clear that the public policy exception should be reserved for exceptional cases such as those violating "constitutionally protected rights and freedoms and fundamental policies . . . of both substance and procedure."[78] The ECJ also relied on earlier European case law that held it necessary to circumscribe the limits of public policy, at least as a basis for non-recognition of a foreign proceeding.[79] "Consequently, while it is not for the [European] Court [of Justice] to define the content of the public policy of a Contracting [member] State, it is none the less required to review the limits within which the courts of a Contracting State may have recourse to that concept for the purpose of refusing recognition to a judgment emanating from a court in another Contracting State."[80]

The court's willingness to interfere in a member state's invocation of public policy to refuse recognition of the proceedings of another member state has distinct overtones in the *Legislative Guide to Insolvency Law*'s observation: "[A] growing number of jurisdictions recognize a dichotomy between the notion of public policy as it applies to domestic affairs, as well as the notion of public policy as it is used in matters of international cooperation and the question of recognition of effects of foreign laws."[81]

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[75] *Id.* at ¶ 18 (emphasis added).
[76] *Eurofood*, *supra* note 69, at ¶18.
[77] *Id.*
[78] *Id.* at ¶¶ 131, 143.
[79] *Id.* at ¶ 138.
[80] *Id.* (emphasis added).
[81] UNCITRAL, LEGISLATIVE GUIDE ON INSOLVENCY LAW, *supra* note 11, at 326.

In other words, "public policy" can have a broad meaning for law that is strictly domestic, but it should have a much more restricted meaning where international concerns are directly implicated, such as when nations have agreed to work together in applying systems of laws. In this restricted category fits a party's right to a fair hearing, or due process. Due process is so fundamental that one state may refuse to recognize another member's proceedings if due process was denied to a party.[82]

For international cooperation to work, individual countries will need to put material limits on their conception of national public policy in certain contexts. The *Eurofood* court urged great restraint in construing "public policy" and acknowledged the option of recognizing foreign proceedings even when they *are* manifestly contrary to a country's national public policy.[83] Nevertheless, the *Eurofood* Court left it to individual EU member states to determine whether a foreign proceeding was so defective as to warrant non-recognition on the basis of Article 26.[84]

D. THE PUBLIC POLICY EXCEPTION'S FUNCTION IN CHAPTER 15

1. THE CONCEPT OF PUBLIC POLICY IN LEGISLATIVE HISTORY AND COMMON LAW

The Model Law was incorporated into U.S. law through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[85] The new Chapter 15 of the U.S. Bankruptcy Code governs cooperation with foreign insolvency proceedings.[86] When adopting the Model Law into the laws of the United States, Congress understood that adopting countries regularly interpreted the public policy exception of Article 6 (now copied into § 1506) narrowly.[87] Congress intended the word "manifestly" to restrict the exception to "the most fundamental policies of the United States."[88]

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[82] *Eurofood*, *supra* note 69, at ¶ 138.
[83] *Id.* at 145, 151.
[84] *Id.*
[85] Pub.L. 109-8, Apr. 20, 2005, 119 Stat. 23.
[86] 11 U.S.C. §§ 1501 to 1532 (2005).
[87] 109 H.R. Rep. No. 31 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 172.
[88] *Id.*

It almost goes without saying that courts interpreting statutes weigh legislative history inconsistently. Soon after adoption of Chapter 15, commentators lamented that neither § 1506 nor the Model Law text defined "public policy."[89] They feared that courts would decide they had broad discretion to determine what constituted "important U.S. public policy."[90] Among the contenders for "important public policy" were exceptions in the U.S. code for the discharge of certain debts such as student loans, certain taxes, domestic support obligations, and certain torts committed by debtors against other debtors.[91]

If U.S. courts are not bound by international convention[92] or the House Report cited above, how might they interpret § 1506? The term "public policy" has been problematic since appearing in the context of contract law in the late 1700s.[93] Courts often did not want to sanction by legal enforcement certain contracts such as gambling debts.[94] In the late 19th and first half of the 20th century, the Supreme Court was dismayed by the wide latitude public policy seemed to offer litigants.[95] The Court noted in 1927 that the meaning of the phrase "public policy" was vague and always changing.[96] There were no fixed rules by which to determine what it was; it had never been defined by the courts but "has been left loose and free of definition, in the same manner as fraud."[97] Because of the pitfalls of a court basing a judgment on a nebulous legal principle, the Supreme Court stated that any judicial remedy based on public policy "should be applied with caution and only in cases plainly within the reasons on which that doctrine rests."[98]

In the context of tax law, an IRS ruling that disallowed expenses incurred in violation of public policy was held unenforceable because it found no support in the regulations, statutes, or any Supreme Court decision.[99] The Court said it would uphold a disallowance of expenses only when sharply-defined "policies frustrated [are] national or state

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89 Jennifer Greene, *Bankruptcy Beyond Borders*, 30 BROOK. J. INT'L L. 685, 717 (2005).

90 *Id.*

91 Justin Luna, *Thinking Globally, Filing Locally*, 19 FLA. J. INT'L L. 671, 694 (2007).

92 Apart from treaties to which the U.S. is a party, of course.

93 *See* WILLIAM R. ANSON, PRINCIPLES OF THE LAW OF CONTRACT 286 (3d Am. ed. 1919).

94 *Id.*

95 Steele v. Drummond, 275 U.S. 199, 205 (1927).

96 *Id.*

97 *Id.*

98 Twin City Pipe Line Co. v. Harding Glass Co., 283 U.S. 353, 356-357 (1931).

99 C.I.R. v. Tellier, 383 U.S. 687, 690 (1966).

policies evidenced by some governmental declaration of them."[100] Even so, the fluidity of the term prevents us from determining what constitutes public policy. In general, the concept of violation of public policy has to do with something illegal, immoral, or that injures the public welfare.[101]

In the context of labor law, the U.S. Supreme Court has set requirements for any appeal to public policy as grounds for rescinding a provision in a collective bargaining agreement: it must be based on a public policy that is "'explicit,' 'well defined,' and 'dominant[,]' . . . 'ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests."[102] A few state courts have gone further in identifying sources of public policy, adding "the constant practice of government officials, and, in certain instances, in professional codes of ethics."[103]

Domestic contract law, tax law, and labor law have seen an expanding role for public policy in American jurisprudence.[104] Courts that have become accustomed to wide latitude in applying law based on liberal notions of public policy might be tempted to apply those principles to foreign insolvency cases.

2. SECTION 1506 AS APPLIED BY U.S. COURTS

In the four years since BAPCPA has been in effect, federal courts in several states have considered challenges to foreign insolvency proceedings under § 1506. We will see how courts have uniformly rejected these, applying a narrow construction to the term "public policy." These early cases are particularly useful, and not only because they seem to be establishing a consistent precedent. Several of them bridge the gap between the former 11 U.S.C. § 304, authorizing cooperation with foreign proceedings based on comity principles, and the ongoing importance of comity considerations.[105] Comity is "neither a

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[100] *Id.* at 694.

[101] M.T. Brunner, Annotation, *Public Policy as Ground for Denying Deduction for Federal Income Tax Purposes*, 27 A.L.R. 2d 498 (2008).

[102] Eastern Associated Coal Corp. v. United Mine Workers of America, Dist. 17, 531 U.S. 57, 62 (2000) (quoting W.R. Grace & Co. v. Rubber Workers, 461 U.S. 757, 766 (1983) and Muschany v. United States, 324 U.S. 49, 66 (1945)).

[103] Drury v. Missouri Youth Soccer Ass'n, Inc., 259 S.W.3d 558, 566 (Mo.App. E.D. 2008) (citing Boyle v. Vista Eyewear, Inc., 700 S.W.2d 859, 871 (Mo. App. W.D. 1985).

[104] *See,e.g.,* 531 U.S. at 62, and Brunner, *supra* note 101, at 498.

[105] *Cf.* RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 481, Reporters' Note 1 (1987) ("The great majority of courts in the United States have rejected the requirement of reciprocity."); *but see id.*,

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."[106]

As the following cases show, comity remains relevant to cooperation, even if recognition is seen as mandatory under Chapter 15.[107]

a. California

California courts have been conservative in their interpretation of public policy vis-à-vis foreign proceedings.[108] In *TSMC North America v. Semiconductor Manufacturing International Corp.*, the court was asked to enjoin a suit in Beijing in apparent contravention of a contractual choice of law provision that specified that California law would apply to any dispute arising out of the contract.[109] According to the contract, the parties consented to personal jurisdiction and venue in California.[110] The plaintiff Taiwanese company accused the defendant of seeking "to evade important California public policies" as embodied in its statutes and common law, by initiating a proceeding in China.[111] However, California's Supreme Court had implicitly rejected such a rationale already in *Advanced Bionics v. Medtronic, Inc.,*[112] and California courts had regularly declined to enjoin parties from filing suits in foreign jurisdictions, even where the state had a strong interest in protecting its citizens with California's substantive law.[113] Where clear public policies were at risk of being contradicted by a foreign court, the local California

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cmt. b ("The judgment of a foreign state may not be enforced unless it is entitled to recognition.").

[106] Cote-Whitacre v. Department of Public Health, 446 Mass. 350, 368, 844 N.E.2d 623, 642 (Mass. 2006) (quoting Hilton v. Guyot, 159 U.S. 113, 163, 164 (1895)).

[107] *Cf. In re* Iida, 377 B.R. 243, 253-58 (B.A.P. 9th Cir. 2007); *In re* Loy, 380 B.R. 154, 164-66 (Bankr. W.D. Vir. 2007).

[108] *See* TSMC North America v. Semiconductor Mf'g. Int'l Corp., 161 Cal. App. 4th 581, 586 (2008).

[109] *Id.*

[110] *Id.*

[111] *Id.* at 597-98.

[112] 29 Cal.4th 697, 706-07 (2002).

[113] *TSMC North America*, 161 Cal. App. 4th at 598.

court was compelled to give considerable weight to "notions of judicial restraint and international comity."[114]

b. Colorado

In a case that began with a securities investigation of a Canadian corporation and Colorado company, both of which were owned by the same two people, the Colorado Securities Commissioner contacted the Canadian agency overseeing securities regulation.[115] The Canadian agency commenced its own action against the Canadian corporation, and a Canadian court put the corporation into receivership,[116] attempting to include the Colorado company among the assets.[117] In a Colorado federal bankruptcy court, the Colorado Securities Commissioner challenged the Canadian receiver's request to take control of the Colorado company, arguing that recognition of the Canadian proceeding as a main proceeding would be contrary to public policy by harming recovery of assets underway in Colorado.[118] The Colorado court was satisfied that Canada was the proper center of main interests,[119] so it turned its attention to the Commissioner's argument that recognition of the foreign proceeding would be contrary to public policy of the United States.[120]

The Commissioner claimed that under the foreign proceeding, American investors would receive less than they would from a proceeding based in Colorado state or federal court.[121] Bankruptcy Judge Michael Romero replied that "all wronged investors should share in the assets accumulated in the Receivership Proceeding, regardless of nationality or locale."[122] Judge Romero dismissed protests that the costs of receivership were higher under a foreign proceeding, noting that

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[114] *Id.* at 599.

[115] *In re* Ernst & Young, Inc., 383 B.R. 773, 775 (Bankr. D. Col. 2008).

[116] Receivership is when a court exercises its authority to place property of the debtor in control of an entity chosen by the court. The entity, known as a receiver, may continue to operate the property or business, or arrange for its sale for the benefit of creditors, or to prepare for a company's reorganization.

[117] *In re* Ernst & Young, Inc., 383 B.R. at 775.

[118] *Id.* at 778.

[119] COMI is discussed *supra* p. 8.

[120] *In re* Ernst & Young, Inc., 383 B.R. at 781.

[121] *Id.*

[122] *Id.* It is not clear that the Canadian proceeding would distinguish between investors in the Colorado company and investors in the Canadian corporation. The substantive law may not have been relevant, as due process and a fair hearing are what are most important.

"[c]osts of liquidation are a reality" from wherever administered, and this factor is unpersuasive with regard to public policy.[123]

c. Hawaii

In a case involving questions of corporate and bankruptcy law, directors and shareholders of two Hawaii corporations were the debtors.[124] An insolvency court in Japan ordered the corporations be placed into receivership of a foreign representative who then removed the debtors as directors and sold corporate assets with the cooperation of other directors and in accord with Hawaiian corporate law.[125] The debtors subsequently filed suit, seeking reinstatement as shareholders and directors, plus proceeds from the sales.[126] In response to the action, the foreign representative filed for Chapter 15 recognition of a foreign main proceeding in U.S. Bankruptcy Court.[127] The debtors opposed the petition for recognition, arguing among other things that recognition of the foreign representative would be "manifestly contrary to the public policy of the United States" because the foreign representative had not obtained permission from the Bankruptcy Court before removing the debtors from their position as directors and sole shareholders.[128]

The Bankruptcy Appellate Panel for the Ninth Circuit affirmed the Bankruptcy Court's holding that the actions of the foreign representative were valid even before formal recognition of the foreign main proceeding.[129] It noted that "Chapter 15 is fundamentally procedural in nature and does not constitute a change in the basic approach of United States law, which . . . has long been one of honoring principles of comity."[130] Where the foreign representative did not need the assistance of a domestic court, formal recognition was not required by Chapter 15.[131] Therefore, the debtors' argument that the foreign representative was manifestly contrary to the public policy of the United States was without merit.[132] The court concluded that the qualifier

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[123] *Id.*
[124] *In re* Iida, 337 B.R. 243, 248 (B.A.P. 9th Cir. 2007).
[125] *Id.* at 249-50.
[126] *Id.* at 250.
[127] *Id.* at 251.
[128] *Id.*
[129] *Id.* at 256 (citation omitted).
[130] *Id.*
[131] *Id.* at 258.
[132] *Id.* at 259.

"manifestly" means that the "public policy exception is narrow and . . . limited only to the most fundamental policies of the United States."[133] The phrase from BAPCPA's legislative history and the Model Law commentary had become a recurring theme in state courts.

d. New York

Some early challenges to recognition of foreign proceedings on public policy grounds were made in the Southern District of New York Bankruptcy Court.

In 2006, products liability litigation over Ephedra resulted in the bankruptcy of a Canadian company marketing ephedra-containing[134] products in the United States.[135] A Canadian insolvency proceeding recognized an expedited claims resolution procedure negotiated between the debtor and several, but not all, claimants.[136] In *In re Ephedra Products Liability Litigation*, four claimants opposed U.S. recognition of the Canadian proceeding based on public policy grounds, namely that the negotiated claims resolution procedure deprived them of due process and trial by jury.[137]

Ephedra Products underscored the principle that due process is at the heart of any notion of public policy. When weighing foreign procedures against our own to determine whether due process has been given, American courts look not for a particular regimen, but for fairness. In the words of the court, "[A] foreign judgment should generally be accorded comity if 'its proceedings are according to the course of a civilized jurisprudence,' i.e., fair and impartial."[138] The court distinguished due process and trial by jury, and pointed out that most of the civilized world renders fair and impartial verdicts without the benefit of jury trials.[139] The Canadian proceeding had been fair since it modified its claims procedure to give claimants additional opportunities to be heard, and so the court ordered its recognition in the United States.[140] Quoting Judge Benjamin Cardozo, Judge Rakoff acknowledged that jury

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[133] *Id.* (citation omitted).
[134] Not to be confused with the brand name Ephedra, as used before.
[135] *In re* Ephedra Products Liability Litigation, 349 B.R. 333, 333 (Bankr. S.D.N.Y. 2006).
[136] *Id.* at 334.
[137] *Id.* at 335.
[138] *Id.* at 336 (quoting Hilton v. Guyot, 159 U.S. 113, 205-06 (1895)).
[139] *Id.* at 337.
[140] *Id.* at 335.

trials are not a *sine qua non* to due process, "We are not so provincial as to say that every solution of a problem is wrong because we deal with it otherwise at home."[141]

More recently, Parmalat was again in court, this time in an American bankruptcy court.[142] While in insolvency proceedings in Italy, Parmalat asked the U.S. court to enjoin a creditor, ABN AMRO, from suing in New York to collect on a nearly $10 million promissory note it had guaranteed to Parmalat.[143] ABN objected to the injunction, claiming that the note specified that New York law, not Italian law, would be applied to disputes.[144] The matter was much more serious than merely expecting an Italian judge to understand the nuances of New York law; Italian rules of evidence precluded the note from being offered as proof of ABN's claim in the Italian insolvency proceeding,[145] whereas the note would have been admitted under New York law.[146] Without proof of its claim, ABN essentially had no claim.

ABN did not invoke § 1506 because Parmalat's bankruptcy proceedings in the United States first began in 2004, before Chapter 15 was law.[147] Instead, ABN asked the American court to refuse comity under 11 U.S.C. § 304, the comity provision granting discretion to the court about whether to recognize the foreign proceeding.[148] As a matter of contract, ABN seemed to have a good case; the original parties to the note had agreed that New York would be the forum for interpretation of the note.[149] To the Italian and then the American court, interpretation of the note never became an issue because the note's legal existence was never established in the relevant forum, the Italian court, where the debtor's economic affairs were being administered in insolvency

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[141] *Id.* at 336 (citing Loucks v. Standard Oil Co., 224 N.Y. 99, 110-11 (1918)).

[142] *In re* Parmalat, 394 B.R. 696 (Bankr. S.D.N.Y. 2008).

[143] *Id.* at 697

[144] *Id.* at 698.

[145] Specifically, the Italian court applied its *data certa* statute, Art. 2704 of the Italian Civil Code, to the note and guarantee [hereinafter, collectively "the note"] and found them impossible to authenticate. *Id.* at 699, note 2.

[146] *Id.* at 699.

[147] *Id.* at 698.

[148] *Id.*

[149] *Id.* at 699. *Cf.* RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 482(f) & cmt. h (1987) (recognizing a judgment from a forum other than the one called for in a contract undermines the policy favoring forum selection clauses). The "Zapata Rule" called for courts to enforce agreements between contracting parties regarding forum selection, even if outside U.S. jurisdictions. The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 8 (1972).

proceedings.[150] American courts routinely do what the Italian court had done, applying foreign law when a contract specifies a choice-of-law provision, but reserving domestic rules of evidence for proving the contract's existence.[151] The court observed, "The simple point is that there is nothing antithetical to fundamental notions of due process of law as applied in the courts of this nation in applying the law of the forum to the manner in which an obligation is proven, even if some other jurisdiction's substantive law is applicable to that obligation."[152]

Although choice-of-law provisions were arguably a matter of public policy in the broad or domestic sense,[153] they did not in this case rise to the level of fundamental notions of due process or public policy in the narrow sense of § 1506.[154]

e. Virginia

Jonathan Loy, in the United States on a temporary visa, owned real estate in Virginia.[155] Mr. Loy was the subject of an English insolvency proceeding, and his property was ordered placed into receivership.[156] In early 2007, shortly before filing for recognition under Chapter 15, the foreign receiver filed a memorandum of *lis pendens*[157] for Loy's property in Virginia.[158] Mr. Loy attempted to quash the memorandum and urged the Virginia bankruptcy court to reject the petition for foreign recognition of the English proceedings.[159] Loy argued that the memorandum improperly referred to foreign proceedings, that the receiver should have first filed for Chapter 15 recognition, and that

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[150] *In re* Parmalat, 394 B.R. at 702 ("[T]he law of the forum is routinely applied to the manner of proving an obligation, regardless of the jurisdiction whose law governs the terms of that obligation.")

[151] *Id. Cf.* Estate of Guerrero, 183 Cal. App. 3d 723, 727-30 (2d Dist. 1986).

[152] *In re* Parmalat, 394 B.R. at 703.

[153] *See supra* note 149.

[154] *See id.*

[155] *In re* Loy, 380 B.R. 154, 154 (Bankr. W.D. Vir. 2007).

[156] *Id.* at 158-59.

[157] That is, a notation that property is subject to pending litigation and any transferees of the property take it subject to the outcome of the litigation. Here the referred-to litigation was in England, though there was no notice of the foreign nature of the litigation on the real estate record itself.

[158] *In re* Loy, 380 B.R. at 159.

[159] *Id.* at 160.

the property was mostly owned by his wife and therefore was mostly outside the bankruptcy estate.[160]

Citing the Hawaii case *In re Iida*,[161] the court rejected most of Loy's arguments, including the notion that any foreign representative had to first pass through U.S. bankruptcy court before taking any legal action whatsoever.[162] Only where the foreign representative seeks the active cooperation of a court in this country is the representative compelled to seek recognition through the bankruptcy court.[163] The court did, however, permit Loy to pursue his action to quiet title.[164] Even so, the court was not remotely inclined to deny recognition to the foreign main insolvency proceeding on the basis of § 1506 public policy or unclean hands.[165]

f. The Restatement (Third) of Foreign Relations

Section 482 of the Restatement (Third) of Foreign Relations provides a practical checklist for the kinds of "public policy" violations that § 1506 seems to contemplate.[166] Among the grounds for mandatory non-recognition of foreign judgments are the following: (1a) the foreign proceedings are not impartial or compatible with due process of law; or (1b) the court did not have jurisdiction over the defendant in accordance with its own law.[167] Among the grounds for permissive non-recognition of foreign judgments: (2a) the foreign court did not have subject matter jurisdiction; (2b) the defendant did not receive notice of the proceedings in time to sufficiently defend itself; (2c) the judgment was obtained by fraud; (2d) the cause of action or the judgment itself is repugnant to the public policy of the United States; (2e) the judgment is in conflict with another final judgment entitled to recognition; or (2f) the proceeding in the foreign court is contrary to a choice-of-forum agreement between the parties.[168]

Subsection (2d) seems to open the door for non-recognition on grounds other than basic procedural fairness.[169] The comments and notes

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[160] *Id.*
[161] 337 B.R. 243.
[162] *In re* Loy, 380 B.R. at 165.
[163] *Id.* at 165 (citing 15 U.S.C. § 1509(c)).
[164] *Id.* at 170.
[165] *Id.* at 169.
[166] *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 482(a) (1987).
[167] *Id.*
[168] *Id.*
[169] *Id.*

to § 482 counsel differently, however. First, it is understood that courts do not recognize foreign judgments based on claims that are contrary to the fundamental notions of decency and justice.[170] Second, the Reporters' Notes acknowledge that few judgments will be denied on the basis of (2d) because specific grounds for denying recognition are already enumerated in § 482.[171] A judgment on the basis of race or religion would certainly be denied recognition,[172] but that is also a matter of procedural fairness.[173]

U.S. courts are applying a double standard when it comes to public policy: one in contexts where domestic laws are the primary consideration, and another in contexts where domestic laws interface with foreign judgments. This double standard is proper and was contemplated by Congress as it adopted Chapter 15, it is in accord with what other nations are doing, and it follows longstanding American jurisprudence.[174] Common to both standards is the requirement that any judgment recognized by American courts be the product of due process and fundamental fairness.[175]

U.S. courts that are uncomfortable with certain foreign insolvency proceedings can refuse to recognize them, citing the public policy exception.[176] But this necessarily is done only with great insult; it is an accusation that the foreign proceeding lacks fundamental fairness. The following section considers ways that American courts have avoided giving effect to questionable foreign proceedings without resorting to the public policy exception of § 1506.

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[170] RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 482, cmt. f (1987).

[171] *Id.*, Reporters' Note 1.

[172] *Id.*; *see also id.*, cmt. b (disqualifying criteria may be the foreign court's lack of fairness in general, its treatment of particular classes of people, or disparity in treatment of alien and citizen litigants).

[173] *See* Bird v. Glacier Elec. Coop., Inc., 255 F.3d 1136, 1141 (9th Cir. 2001) (in tribal court, closing arguments encouraging ethnic and racial bias of Indian jury against non-member defendant offended due process and the proceeding should not have been given comity in federal district court).

[174] *See* Hilton v. Guyot, 159 U.S. 113, 163, 164 (1895) (quoted *supra* note 106).

[175] *See id.*

[176] *See id.*

III. ALTERNATIVES TO THE PUBLIC POLICY EXCEPTION AS A MEANS OF CONTROL

By design and implementation, the public policy exception has limited value to creditors who have had an opportunity to be heard in a foreign insolvency but are dissatisfied with the forum's priorities for distribution. U.S. courts can prevent miscarriages of justice without resorting to the public policy exception. They can ensure that American creditors and debtors are given opportunities to make their case for relief in an American court when foreign courts are unwilling to listen, or when foreign distribution priorities have no reasonable relation to the debtors' business. Two methods can be used to justify American non-recognition of foreign proceedings: 1) challenging the characterization of the foreign proceeding as a "main proceeding" by arguing that the foreign jurisdiction is not the debtor's Center of Main Interests (COMI); and 2) appealing to § 1521 which requires that the American court cooperating with a foreign proceeding be satisfied that interests of creditors in the United States be sufficiently protected before turning the debtor's assets over to foreign representatives.[177]

A. CHALLENGING THE DEBTOR'S CENTER OF MAIN INTERESTS

At the time of the adoption of Chapter 15, it was feared that the public policy exception was the only way a court would be able to deny recognition of a foreign insolvency proceeding.[178] The statute itself sowed the seeds of this fear. Section 1517 says that an order of recognition shall be entered if the foreign representative petitioner complied with filing requirements and the foreign proceeding was either main or non-main.[179] Section 1502 clarifies the difference: a proceeding is "main" if the debtor has its COMI in that country; it is "non-main" if the debtor merely has an establishment in that country.[180]

The duty of U.S. courts to cooperate with foreign insolvency proceedings begins with the Bankruptcy Court's formal recognition of

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[177] 11 U.S.C. § 1521(b) (2007).

[178] *E.g.*, Greene, *supra* note 89, at 716.

[179] 11 U.S.C. § 1517(a) (2007).

[180] 11 U.S.C. § 1502(4) and (5) (2007). If the debtor has neither COMI nor an establishment in the U.S., then U.S. law should not recognize the foreign proceeding, according to commentator Daniel Glosband, *Bankruptcy Court Rejects Cayman Proceedings of Bear Stearns Hedge Funds*, 26-8 AM. BANKR. INST. J. 38, 63 (2007).

such proceedings.[181] Conversely, if the court denies recognition altogether, it is empowered by the Bankruptcy Code to "issue any appropriate order necessary to prevent the foreign representative from obtaining comity or cooperation from courts in the United States."[182] Short of that extreme response to a petition for recognition, U.S. bankruptcy courts can chose to recognize the foreign proceeding as non-main, rather than main.[183] If the foreign proceeding is determined to be a main proceeding, then the enforcement mechanisms of the Code[184] become available to carry out the foreign court's orders.[185] An automatic stay, perhaps the most important of these, is available only in connection with a foreign main proceeding.[186] However, if the foreign proceeding is main, the protection of the U.S. courts can extend only to debtor's property within the territorial jurisdiction of the United States.[187]

Even if the foreign proceeding is determined to be a non-main proceeding, then the U.S. court has considerable discretion regarding the enforcement that should be offered to the foreign court.[188] Also, if the proceeding is non-main, the U.S. court has the additional burden of safeguarding assets that should be administered only by a foreign main proceeding.[189] The drafters of the Model Law intended non-main proceedings to be given "cooperation," whereas main proceedings should vest the foreign representative with "authority over a debtor's assets situated in the Recognizing State."[190]

Because recognition of a foreign proceeding as a main proceeding means that the American courts may be deferential to foreign substantive as well as procedural law, domestic creditors may seek to prevent such recognition if possible. Particularly when forum-shopping appears to have been blatant, as with an eleventh-hour change in

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[181] 11 U.S.C. § 1517 (2007).

[182] 11 U.S.C. § 1509(d) (2007). *Cf.* RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 482, Reporters' Note 4 (1987) ("If an attempt to secure enforcement of a foreign judgment in the courts of one State of the United States is unsuccessful for one of the reasons stated in this section, the judgment of nonrecognition is entitled to full faith and credit in all other States. U.S. Const., Art. IV, § 1.")

[183] 11 U.S.C. § 1517(b) (2).

[184] Particularly 11 U.S.C. §§ 361, 362, 363, 549, 552 (2007).

[185] 11 U.S.C. § 1520(a).

[186] 11 U.S.C. § 1520(a), 1521(c).

[187] 11 U.S.C. § 1520(a)(1) .

[188] 11 U.S.C. § 1521(a), (b).

[189] 11 U.S.C. § 1521(c).

[190] Thomas M. Gaa and Paula E. Garzon, *International Creditors' Rights and Bankruptcy*, 31 INT'L LAWYER 273, 276 (1997).

corporate registration, American courts have given a hard stare at foreign requests for recognition as main. For example, in *In re Tri-Continental Exchange, Ltd.*, a California bankruptcy court understood that Chapter 15 had given it considerable room to maneuver in its cooperation with a foreign court.[191] Three insurance companies operating and registered in St. Vincent and the Grenadines had committed fraud in Canada and the United States.[192] Following commencement of insolvency proceedings in St. Vincent, foreign representatives sought, in the U.S. courts, recognition of the St. Vincent proceedings as main proceedings.[193] One judgment creditor opposed such recognition.[194] Whether the proceedings were main or non-main depended on the situs of the debtors' COMI, which "requires a fact-based inquiry in which the default position focuses on the registered office."[195] Here, the court resisted the urge to retain control when its citizens were the ones injured by the debtors. Instead, it yielded to the spirit of comity for which Chapter 15 was created: "the term 'center of main interests' [must] be interpreted in a manner consistent with the application of similar statutes adopted by foreign jurisdictions. 11 U.S.C. § 1508."[196]

That same year, a foreign representative approached a bankruptcy court in New York seeking recognition of a Cayman Islands proceeding as main.[197] SPhinX, Ltd. was an administrator of hedge funds incorporated in the Cayman Islands for tax and regulatory reasons only.[198] The corporation had no assets in the Cayman Islands; these were almost entirely in the United States.[199] Nevertheless, Judge Robert Drain accepted the presumption that the Cayman Islands was the funds' COMI, a presumption to which they were entitled as the place of the funds' registration.[200] Judge Drain ultimately did not grant the assistance sought

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[191] *In re* Tri-Continental Exchange, Ltd., 349 B.R. 627, 638 (Bankr. E.D. Cal. 2006).

[192] *Id.* at 631.

[193] *Id.* at 629.

[194] *Id.*

[195] *Id.*

[196] *Id.* at 633. Although the *Tri-Continental* court did not deny recognition as a main proceeding in St. Vincent, it allayed creditor's fears regarding distribution of the debtors' assets. When it came time to distribute the insurance companies' assets, the American court would have to be satisfied that the interests of creditors in the United States were "sufficiently protected," per § 1521(b). *Id.* at 636.

[197] *In re* SPhinX, Ltd., 351 B.R. 103, 103 (Bankr. S.D.N.Y. 2006).

[198] *Id.*

[199] *Id.* at 107.

[200] 11 U.S.C. § 1516(c) (2007). Judge Drain enumerated factors to be considered in determining the debtor's COMI, but held that the court should defer to creditors' acquiescence in the debtor's

by the foreign representatives for other reasons, but mere registration in the Cayman Islands did not add any urgency to the representatives' request.[201]

Another case involving a Cayman-registered hedge fund received different treatment in the same district but from a different judge.[202] A Bear Stearns hedge funds collapsed in 2007 due to the sub-prime mortgage crisis in the United States.[203] Insolvency proceedings commenced in the Cayman Islands where the funds were registered, but Judge Lifland declined to recognize them as either main or non-main proceedings.[204] Judge Lifland reasoned that the COMI presumption called for by § 1516 was rebuttable by mere evidence, rather than proof, that the debtor's center of main interests lay elsewhere than the place of registration.[205] Because the fund did not have any establishment in the Cayman Islands, Judge Lifland could not grant even non-main recognition to the foreign representative.[206] Instead, he granted the parties thirty days in which to file a Chapter 7 liquidation or Chapter 11 reorganization in a U.S. bankruptcy court.[207]

Daniel Glosband, co-drafter of the Model Law and Chapter 15, supported the *Bear Stearns* decision not to recognize the Cayman Island proceedings, stating, "[T]here is a U.S. legislative policy to provide the assistance of its bankruptcy courts only to those foreign bankruptcy proceedings that are premised on a tangible presence of the debtor in the foreign jurisdiction."[208] It should be noted that a general "legislative policy" does not rise to the § 1506 public policy exception. Rather, Glosband refers to Chapter 15's "mandatory eligibility test," that is,

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stated COMI. *In re* SPhinX, Ltd., 351 B.R. 103, 117. This approach is still considered, as in *In re* Grand Prix and Associates Inc., 2009 Bankr. LEXIS 1239, 20 (Bankr. N.J.). Although discussed, such deference was not dispositive in that case.

[201] *In re* SPhinX, Ltd., 351 B.R. at 122.

[202] *In re* Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122 (Bankr. S.D.N.Y. 2007), *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008)).

[203] *Id.* at 125.

[204] *Id.* at 132.

[205] *Id*. at 128.

[206] *Id*. at 131, *citing* 11 U.S.C. § 1502(5) (2007).

[207] *Id*. at 133.

[208] Daniel M. Glosband, *Glosband on In re* Basis Yield Alpha Fund (Master), LEXISNEXIS EXPERT COMMENTARIES, at 8 (Mar. 2008) (citing Daniel M. Glosband, *Bankruptcy Court Rejects Cayman Proceedings of Bear Stearns Hedge Funds*, 26-8 AM. BANKR. INST. J. 38, at 38 (Oct. 2007)).

"Does the debtor have its COMI or an establishment in the Cayman Islands?"[209]

The *Bear Stearns* approach was reinforced in 2008 by *In re Basis Yield Alpha Fund*.[210] In that case, factually similar to *Bear Stearns*, the foreign representatives sought recognition of the Cayman Islands insolvency proceedings as a main or non-main proceeding.[211] No objections having been filed, the representatives moved for summary judgment to recognize the foreign proceedings as main.[212] Judge Robert Gerber denied the motion, noting that recognition required a determination of whether the foreign proceeding was main or non-main.[213] In contrast to earlier practice under § 304 (allowing for comity considerations), the procedural requirements for recognition of foreign proceedings have become quite rigid under Chapter 15.[214] Whereas the *SPhinX* court felt compelled to recognize the proceeding absent objection from some party in interest, Judge Gerber in *Bear Stearns* used his prerogative to call for evidence to support the statutory presumption that the debtor's place of registration was its COMI.[215] Because the foreign representatives had been "strikingly silent" as to any business activity of Basis Yield in the Cayman Islands, the court was, as a matter of law, unable to recognize the proceeding as a main proceeding.[216] Judge Gerber agreed with Judge Drain's observation in *In re SPhinX* that the public policy exception was to be construed narrowly, and no party was raising it in this case as if to question the fairness of Cayman Islands' law or its courts.[217] For U.S. courts, the focus is not on the foreign forum itself, but on the debtor's designation of a foreign forum as its COMI.[218]

Thus, American courts can be dissuaded from recognizing foreign proceedings as main proceedings, unless a quantum of contact with the foreign forum exists to justify the § 1516(c) statutory presumption that the foreign forum is in the debtor's COMI. A company that senses the end is near cannot take for granted that re-registering in a foreign jurisdiction will establish that jurisdiction as a new COMI. This

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[209] *Id.* at 5.
[210] 381 B.R. 37 (Bankr. S.D.N.Y. 2008).
[211] *Id.* at 40.
[212] *Id.*
[213] *Id.* at 45-46.
[214] *Id.* at 46, citing 11 U.S.C. § 1517(b) (2007).
[215] *Id.* at 54. This prerogative is granted by Fed. R. Evid. 614(a).
[216] *In re* Basis Yield, 381 B.R. at 42.
[217] *Id.* at 45, n.27.
[218] *See id.*

forces the U.S. courts to defer to the foreign jurisdiction's judgments regarding distribution of the debtor's assets.

Not recognizing a foreign insolvency proceeding as main based on the debtor's COMI has an advantage over exercising the public policy exception: it does not directly insult the foreign court as incompetent or unjust. Rather, it seems to accuse the debtor of improper forum selection. However, it is impossible to escape the conclusion that by consenting to the debtor's choice, the foreign court has decided that its venue was proper. Its representatives are spurned when the American court denies it the distinction of being a main proceeding of the debtor. American courts ought to reserve nonrecogition for only extreme cases of unjustifiable forum-shopping.

B. SAFEGUARDING DOMESTIC CREDITORS THROUGH SECTION 1521

Even if a foreign jurisdiction has a viable claim to be the center of a debtor's main interests, § 1521 gives an American bankruptcy court considerable latitude when it works with the foreign court.[219] First, upon recognition of the foreign proceeding as main or non-main,[220] the court has discretion to grant "any appropriate relief" requested by the foreign representative.[221] "Any appropriate relief" includes staying any action not already included in the automatic stay, freezing assets of the debtor, taking evidence concerning the debtor's affairs, or entrusting the debtor's assets to another to preserve their value.[222]

Second, upon recognition of the foreign proceeding, the court is authorized to entrust the debtor's assets to the foreign representative, or anyone else, "provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected."[223] In other words, the turnover of a debtor's assets remains a discretionary process after recognition of the foreign proceeding. Before the adoption of Chapter 15, 11 U.S.C. § 304(c) made relief available to a foreign representative subject to a court's discretion and subject to certain factors.[224] At the time of the adoption of Chapter 15, it was recognized

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[219] *See* 11 U.S.C. § 1521(a) (2007).

[220] One of these must be recognized according to *SPhinX;* possibly neither will be recognized following *Bear Stearns* and *Basis Yield*.

[221] 11 U.S.C. § 1521(a) (2007).

[222] *Id.*

[223] 11 U.S.C. § 1521(b) (2007).

[224] 11 U.S.C. § 304(c) [2003], *repealed by* P.L. 109-8, 119 Stat. 146 (2005).

that the turnover of property to a foreign representative would remain subject to the U.S. courts' satisfaction that American interests were sufficiently protected.[225] At least, the interests of creditors need to be sufficiently protected; no provision is made in § 1521(b) for the interests of American debtors.[226] This section may encourage foreign creditors to involve their American counterparts in the insolvency process early on, if the foreign distribution plan depends on assets held in the United States that will require the involvement of American courts.

Finally, when the foreign insolvency proceeding is non-main, the American court must be satisfied that its involvement relates to assets that are appropriately administered in that foreign non-main proceeding.[227]

Like § 1506, § 1521 was adopted almost verbatim from the Model Law.[228] The principal difference is that where the Model Law prescribes "any appropriate relief" where necessary to protect the assets of the debtor, Congress added that it must also be necessary "to effectuate the purpose of this chapter."[229] Seeing that the purpose of Chapter 15 is not only to protect the value of the debtor's assets, but also to promote cooperation between U.S. courts and courts of foreign countries and to increase predictability in commerce,[230] Congress' addition seems to be an improvement on the Model Law. It reminds courts that cooperation with fundamentally fair foreign courts is a legitimate end in itself.

IV. CONCLUSION

Whether one is a creditor or debtor, going through the insolvency of a company is like being on a ship that is taking on water. We trust the operators of the ships we choose to board, and usually that faith is well-placed, even in a crisis. The vast majority of nations write their insolvency laws to protect innocent creditors, and legislators weigh the risks those creditors voluntarily take. The vast majority of nations share the same interest that U.S. citizens have in the stability of

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[225] Greene, *supra* note 89, at 721.
[226] 11 U.S.C. § 1521(b) (2007).
[227] 11 U.S.C. § 1521(c).
[228] Model Law, Art. 21, *also available at* http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf.
[229] Compare 11 U.S.C. 1521(a) (2007) and Model Law Art. 21, para. 1.
[230] 11 U.S.C. § 1501(a)(1), (2), and (4) (2007).

international commerce. The vast majority of nations do not want their courts to render decisions that might benefit local creditors in the short term, but discourage international investment in their country for the long term.

As long as there are differences in nations' insolvency laws, international debtors and creditors are likely to forum-shop for courts most sympathetic to their interests. The Model Law and Chapter 15 represent a multinational attempt to discourage unjustifiable forum-shopping. At the same time, they encourage cooperation among jurisdictions where debtors' assets are located. The public policy exception is a necessary safety valve for their broad framework calling for international cooperation, because while most courts around the world operate according to acceptable levels of due process, there may be exceptions. The public policy exception assumes that courts desire to nurture comity; so the exception will probably continue to be narrowly construed by U.S. courts and their foreign counterparts.

To the extent that other provisions of Chapter 15 and the Model Law allow for non-recognition of foreign proceedings, they have potential to undermine the spirit of comity that American courts have worked hard to develop. American courts should exercise with great restraint the considerable discretion that remains to them under Chapter 15, and refuse recognition in only the most egregious cases of improper forum-shopping.