

IS CHAPTER 15 UNIVERSALIST OR TERRITORIALIST? EMPIRICAL EVIDENCE FROM UNITED STATES BANKRUPTCY COURT CASES

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This article reports the findings of an empirical study of relief granted in all Chapter 15 cases filed since it was enacted in 2005. It argues that United States courts applying Chapter 15 have not unconditionally turned over debtor's assets in the United States to foreign main proceedings. The results of the study show that while United States courts recognized foreign proceedings in almost every Chapter 15 case, courts entrusted United States assets to foreign proceedings for distribution in only 45.5% of cases where foreign proceedings were recognized. When such entrustment was granted, 31.8% of cases were accompanied by qualifying factors including, orders which protected United States creditors by allowing them to be paid according to the priority scheme under United States bankruptcy law; or assurances that certain United States creditors would be paid in full or in priority. In only 9.1% of cases, entrustment of assets for distribution was ordered without any qualifications; and where there were US creditors and assets at stake. From this data, this paper concludes that when deciding Chapter 15 cases, United States courts seldom grant Entrustment without Qualifications when United States creditors may be adversely affected. As a result, this article argues that Chapter 15 is not as universalist as its proponents claim it to be and exposes the inability of Chapter 15 to resolve conflicting priority rules between the United States and foreign proceedings.

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I. INTRODUCTION

Universalism, as a theory of international insolvency law, is defined as “a system where one central court administers the bankruptcy of a debtor on a worldwide basis with the help and cooperation of courts in each affected country.”¹ Universalists claim that all of a multinational debtor’s assets, wherever located, should be administered in a single bankruptcy proceeding. Orders and judgments made pursuant to this proceeding should be effective everywhere.² Further, universalists have argued that universalism results in “enhanced global efficiencies and economic activity”³ through “reduced administrative costs due to a reduction in the number of proceedings”⁴ and “reducing confusion over competing choice of laws.”⁵

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¹ Jay L. Westbrook, *Book Review: Multinational Financial Distress: The Last Hurrah of Territorialism*, 41 TEX. INT’L L. J. 321, 322 (2006).

² Jay L. Westbrook, *Universalism and Choice of Law*, 23 PENN ST. INT’L L. REV. 625, 625-6 (2005) (“However, the modern approach is ‘universalism.’ In its ideal form, universalism envisions a single bankruptcy proceeding in the debtor’s ‘home country.’ A single court would make a unified worldwide distribution to creditors through liquidation or reorganization.”)

³ John Chung, *The New Chapter 15 of the Bankruptcy Code: A Step Toward Erosion of National Sovereignty*, 27 NW. J. INT’L L. & BUS. 89, 94 (2006).

⁴ *Id.* For arguments that universalism reduces administration costs and number of procedures see Lucien Arye Bebchuk & Andrew T. Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 J. LAW & ECON. 775, 778 (1999). (“The case against the grab rule and in favor of universalism typically points to the reduction in costs associated with a single adjudication and distribution of the bankrupt entity’s assets.”)

⁵ *Id.* For arguments with regard to reducing confusion over choices of laws see Jay L. Westbrook, *Universal Participation in Transnational Bankruptcies*, in ROSS CRANSTON ED., MAKING COMMERCIAL LAW: ESSAYS IN HONOUR OF ROY GOODE 419, 421 (1997) (“Territorialism produces distributions that are a function of local priorities and the presence of a greater abundance of assets in one jurisdiction than in another... The distributions are always unpredictable and often unfair.”) In addition to reduction in administrative costs and reducing confusion over competing choices of laws, universalists claim that there are other efficiency gains from universalism. They include more efficient allocation of capital, reducing deadweight loss from forum shopping, reducing transaction costs by facilitating reorganizations, increasing liquidation and reorganization value and reducing transaction costs through certainty and clarity. See Bebchuk & Guzman, *supra* note 4 at 779 (“Rules designed to protect the interests of local creditors in the adjudication of bankruptcies may have harmful results on the allocation of capital across countries by causing suboptimal investment by multinational firms.”); Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT’L L. 1, 27 (“Permitting individual creditors to pursue their state-law remedies leads to a number of inefficient results, including the piecemeal sale of the assets of the firm which may be worth more if kept together; excessive monitoring by individual creditors to ensure they are not last in line once the race to the assets begins; and numerous judicial proceedings as each creditor rushes to its preferred forum.”); Jay L. Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM.

Chapter 15 was enacted in 2005⁶ and represents United States adoption of the UNCITRAL Model Law on Cross-Border Insolvency (the “Model Law”). When it was enacted, universalists claimed Chapter 15 as victory and promised Chapter 15 to be a good and necessary first step toward the internationalization of United States bankruptcy laws.⁷ To them, Chapter 15 was a crucial step toward eventual and inevitable universalism of international bankruptcy law.⁸ Bufford notes, “the Model Law embraces modified universalism as its touchstone, in contrast with past international bankruptcy harmonization efforts which mostly aspired to some form of doctrinal purity, that is, the principles of universalism and unity.”⁹

However, universalists admit that Chapter 15 and the Model Law do not represent universalism at its purest. Instead, they are forms of modified universalism¹⁰. Modified

BANKR. L.J. 457, 465 (1991) (hereinafter, *Theory and Pragmatism*) (“That assertion is persuasive, because the preservation of going concern values and the maximizing of liquidation values by integrated sales will likely increase returns to creditors greatly. If gains and losses even out, sharing in a much bigger pie will produce great benefits for local claimants overall”.); Westbrook, *Theory and Pragmatism*, *id.* at 465 (“That assertion is persuasive, because the preservation of going concern values and the maximizing of liquidation values by integrated sales will likely increase returns to creditors greatly. If gains and losses even out, sharing in a much bigger pie will produce great benefits for local claimants overall”.) Westbrook, *Theory and Pragmatism*, *id.* at 421 (“Territorialism produces distributions that are a function of local priorities and the presence of a greater abundance of assets in one jurisdiction than in another... The distributions are always unpredictable and often unfair.”); Robert K. Rasmussen, *id.* at 6. (“The transnational bankruptcy problem stems from the fact that each country has its own set of bankruptcy rules. These differing rules lead to potential forum shopping incentives on the part of both creditors and debtors. These incentives often ensure that more than one country is asked to resolve the financial distress of a single, multinational enterprise.”)

⁶ The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act, 119 STAT. 23 (2005).

⁷ Westbrook, *supra* note 1 at 325. (“Modified universalism is a modest mechanism designed to improve management of multinational defaults within the limitations presented by current circumstances. Universalism is the larger solution that must await further developments in our legal infrastructures.”)

⁸ John Chung, *The Retrogressive Flaw of Chapter 15 of the Bankruptcy Code: A Lesson from Maritime Law*, 17 DUKE J. COMP. & INT’L L. 253, 270 (2006).

⁹ HON. SAMUEL L. BUFFORD, UNITED STATES INTERNATIONAL INSOLVENCY LAW 4 (2009).

¹⁰ Westbrook, *supra* note 2 at 626 (“Because a pure form of universalism is not immediately achievable, many universalists have adopted ‘modified universalism,’ in which the courts seek a result in multinational cases as close as possible to a unified worldwide administration and distribution.”); See Jay L. Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2302 (2000) (“[M]odified universalism permits the court to view the default and its resolution (liquidation or reorganization) from a worldwide perspective and to cooperate with other courts to produce results as close to those that would arise from a single proceeding as local law will permit.”); see also, Hon. Samuel Bufford, *Global Venue Controls Are Coming: A Reply to Professor LoPucki*, 79 AM. BANKR. L.J. 105, 112 (2005) (“Modified universalism shares the view that there should be a single main case for an international business in its home country, governed for the most part by the laws of the home country. However, modified universalism recognizes that the main case may need support through secondary or ancillary cases in other countries where assets are located or local court support is otherwise needed. A local court, under this view, normally applies domestic law to its

universalism” has been defined as “universalism tempered by a sense of what is practical at the current stage of international legal development”¹¹. Chapter 15 provides that United States bankruptcy courts recognize foreign proceedings as main proceedings if they take place in the country where the debtor has its center of main interests (“COMI”). The main proceeding is where “the principal decisions are expected on the course of various bankruptcy cases...such as the decision whether (and to what extent) the business should be reorganized or liquidated.”¹² More importantly, “(t)hat is the proceeding expected to determine to a large extent, what should be done with the assets of the debtor.”¹³ However, the Model Law and Chapter 15 retains some territorial aspects insofar as “it respects the differences between national procedural laws and does not attempt a substantive unification of insolvency law...the Model Law allows the courts in the enacting State to determine what coordination or other relief is warranted among the jurisdictions for optimal disposition of the insolvency.”¹⁴

Chapter 15 gives United States courts the discretion whether or not the debtor’s assets in the United States (“Local Assets”) should be entrusted to foreign proceedings for distribution. While a foreign representative of a foreign main proceeding is entitled to automatic relief which includes an automatic stay against the commencement or continuation of actions against the debtor and/or its assets,¹⁵ he is only entrusted with the debtor’s assets for the purposes of distribution at the discretion of the United States court.¹⁶

proceedings, and it retains the discretion to evaluate the fairness of home country procedures and to protect the interests of local creditors where appropriate.”).

¹¹ Westbrook, *supra* note 1 at 323. *C.f.* Dawson in his own empirical study argues that the process of recognition undertaken by United States courts is not as automatic as it seems. He has argued that some judicial discretion is required in interpreting and applying the COMI standard. See Andrew B. Dawson, *Offshore Bankruptcies*, 88(2) NEB. L. REV. 317 (2009).

¹² Bufford, *supra* note 9 at 120.

¹³ *Id.*

¹⁴ BOB WESSELS ET AL, INTERNATIONAL COOPERATION IN BANKRUPTCY INSOLVENCY MATTERS 201 (2009). Bufford notes, “the Model Law embraces modified universalism as its touchstone, in contrast with past international bankruptcy harmonization efforts which mostly aspired to some form of doctrinal purity, that is, the principles of universalism and unity”.

¹⁵ Section 1520 provides that upon recognition of a foreign main proceeding, Section 362 which stays the commencement or continuation against the debtor’s property automatically applies. This prevents United States creditors from gaining preferential access to Local Assets. Further, Section 1520(a)(3) authorizes the foreign representative to operate the debtor’s business.

¹⁶ Section 1521(b) is contrasted to Section 1521(a)(5) which provides, as a discretionary relief, that the court may entrust the administration or realization of all or part of the debtor’s assets to the foreign representative. Bufford explains the distinction, “(t)here is an important distinction between entrustment for distribution as permitted in Section 1519(a)(2) and 1521(a)(5) , and entrustment for distribution as permitted in Section 1521(b). Entrustment for administration simply means that the foreign representative may use, sell or lease the debtor’s property. Entrustment for distribution turns over the property to the foreign representative for distribution to creditors”. Bufford, *supra* note 9 at 134-5.

Section 1521(b) of Chapter 15 states, “(u)pon recognition of a foreign proceeding, whether main or nonmain, the court, may at the request of the foreign representative, entrust the *distribution of all or part of the debtor’s assets located in the United States* to the foreign representative...provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected.” (emphasis added).

Yet, “(m)odified universalism’s goal is a single worldwide distribution, which would suggest turnover of *all assets* to the primary court for distribution under its rules or under some protocol agreed to by the relevant courts.”¹⁷ (emphasis added) The question of which forum is allowed to distribute the debtor’s assets affects whether and how much individual creditors will receive in the distribution.¹⁸ Each forum’s distribution scheme “is an integrated system in which each class of creditors’ priority depends both on the likelihood that other classes of debt will arise and on the preferences given to them.”¹⁹ By providing for a single worldwide distribution by a single forum, modified universalism “mak(es) priorities specified under the law of the forum available to foreign as well as domestic creditors. For example, in the Mexican bankruptcy of a Mexican company, an employee who worked for the company in the United States would be entitled to the priority accorded wages under Mexican bankruptcy law, not the priority accorded wages under U.S. bankruptcy law.”²⁰

Accordingly, universalists assume that a United States court applying Chapter 15 and which grants recognition of a foreign main proceeding should exercise its discretion and turn over all the debtors’ Local Assets to the foreign main proceeding for distribution pursuant to foreign priority schemes. Chapter 15 replaces Section 304 of the Bankruptcy Code.²¹ Like Chapter 15, Section 304 was considered by universalists as a form of

¹⁷ Jay Lawrence Westbrook, *Priority Conflicts as a Barrier to Cooperation in Multinational Insolvencies*, 27 PENN ST. INT’L L. REV. 869, 871 (2009).

¹⁸ Frederick Tung, *Fear of Commitment in International Bankruptcy*, 33 GEO. WASH. INT’L L. REV. 555, 568 (2001). (“With respect to creditor distributions, the central function of bankruptcy is to decide which among debts justly owed and rightfully asserted are most worthy. Given the scarcity of assets, not all creditors get paid, and many get nothing at all.”)

¹⁹ Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, CORNELL L. REV. 696, 710 (1999). Moreover, a country’s priority scheme represents the country’s social policies. Tung, *supra* note 18 at 573. (“Each state has its favored creditors, whose recovery take priorities over the general body of creditors. In the United States, grain producers and United States fishermen enjoy priority over general creditors in certain cases...In South Korea, Mexico and France, employee priority claims are senior to secured claims.”) The universalists endeavor of “cross-priority” would hence result in the export of social policy from the main proceeding to the secondary proceedings. LoPucki, *id.* at 759. (“(t)o require a second country to recognize that claim exports the social policy of the first.”)

²⁰ *Id.* at 706.

²¹ Chung, *supra* note 3 at 99 (“While Section 304 and Chapter 15 may have similar goals, a major difference between the two is that the language of Section 304 was primarily discretionary (as opposed to the mandatory language of many of the provisions of Chapter 15). Section 304 did not require the courts to grant any

modified universalism.²² However, critics claimed that United States courts applying Section 304 deferred to foreign proceedings “only after laying down specific conditions that such proceedings must satisfy. These conditions usually contain a promise to apply some aspect of U.S. law to the distribution.”²³ This caused Section 304 to be “virtually indistinguishable from territoriality”²⁴. Universalists railed against hypocritical application of Section 304. Professor Westbrook states, “Section 304 simply proclaims universalism and local preference in the same breath and leaves it to the courts to fashion something worthwhile from its conflicting motives”.²⁵ Professor LoPucki noted of Section 304, “(m)odified universalism under the first of these two possible standards - the strain adopted by the United States in Bankruptcy Code section 304 - is virtually indistinguishable from territoriality. That is, all distributions from local assets are made in accord with the law of the place where the asset is located at the time of bankruptcy. That distribution can be made by a foreign court, but only with the express acquiescence of the local court in the particular case.”²⁶ Hence, universalists assume that if Chapter 15 is to achieve more than its predecessor, United States courts, which turn over Local Assets to foreign main proceedings, should turn over all Local Assets and should do so without conditions which benefit United States creditors or apply United States priority rules.²⁷

This paper argues that United States courts applying Chapter 15 have not unconditionally turned over Local Assets to foreign main proceedings. It reports the findings of an empirical study of relief granted in all Chapter 15 cases filed since it was enacted in 2005. In examining the court files of these cases, I recorded cases where United States courts entrusted Local Assets of debtor companies to foreign representatives for

particular relief; it merely stated the court "may" grant the relief enumerated in the section. This discretionary language resulted in a wide variety of decisions under the old law, some maintaining territoriality, and others embracing universalism.”)

²² Charles D. Booth, *Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of the United States Courts*, 66 AM. BANKR. L.J. 135, 171-2 (1992) (“In enacting § 304, Congress demonstrated ‘a desire for greater international cooperation in transnational insolvencies.’ Nevertheless, judicial reaction has been mixed -- the courts have interpreted § 304 inconsistently and have sometimes failed to follow the legislative intent that produced it.”)

²³ Mary Elaine Knecht, *The “Drapery of Illusion” of Section 304 – What Lurks Beneath: The Territoriality in the Judicial Application of Section 304 of the Bankruptcy Code*, 13(1) U. Pa. J. Int’l Bus. L. 287, 300 (1992).

²⁴ Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216, 2221 (2000).

²⁵ Westbrook, *Theory and Pragmatism*, *supra* note 5 at 473.

²⁶ *Supra* note 24 at 2216.

²⁷ Jay Lawrence Westbrook, *Chapter 15 at Last*, 79 AM. BANKR. L. J. 713, 724. (2005) (“It is important...that these provisions do not require that United States creditors must enjoy the same rights, priorities, or realizations that would result in a United States full bankruptcy case. If they did, no meaningful international cooperation would be possible. It means rather that the creditors must be treated in a way that is fair and reasonable in the context of the global financial crisis that has engulfed the debtor's estate.”)

distribution either pursuant to Section 1521(b) above or where the substance of an order was to allow the foreign representative to distribute specific assets. The term “Entrustment” defines such cases.

Further, where orders for Entrustment were made, the study recorded whether there were any factors that qualified such Entrustment. The language of Section 1521(b) does not explicitly provide that a United States court may impose conditions when making orders for Entrustment. However, the legislative history of Section 1521(b) provides that “this section does not expand or reduce the scope of relief currently available in ancillary cases under sections 105 and 304”.²⁸ Consequently, United States courts retain their power to make orders that may protect United States creditors or ensure compliance with United States priority rules when applying Section 1521(b).²⁹ As noted earlier, United States courts applying Section 304 deferred to foreign proceedings “only after laying down specific conditions that such proceedings must satisfy. These conditions usually contain a promise to apply some aspect of U.S. law to the distribution.”³⁰ Hence, it follows that United States courts retain the same discretion to lay down conditions when applying Section 1521(b).

In the study, I also examined orders which accompanied orders for Entrustment. In Entrustment cases, orders which benefit United States creditors or ensure compliance with United States priority rules are defined as “Qualifications”. Such Qualifications include orders that United States creditors were to retain or acquire secured status; orders that certain United States creditors were to be satisfied in part or in full before foreign creditors or in accordance to United States bankruptcy law; or if the court had been assured that certain United States creditors would be satisfied in full or if there were stipulations with certain United States creditors on distribution of the debtor’s assets.

The results of the study show that while United States courts recognized foreign proceedings in almost every Chapter 15 case, courts granted Entrustment in only 45.5% of cases where foreign proceedings were recognized. In 28.4% of cases where foreign proceedings were recognized, the foreign representative unsuccessfully requested for Entrustment and in 26.1% of cases, the foreign representative did not request for Entrustment and was not granted the same.

²⁸ H.R. REP. NO. 107-3, pt. 1 (2001), accompanying H.R. 333 at 86.

²⁹ Paul L. Lee, *Ancillary Proceedings Under Section 304 and Proposed Chapter 15 of the Bankruptcy Code*, 76 AM. BANKR. L.J. 115, 192-193(2002). “(t)he relevant § 304(c) factors are readily subsumed within the § 1521(b) test whether the interests of creditors in the United States are ‘sufficiently protected.’ The House Report provides indirect support for this proposition as well. In describing the purpose of § 1521, the House Report states that ‘this section does not expand or reduce the scope of relief currently available in ancillary cases under sections 105 and 304’ This language can be read to incorporate the case law interpretations on the scope of relief, including turnover relief, under § 304.”)

³⁰ Knecht, *supra* note 23 at 300.

Of the 45.5% of cases where Entrustment was granted, a large majority of such orders were accompanied by Qualifications. Such Qualifications included, *inter alia*, orders which protected United States creditors by allowing them to be paid according to the priority scheme under United States bankruptcy law³¹; or assurances that certain United States creditors would be paid in full or in priority. All in all, Entrustment was accompanied with Qualifications in 31.8% of cases where recognition was granted.

Further, I recorded, from each case's file, whether there were United States creditors or Local Assets or whether these factors were unknown to the court on the face of the court documents. The study found that in 2.3% of cases where recognition was granted, there were no US creditors at stake. In another 2.3% of cases where recognition was granted, the presence of US creditors was unknown to the court on the face of the court documents. That leaves only 9.1% of cases where recognition was granted with Entrustment; without Qualifications; and where there were known US creditors and Local Assets at stake.

From this data, this paper concludes that when deciding Chapter 15 cases, United States courts seldom grant Entrustment without Qualifications when United States creditors may be adversely affected. Evidently, despite Chapter 15, United States courts in international bankruptcy cases continue to act territorially as a result of their power to order discretionary relief relating to the distribution of Local Assets.

The implications of this finding are as follows. First, Chapter 15 is not as universalist as its proponents claim it to be. It permits United States courts to refuse Entrustment of Local Assets and to impose Qualifications to protect United States creditors. As a result, Chapter 15 suffers the same hypocrisy as Section 304 by proclaiming universalism while allowing United States courts to act for the benefit of United States creditors and with preference to United States priority rules.³² It can purport to be universalist because recognition of foreign proceedings was granted in almost every Chapter 15 case. Yet, it is in effect territorial because United States courts seldom grant Entrustment without Qualifications when United States creditors may be adversely

³¹ 11 U.S.C. § 507 provides for which expenses and claims have priority in bankruptcy. For instance, the administrative expenses of the bankruptcy have priority over other unsecured claims.

³² Westbrook, *Theory and Pragmatism*, *supra* note 5 at 473. (“(S)tanding against universalism is § 304(c), which gives a shopping list of factors for the court to consider in determining what, if any, relief to give in deference to the foreign proceeding...We are far better off with § 304 than we would be without it...Section 304(c) demonstrates that Congress has utterly failed to come to grips with the problem of outcome differences. Section 304 simply proclaims universalism and local preference in the same breath and leaves it to the courts to fashion something worthwhile from its conflicting motives. The result has been a mixed bag of judicial results. Most often the U.S. courts have shown a willingness to defer, but there are several examples of nondeference. Furthermore, the utter failure of international cooperation in the U.S. Lines case, among others, may cause the U.S. courts to lose their enthusiasm for international cooperation and to use the statutory confusion to back away from deference.”)

affected. Second, the finding in this paper exposes the inability of Chapter 15 and modified universalism to resolve conflicting priority rules between the United States and foreign proceedings.³³ It shows that United States courts are simply resisting against allowing foreign proceedings from applying foreign priority rules to United States creditors.³⁴

Third, proclaiming universalism while allowing United States courts to act according to local preferences proves a setback rather than a step forward for international cooperation in insolvency law. The hypocrisy of Chapter 15 leads to an inability for other Model Law countries to distinguish between cases where the United States is cooperating and cases where it is not cooperating. Hence, other countries that have adopted the Model Law may follow the lead taken by United States and apply Model Law in the same territorial way.³⁵ Like the United States, they may do so and still purport to comply with the Model Law. Fourth, the finding shows that purported efficiency gains from universalism are invalidated by United States courts behaving in a territorial manner. Instead of reducing administrative costs arising from multiple proceedings, Chapter 15 may lead to “a bankruptcy proceeding in every country in which the debtor has assets, and perhaps even more”³⁶. This arises out of the inability for creditors to predict whether or not and to what extent the United States court will respect the priority rules of the foreign proceeding.³⁷

This paper is structured as follows. Section II recounts the data collection methodology in this empirical study and the study’s findings. Thereafter, Section III discusses the implications of the study’s findings on the existing theoretical debate. Finally, Section IV provides a brief conclusion.

³³ LoPucki, *supra* note 19 at 710. (“The priority problem cannot be resolved merely by making a few simple adjustments. Each nation’s priority scheme is an integrated system in which each class of creditors’ priority depends both on the likelihood that other classes of debt will arise and on the preferences given to them.”)

³⁴ LoPucki, *supra* note 19 at 728. (“Given the wide differences in bankruptcy regimes throughout the world, modified universalism will often, if not usually, lead to a refusal to cooperate”).

³⁵ Tung, *supra* note 18 at 582. (“Reciprocity also depends on states’ ability to distinguish cooperation from defection in order to respond appropriately...Can universalist obligations be sufficiently specified such that foreign courts decisions may accurately be interpreted as cooperation or defection?”)

³⁶ LoPucki, *supra* note 19 at 729.

³⁷ LoPucki, *supra* note 19 at 729. (“First, the regime or regimes that will ultimately distribute the debtor’s assets may depend on the country in which the assets are located at the time of bankruptcy. To illustrate, assume that Debtor Corporation, a Swiss corporation, has \$ 1 million in assets. If those assets are located in Switzerland at the time of the bankruptcy, Swiss law will govern the distribution. If they are located in the United States, the choice of law will depend on whether the Swiss distribution would be substantially different than the U.S. distribution. If it would, the United States will refuse to surrender the assets. Ultimately, those assets will be distributed under U.S. law. Second, for the lender to predict the regime applicable to distribution at the time of the loan, the lender must guess what intercountry differences in bankruptcy law the forum court will consider substantial.”)

II. METHODOLOGY AND FINDINGS

A. Methodology of the Study

The data for the study included all 94 Chapter 15 cases filed between October 17, 2005 and June 8, 2009. Where there were administratively consolidated petitions, the data included only the lead cases. The total number of petitions filed, as documented on the Chapter 15 website, was no less than 212. The primary sources of data were the court files obtained from the Chapter 15 website.³⁸ Where the Chapter 15 website did not provide documentation of the latest filings or incomplete documentation of existing filings, Public Access to Court Electronic Records (“PACER”) was used as a secondary source of data as well as a verification tool for documents found on the Chapter 15 website during the stated time period. Most of the data was found in the verified affidavits accompanying Chapter 15 petitions; draft orders for recognition and relief (where submitted by counsel); and the orders for recognition and relief.

In the study, a “case” was defined as a business bankruptcy case since October 17, 2005 which has been finally disposed by the courts. This includes cases where the petition is granted or dismissed by either the bankruptcy court of first instance or the appeals court where applicable. Where there were administratively consolidated petitions, the data included only the lead cases. The code categories used and the rules that define them (where not self-explanatory) are as follows.

1. Duration between date of filing and the resolution of the case: Resolution of the case is defined as the granting or dismissal of the petition for recognition either by the bankruptcy court of first instance or by the appeals court if applicable.
2. Whether recognition as a main or non-main proceeding was granted.
3. Where recognition of a main proceeding was not granted, on what basis the Court refuse recognition: When recognition of a main proceeding was not granted, I coded these cases according to whether the court found that the main proceeding was not in a state where the debtor had its COMI or whether there were other reasons such as procedurally defective petitions.

³⁸ The primary sources of data were the Chapter 15 website at <http://www.chapter15.com> (the “C15 Website”). Where the C15 Website did not provide documentation of the latest filings, Public Access to Court Electronic Records (“PACER”) was used as a secondary source of data as well as a verification tool for documents found on the C15 Website. In particular, it should be noted that the C15 Website stopped updating its documentation in July 2009. Accordingly, additional documents had to be obtained through PACER. From the C15 website, the number of total petitions filed was no less than 212.

4. The type of foreign proceeding: The types of foreign proceedings were coded as reorganization, liquidation or receivership. This information was explicit in the Chapter 15 petition.
5. The presence and type of United States creditors: I wanted to determine if there was a correlation between the presence and type of United States creditor on one part, and whether Entrustment was order with or without Qualifications on the other part. A correlation between the two the presence of United States creditors and Qualifications would indicate that United States courts acted in favor of United States creditors. United States creditors were defined as entities that are incorporated in the United States (in the case of corporations) or resident in the United States (in the case of natural persons). The United States creditors were coded as secured creditors, priority creditors and unsecured creditors and were explicit in the Chapter 15 petitions. Where they were not explicitly identified, the cases were coded as “unknown” in this category.
6. The presence of and type of Local Assets: The Local Assets were coded into money, chattel, real estate and shares and were explicit in the Chapter 15 petitions. Where they were not explicitly identified, the cases were coded as “unknown” in this category.
7. Whether orders for Entrustment were requested by the foreign representative: As part of the study, I realized that low numbers of orders for Entrustment could be due to foreign representatives not requesting for Entrustment in the first place. In order to control for this variable, I decided to code requests for Entrustment by foreign representatives. While coding the data, I found that Entrustment was requested by foreign representatives in a diverse number of ways. It was not in all cases that foreign representatives specifically asked to be entrusted with assets for distribution pursuant to Section 1521(b). In many cases, *carte blanche* requests for all available Section 1520 and 1521(a) and (b) relief to be granted were made by foreign representatives. Such cases were coded as requests for Entrustment. Moreover, where the substance of a request for recognition allowed the foreign representative to distribute specific assets, I coded the case as a request for Entrustment. For instance, in several Chapter 15 cases, foreign representatives sought enforcement and recognition of a foreign plan of reorganization or scheme of arrangement. In these cases, if the foreign plan or scheme provides for the distribution of the debtor’s assets they were coded as instances of requests for Entrustment.

8. Whether orders for Entrustment were granted: As defined earlier, orders for Entrustment are made in cases where recognition of a foreign proceeding was granted and where a Section 1521(b) order was made. However, as above, I took care to ensure that even where Section 1521(b) was not specifically ordered, if the substance of an order allowed the foreign representative to distribute specific assets, I coded the case as an order for Entrustment. For instance, in several Chapter 15 cases, the order provided for the enforcement and recognition of a foreign plan of reorganization or scheme of arrangement. In these cases, if the foreign plan or scheme provides for the distribution of the debtor's assets they were coded as instances of Entrustment. For example, in *In re Arion Insurance Company Ltd.*³⁹, the United States court was asked to recognize a Bermuda scheme of arrangement. The Bermuda scheme of arrangement provided for the payment of claims to creditors. However, where schemes of arrangement did not provide for distribution, they were not coded as cases where orders for Entrustment were made.⁴⁰ Where the US court approved the sale and subsequent distribution of proceeds of sale of Local Assets, these cases were also coded as Entrustment.
9. Whether there were Qualifications that accompanied, followed or preceded the granting of orders for Entrustment: As defined earlier, Qualifications are orders which benefit United States creditors or require the application of United States priority rules. They include, orders that United States creditors were to retain or acquire secured status; orders that certain United States creditors were to be satisfied in part or in full before foreign creditors or in accordance to United States bankruptcy law; or if the court had been assured that certain United States creditors would be satisfied in full or if there were stipulations with certain United States creditors on distribution of the debtor's assets.⁴¹ For instance, in *In re CPI Plastics*

³⁹ *In re Arion Insurance Company Ltd.* Case No. 07-12108.

⁴⁰ Professor Westbrook, in private correspondence, has opined that payment of claims should not be placed in the same category as distribution of assets. My view is that claims are paid out of the debtor company's assets and may be made in favour of non-United States creditors and to the detriment of United States creditors. Seen in this manner, there is no real difference between payment of claims and distribution of assets. In fact, by ordering the payment of some claims before others (if not done pursuant to the order of priority under the Bankruptcy Code), United States courts appear to be following foreign priority rules rather than United States priority rules.

⁴¹ Professor Westbrook, in private correspondence, has correctly noted that cases with stipulations may result from judicial pressure and a bench determination but may also represent concessions made between the debtor company and the particular creditor. However, from the court records it was extremely hard to distinguish between the two. Nonetheless, my view was that even if the stipulations were made as part of a concession between the debtor company and particular creditors, the fact that stipulations were made, regardless of the motivation behind them, would be a relevant factor for the court to consider when making an order for Entrustment. In other words, stipulations with United States creditors may be a factor in a court's

Group Ltd. et al.⁴², the court recognized a Canadian distribution order after it was assured that there were no outstanding United States priority claims (such as wage and tax claims and other administrative priority claims⁴³) and that there would be no further distribution of proceeds to unsecured creditors.

B. Findings

First, the data show that United States courts granted recognition in almost every Chapter 15 case.⁴⁴ Out of 94 Chapter 15 cases filed between October 17, 2005 and June 8, 2009, recognition of either a foreign main or a non-main proceeding was granted in 88 cases. Second, of the 88 cases where recognition was granted, the court made orders for Entrustment in only 40 cases. Of the remaining 48 cases where Entrustment was not granted, Entrustment had been requested by foreign representatives in 25 of these cases. In *In re Cavendish Analytical Laboratory Ltd.*⁴⁵, the foreign representative had explicitly made a request for relief pursuant to Section 1521(b). However, the court declined to grant Entrustment stating that it “is not ruling at this time on such request”⁴⁶. Therefore, it is not plausible that the low number of Entrustment cases can be explained by foreign representatives not requesting Entrustment in the first place.

Third, of the 40 cases where the courts made orders for Entrustment, 28 cases included Qualifications. For instance, in *In re ROL Manufacturing (Canada) Ltd., et al.*⁴⁷, the foreign representative stipulated with certain United States creditors with respect to the distribution of assets, with some United States creditors to be paid in accordance to the United States priority rules; in *In re Three Estates Company, Ltd.*⁴⁸, the court ordered the foreign representative to repay secured and priority creditors in full out of the proceeds of sale of certain Local Assets; in *In re Gestion-Privee Location LLC*⁴⁹, the court approved the sale and distribution of proceeds of sale of certain Local Assets but ordered that United States lien holder be satisfied first; in *In re Corporacion Durango, S.A.B. de C.V.*⁵⁰, the

consideration of “whether the interests of creditors in the United States are sufficiently protected” as provided in Section 1521(b).

⁴² *In re CPI Plastics Group Ltd. et al.*, Case No. 09-20175 (E.D. Wis.) (Jun. 11, 2009).

⁴³ 11 U.S.C. § 507(a)(4) provides that these are priority claims.

⁴⁴ *Cf. In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.* 389 B.R. 325, 335 (S.D.N.Y. 2008). The court stated, “(a) judge is more than a moderator; he is charged to see that the law is properly administered, and it is a duty which he cannot discharge by remaining inert.”

⁴⁵ *In re Cavendish Analytical Laboratory Ltd.*, Case No. 4-07-bk-00922 (Ari.).

⁴⁶ *Id.* at 3.

⁴⁷ *In re ROL Manufacturing (Canada) Ltd., et al.*, Case No. 08-31022 (S.D. Oh.).

⁴⁸ *In re Three Estates Company, Ltd.*, Case No. 07-23597-B-15 (E.D. Cal.).

⁴⁹ *In re Gestion-Privee Location LLC*, Case No. 06-80071 (M.D. N.C.).

⁵⁰ *In re Corporacion Durango, S.A.B. de C.V.*, Case No. 08-13911 (S.D. N.Y.).

court granted Entrustment on the basis that the foreign reorganization plan assured “distribution of proceeds of Corporacion Durango’s estate substantially in accordance with the order prescribed by the Bankruptcy Code”.⁵¹

Moreover, of the 40 cases where the court made order for Entrustment, there were 4 cases where there were no United States creditors or where the presence of United States creditors were unknown on the face of the court’s records. Courts faced with cases where there are no or known United States creditors have no incentive to order Qualifications as there are no one to protect.

Ultimately, as shown in Figure 1, of the 88 Chapter 15 cases where recognition was granted, Entrustment were granted without Qualifications where there were known United States creditors or Local Assets in only 9.1% of cases. This is compared to 54.5% where there were no orders of Entrustment, 31.8% where the orders of Entrustment came with Qualifications and 4.6% where there were Entrustment orders without Qualifications but there were no or unknown United States creditors to be affected.

Figure 1. United States Court Entrustment of Assets to Courts Recognized as Foreign Proceedings (2005-2009)

Category	Number of Cases	Percent of all cases
Entrustments		
With Qualification	28	31.8%
Without Qualification, US Creditors and Local Assets	8	9.1%
Without Qualification, No US Creditors	2	2.3%
Without Qualification, Unknown US Creditors	2	2.3%
No Entrustment		
Request for Entrustment	25	28.4%
No Request for Entrustment	23	26.1%

⁵¹ *Id.*

TOTAL	88	100.0%
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Ultimately, this data shows that in Chapter 15 cases, United States courts seldom entrust Local Assets for distribution by foreign representatives when United States creditors may be adversely affected. Further, the data shows that the United States courts are, in many cases, inclined to make Qualifications to orders for Entrustment which favor United States creditors by ordering for them to be satisfied in full or before foreign creditors; or in circumstances where the court had been assured that certain United States creditors would be satisfied in full; or if there were stipulations with certain United States creditors on distribution of the debtor’s assets.

C. Note on the Study

At this juncture, two things should be noted about this study. First, this study was limited by the extent of information available through the court records. Petitions and accompanying affidavits in each case were the main source of data on what the debtor’s assets were or who all the creditors were in each case. However, in some cases, counsel did to provide details of the same. In that event, there is a chance that the case may be wrongly coded. Moreover, draft orders were the main source of data on whether and to what extent foreign representatives requested for Entrustment. Yet, in some cases, draft orders were not available on the C15 website or in PACER. To minimize the risk of coding error, I examined all documents available to me on the C15 website and in PACER.

Coding errors change the findings in the study. For example, additional information may uncover that in the 4 cases which were coded as cases where the courts made orders for Entrustment without Qualifications where there were no or unknown United States creditors or Local Assets were actually cases where there were United States creditors or Local Assets. This will change the number of cases where orders of Entrustment were granted without Qualifications where there were known United States creditors from 8 to 12 and increase the percentage to 13%. Second, and related to the first point, there was no information available on the comprehensive eventual distributions of the debtor’s assets in each case. Such information would be available from the foreign proceeding’s records and not the United States court records.

However, incomplete information in this regard does not substantially affect the implications of the finding. The study seeks to understand whether Chapter 15 is universalist with respect to whether United State courts entrust Local Assets to foreign proceedings for distribution. As noted earlier, Chapter 15’s proponents expect that United States courts should do so with respect to *all* Local Assets and without qualification. Principal proponents of Chapter 15, like Professor Westbrook, had stated that Chapter 15

should not be applied in a way that would benefit United States creditors or prefer United States priority rules, namely:

[i]t is important...that these provisions do not require that United States creditors must enjoy the same rights, priorities, or realizations that would result in a United States full bankruptcy case. If they did, no meaningful international cooperation would be possible. It means rather that the creditors must be treated in a way that is fair and reasonable in the context of the global financial crisis that has engulfed the debtor's estate.⁵²

The findings of the study directly contradict this statement. Proponents of Chapter 15 expect that United States courts order Entrustment without Qualifications in 100% of Chapter 15 cases whether or not United States creditors are affected. On the contrary, the study shows only 9.1% of cases where United States courts applied Chapter 15 in a manner which did not require United States creditors to enjoy similar priorities that would result in a United States bankruptcy case. It is unlikely that any new information can shift the current percentage of 9.1% to 100%.

Second, this study was limited by the very nature of United States Bankruptcy Court proceedings. Typically, United States Bankruptcy Court proceedings can last over a long period of time. Months and even years can elapse between the time when recognition of a foreign proceeding is granted and the time when a request for Entrustment is made then granted or denied.⁵³ In the course of the study, I found that if the database consisted of only cases which were closed, it would be too small for a meaningful study to be conducted. Accordingly, I made the decision to study cases which were either closed or still open. This leaves the possibility that in 28.1% of cases where there were no requests for Entrustment, a request can be (or could have been) made after the study was concluded and the possibility that in all these cases, Entrustment can be (could have been) granted. If so, the current percentage of cases where United States courts applied Chapter 15 in a manner which did not require United States creditors to enjoy similar priorities that would result in a United States bankruptcy case would increase by 28.1% to 37.2%. However, as noted above, proponents of Chapter 15 expect that United States courts order Entrustment without Qualifications in 100% of Chapter 15 cases whether or not United States creditors are affected. 37.1% is a far shout from 100%

III. IMPLICATIONS

A. Chapter 15 is Not as universalist as it Proponents Claim

⁵² Westbrook, *supra* note 27 at 724.

⁵³ I am grateful to Professor Westbrook for pointing this out in private correspondence with me.

First, universalists should not have been so quick to claim Chapter 15 as a victory. This study shows that United States courts have not applied Chapter 15 in a universalist manner. Professor Westbrook, one of Chapter 15's main proponents, had estimated that *at worst*, United States court will act in a universalist manner in 75% of cases. To quote him in full,

(W)e might assume that half of the multinational cases raise a serious question about which jurisdiction is the debtor's home country. In perhaps half of the remaining cases, honest judges would reach the same conclusion about that issue. So now three-fourths of the cases enjoy the benefits of modified universalism. In the remaining quarter of the cases, each of two jurisdictions claim to be the main one. In those remaining cases, there is a risk of noncooperation between courts except when both proceedings would benefit, with a definite possibility of dueling injunctions and other conflicts - that is, the usual horrors of territorialism, although probably limited to two countries rather than a dozen. *Three-fourths of the cases* are much better handled, while the rest are no worse off.⁵⁴ (emphasis mine)

This prediction has not been entirely accurate on two accounts. The good news for the universalist claim is that rather than half of Chapter 15 cases raising a serious question about jurisdiction, United States courts have recognized foreign proceedings in almost every case. The bad news for the universalist claim is that United States courts applying Chapter 15 have moved the debate away from jurisdiction and toward the type of relief granted. Second, Professor Westbrook's estimation that three-fourths or 75% of cases are much better handled (in a universalist manner) is refuted. The empirical evidence shows that 9.1% of cases, rather than 75%, relief was granted in a way consistent with universalism. Further, there has been some anecdotal evidence that Chapter 15 has provided an opportunity for United States courts to act extra-territorially.⁵⁵ When Chapter 15 was enacted, its detractors argued that it represents an erosion of United States national sovereignty and is a "backdoor" toward universalism of bankruptcy law.⁵⁶ Perversely, the

⁵⁴ Westbrook, *supra* note 1 at 326.

⁵⁵ Look Chan Ho argues that in *In re Castle Holdco 4, Ltd.*, Case No. 09-11761 (REG) (Bankr. S.D.N.Y. 2009), the court "imposed an injunction against transfer of the Debtors' property, *wherever located*. It would have been helpful if the court explained the circumstances in which such extra-territorial injunction would be granted, bearing in mind its potential burden on foreign third parties. Look Chan Ho, *Creative Uses of Chapter 15 of the US Bankruptcy Code to Smooth Cross-Border Restructurings*, J. BANKING L. & REG. 485, 493 (2009).

⁵⁶ Lynn M. LoPucki, *Universalism Unravels*, 79 AM. BANKR. L.J. 143, 166 (2005). ("Universalists are trying to bring their system in through the back door. The UNCITRAL Model Law was negotiated by a delegation

evidence indicates that the relief provisions of Chapter 15 provide a “backdoor” into territorialism. If so, as noted by Luna, it is the foreign debtors and creditors that will be prejudiced by Chapter 15.⁵⁷

Moreover, the findings of this paper echo previous analysis of Section 304 cases, which distinguishes three lines of cases. First, there were cases where United States courts deferred to foreign proceedings unconditionally. In such cases, United States courts “did not have to worry about the possibility that the distribution of the proceeds might compromise the U.S. claimholders”.⁵⁸ Second, there were cases where the courts deferred to foreign proceedings unconditionally. However, in those cases, no return of assets was involved.⁵⁹ Third, there were cases where United States courts refused to turn over assets on the basis that the foreign proceeding would not distribute assets in the same way as the United States⁶⁰ or they turned over assets only on the condition that the foreign proceeding apply some aspect of United States law or that the United States courts apply some aspect of United States law before the turnover.⁶¹

In her analysis of Section 304 court opinions, Knecht found that “while majority of U.S. courts claim to employ universality in dealing with foreign bankruptcy proceedings, the majority of cases reveal that the courts only apply universality when they have assurances that foreign law will treat U.S. creditors virtually the same way that filing in the United States would have.”⁶²

led by universalist Jay L. Westbrook, and then sold to Congress as not really universalist. At the Congressional hearing, only supporters of the Model Law were permitted to testify.”)

⁵⁷ Justin Luna, *Thinking Globally, Filing Locally: The Effects of the New Chapter 15 on Business Entity Cross-Border Insolvency Cases*, 19 FLA. J. INT’L L. 671, 695 (2007). (“In an attempt to improve the lives of all those seeking protection through reorganization or liquidation, Chapter 15 still has holes a 747 could fly through. It is the foreign based debtors that will be prejudiced by the new Chapter 15, which is exactly for whom Chapter 15 was implemented to protect. Foreign debtors and foreign creditors will have to rethink their filing impulses in order to maximize their post-insolvency lives.”)

⁵⁸ Knecht, *supra* note 22 at 305. (“As in *Culmer and Cunard*, the *Lines* court did not have to worry about the possibility that the distribution of proceeds might compromise the U.S. claimholders—because in this case, the Bermuda court would interpret the agreement under New York Law.”)

⁵⁹ Knecht, *supra* note 22 at 305. (“Two other decisions, *Angulo v. Kedzep* and *In re Gee*, express principles of the universality theory but do not involve ‘the essence of Section 304, the return of assets to a central bankruptcy administration.’”)

⁶⁰ Knecht, *supra* note 22 at 314. (“Not all of the Section 304 cases have ruled in favor of the foreign representative. In fact, in several cases the U.S. courts have found that a transfer of the assets would violate the interests of the U.S. claimholders. These cases demonstrate the persistence of the U.S. judicial endorsement of territoriality.”)

⁶¹ Knecht, *supra* note 22 at 313. (“In imposing conditions on the transfer of U.S. assets, these four cases reveal that U.S. courts invariably focus on and privilege the interests of U.S. creditors.”)

⁶² Knecht, *supra* note 22 at 299.

This hypocrisy in interpreting Section 304 was most apparent from the case of *In re Alison Treco & David Patrick Hamilton*⁶³. In that case, the Second Circuit had to decide whether or not to turn over certain Local Assets of a Bahamas company in liquidation proceedings in the Bahamas. The Bank of New York and JCPL Leasing Corp. were secured United States creditors of the debtor company and opposed the turnover of assets. The 2nd Circuit proclaimed that “comity is the ultimate consideration in determining whether to provide relief under § 304”⁶⁴ However, despite this, it refused to turn over the Local Assets on the basis that distribution of assets under Bahamas law would not be “substantially in accordance” with United States priority and that the interests of the United States secured creditors would not be protected in the Bahamas liquidation proceeding.⁶⁵

The findings of this paper show that the same criticism of hypocrisy can be leveled against Chapter 15. United States courts can claim to have acted in a universalist manner because they granted recognition in almost all Chapter 15 cases. However, they only made orders for Entrustment without Qualifications where there were known United States creditors in only 9.1% of cases. This finding shows that they are really acting territorially to the benefit of United States creditors or by applying United States priority rules.

Moreover, Professor Westbrook’s and other proponents of Chapter 15 hopes that Chapter 15 would be applied in a universalist way are misplaced. According to its legislative history, Section 1521(b) relies on Section 304 jurisprudence. In describing the purpose of Section 1521, the House of Representatives report states, “this section does not expand or reduce the scope of relief currently available in ancillary cases under sections 105 and 304”⁶⁶ Bufford suggests, “[a]ccording to the legislative history, (Section 1521(b)) should be interpreted by reference to the case law developed under former Section 304(c) involving the turnover of assets for distribution in a foreign proceeding.”⁶⁷

⁶³ *In re: Alison J. Treco & David Patrick Hamilton, as Liquidators of Meridien International Bank Limited (in liquidation)*, 240 F.3d 148 (2nd Cir. 2001).

⁶⁴ *Id.* at 19.

⁶⁵ *Id.* at 28-29. (“The district court relied on the abstract observation that Bahamian law recognizes a distinction between secured and unsecured claims. But that distinction does not change the fact that United States law and Bahamian law treat administrative expenses differently -- a difference that would apparently have a substantial impact on BNY’s claim. The district court acknowledged that the prioritization of administrative expenses over secured claims “ultimately may be detrimental to the interests of a secured claimant” under Bahamian law, but found that this factor was “not sufficient to render turnover inconsistent with § 304(c)(4).” We disagree.”)

⁶⁶ H.R. REP. NO. 107-3, pt. 1 (2001), accompanying H.R. 333 at 86.

⁶⁷ Bufford, *supra* note 10 at 134. Also, Lee, *supra* note 29 at 192 (“The statutory test for turnover of assets would now be whether the court is satisfied that the interests of creditors in the United States are sufficiently protected. Will this statutory test result in an outcome different from that under § 304(c)? There is ample reason to believe that a bankruptcy court in applying the test in § 1521(b) would look to the case law precedents under § 304(c). The relevant § 304(c) factors are readily subsumed within the § 1521(b) test whether the interests of creditors in the United States are “sufficiently protected.”)

Section 304(c) states,

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.⁶⁸

Universalists found the enumeration of these 6 factors to guide the courts in their decision of whether or not to grant relief⁶⁹ to be particularly offending. It “explicitly refers to distribution of proceeds in a way “substantially in accordance” with U.S. notions... the listing of “comity” as one of the factors to be considered...can have the perverse effect of making comity seem just one more factor to be weighed.”⁷⁰ As a result, United States courts applying Section 304 interpreted each factor as a separate test as a prerequisite to granting relief and only granted relief when a foreign proceeding satisfied all six tests.⁷¹

Section 304 was criticized by Professor Westbrook and other universalists as “simply proclaim(ing) universalism and local preference in the same breath and leaves it to the courts to fashion something worthwhile from its conflicting motives.”⁷² The same universalists moved Chapter 15 through Congress and understand the legislative intent that Section 1521(b) should import Section 304(c) jurisprudence. There is no reason for them to expect that Section 1521(b) would not produce the same hypocrisy as Section 304.

B. Domestic Courts Favor Local Priority over “Cross-Priority”

Chapter 15 cannot resolve differences of priority schemes between states. Chapter 15 seeks to achieve a system of “cross-priority” “making priorities specified under the law

⁶⁸ 11 U.S.C. § 304(c)

⁶⁹ Knecht, *supra* note 23 at 297. (“Section 304(c) enumerates six factors to direct the court in tailoring its decision concerning whether to grant relief.”)

⁷⁰ Westbrook, *Theory and Pragmatism*, *supra* note 5 at 474.

⁷¹ Ulrich Huber, *Creditor Equality in Transnational Bankruptcies: The United States Position*, 19 VAND. J. TRANSNAT’L L. 741, 748 (1986). (“A review of the cases dealing with the principles illustrates, however, that contrary to the intent of Congress, courts have granted relief in cases where the foreign proceeding passed all six tests of section 304(c).”)

⁷² Westbrook, *Theory and Pragmatism*, *supra* note 5 at 473.

of the [recognized foreign proceeding] available to foreign as well as domestic creditors.”⁷³ However, as this paper has shown, despite Chapter 15, the United States is resistant toward subjecting its creditors from foreign priority rules. In so doing, United States courts’ application of Chapter 15 frustrates this system of “cross-priority” by pre-empting the priorities specified under the law of the recognized foreign proceeding and replacing them with United States’ priority rules. Recently, Professor Westbrook admitted that differences between priority rules are an obstacle for Chapter 15 and other forms of modified universalism.⁷⁴ “Meaningful cooperation among courts will often require that one or the other priority system prevails. The question is whether a court will feel so bound by the local system so as to prevent cooperation with a foreign court.”⁷⁵

This is an obstacle that Professor Westbrook had previously underestimated. In 2005, when Chapter 15 was first enacted, he did acknowledge “the question of discrimination in the application of priorities in distribution.”⁷⁶ However, at that time, he was content to accept that establishing a “minimum level of fair treatment” would be sufficient to prevent non-discrimination between foreign and local creditors.⁷⁷

Professor LoPucki correctly notes that the priority problem is not so easily resolved. “The priority problem cannot be resolved merely by making a few simple adjustments. Each nation’s priority scheme is an integrated system in which each class of creditors’ priority depends both on the likelihood that other classes of debt will arise and on the

⁷³ Lopucki, *supra* note 19 at 706.

⁷⁴ Westbrook, *supra* note 17 at 869-870. (“Meaningful cooperation among courts will often require that one or the other priority system prevails. The question is whether a court will feel so bound by the local system so as to prevent cooperation with a foreign court. This problem did not appear in the old-style territorialist approach to international insolvency. Each court grabbed the assets it could reach and distributed them according to local priority rules. Only when courts try to cooperate to maximize value and fairness in a multinational case does the problem of differing priorities arise. In recent years we have seen the general acceptance of “modified universalism” - a pragmatic, accommodating form of the universalist approach to insolvency that seeks to promote cooperation between courts and to produce results as near as possible to the ideal of a single, global proceeding. This approach also permits a meaningful chance for a global reorganization of a business, thus avoiding the serious loss of value almost always associated with piecemeal liquidation.”)

⁷⁵ Westbrook, *supra* note 17 at 878. (“Yet the clash of priority systems presents a serious obstacle to the universalist project. An important obstacle to cooperation and the ultimate ideal of a single, worldwide proceeding is the presence of so many varying rules concerning the distribution of the values realized by insolvency proceedings.”)

⁷⁶ Jay Lawrence Westbrook, *Multinational Enterprises in General Default: Chapter 15, the ALI Principles and the EU Insolvency Regulation*, 76 AM. BANKR. L. J. 1, 16 (2002).

⁷⁷ *Id.* (“While this exception to the nondiscrimination principle was thought necessary, it was important to limit the exception by establishing a minimum level of fair treatment. That minimum requirement of nondiscrimination means that a foreign creditor must be treated in a distribution at least as well as a general, unsecured creditor, if a similarly situated local creditor would receive at least that treatment. It also leaves to the enacting state, as an option, whether to accept foreign tax claims in an insolvency.”)

preferences given to them.”⁷⁸ The wide variance in priority rules between countries means that more often than not, some United States creditors will be prejudiced by application of foreign priority rules. Hence, Professor LoPucki comes to the conclusion that,

“(E)ven the relatively minor differences between the bankruptcy laws of the United States and those of Canada and Australia have proven sufficiently prejudicial in some circumstances to warrant refusals to cooperate. Given the wide differences in bankruptcy regimes throughout the world, modified universalism will often, if not usually, lead to a refusal to cooperate.”⁷⁹

Efforts at establishing a system of cross-priorities through Chapter 15 are stillborn. United States courts simply will not apply it.

C. The Hypocrisy of Chapter 15 is a Disincentive to Further Cooperation

As argued earlier, the findings in this paper show that United States courts can claim to have acted in an universalist way because they granted recognition in almost all Chapter 15 cases while turning over assets unconditionally where there were known United States creditors in only 12% of cases. Knecht has alluded to judicial application of Section

⁷⁸ LoPucki, *supra* note 19 at 710. (“To illustrate, in Mexico, generous legal entitlements ensure that bankrupt firms are likely to owe substantial amounts to employees for wages, benefits, and potential severance pay. Mexican law requires that these employment claims be paid prior to the claims of other unsecured creditors and most secured creditors, making employees the most likely “residual owners” of the bankrupt firm. By contrast, in the United States, employment claims are likely to be small. Statutes limit their priority to \$ 4,000 per employee and require the claimed wage to be earned within ninety days before the date of the filing of the petition. In addition, employment claims are subordinated to the claims of secured creditors (including those unsecured due to a lack of adequate protection), administrative expenses, and postpetition lending. As a result, employment claimants seldom have much power in U.S. bankruptcy cases. Yet in a universalist system, the priority of Mexican workers’ employment claims against a U.S. firm operating in Mexico would be determined by U.S. rules of priority - much to the disappointment of the affected Mexican workers. As a practical matter, the Mexican employee, the Mexican trade creditor, and even their U.S. counterparts are unlikely to know enough about foreign insolvency laws to adjust to them. Any trade creditor that sells its products to large numbers of customers is selling to debtors from a variety of home countries - even if all of the sales and deliveries are made domestically. Even in a universalist regime, a trade creditor rarely would find it cost-effective to discover the home countries of its corporate customers, let alone to evaluate the insolvency regimes of those countries and to adjust the credit terms accordingly. The likelihood of the insolvency of any particular customer would be too small. In practice, universalism would be unpredictable to all but the largest creditors of multinational companies.”)

⁷⁹ LoPucki, *supra* note 19 at 730.

304 as hiding behind “a drapery of illusion”⁸⁰. She states, “(if) the United States truly wishes to encourage other nations to cooperate in international bankruptcy proceedings and sincerely seeks to implement the legislative intent behind Section 304, it must enjoin its courts to consistently adopt a universalist approach.”⁸¹

If Chapter 15 has accomplished something, it has created thicker drapes. Chapter 15 increases the ability of United States courts to purport to be universalist. After all, 91 of 94 cases were granted recognition. Hence, United States courts may purport to comply with the Model Law despite granting relief, which is inconsistent with the spirit of the Model Law. This is what Tung refers to as a “fuzzy commitment”. As Tung notes with respect to the malleability of the COMI doctrine,

(f)uzzy commitments allow each state to assert plausible good faith claims to compliance. This lack of clarity weakens the credibility of any universalist commitment and creates problems of misperception and misinterpretation: states will have trouble distinguishing cooperation from defection...Without accurate matching of rewards and punishments to cooperation and defection, any message among players becomes garbled. Reciprocity is frustrated; cooperation is undermined.⁸²

Ultimately, inability to gauge true compliance with the Model Law frustrates future attempts to deepen the commitments with the Model Law and encourage wider adoption of the Model Law among countries. With Chapter 15, the United States can now point towards high numbers of cases where recognition was granted as evidence of cooperation. This obscures the fact that it really entrusted Local Assets to foreign proceedings in only 12% of cases. Other countries will not know whether the United States is complying with

⁸⁰ Knecht, *supra* note 23 at 322. (“Until U.S. courts demonstrate their concerted commitment to universality, the United States will find itself hiding behind a “drapery of illusion” that has become completely transparent to the world.”)

⁸¹ Knecht, *supra* note 23 at 322.

⁸² Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT’L L. 31, 80-2 (2001). (“The ambiguity inherent in standards, and haziness with respect to whether the particular application of a standard was “correct” given the underlying circumstances, impair states’ abilities to coordinate on what constitutes cooperation versus defection. Therefore, the administering of appropriate rewards and punishments becomes difficult. Ambiguity and uncertainty about defection ... wreak havoc with [the reciprocity] mechanism of sustaining cooperation. Under many circumstances, determining whether a state’s actions constitute defection may be difficult or impossible. For example, in the presence of an unforeseen contingency, reasonable people may disagree about how a given agreement should be applied. When they disagree, they cannot coordinate their responses, implying that full cooperation cannot be sustained. Even with perfect monitoring and ability to identify defection, cooperation is not easy to sustain. But when “noise” is introduced, sustained cooperation becomes even less likely”)

the Model Law or not and whether they should in turn comply with or even adopt the Model Law.

D. Chapter 15 will Result in a Greater Multiplicity of Proceedings and Greater Confusion

Proponents of Chapter 15 have claimed that it will “reduce administrative costs due to a reduction in the number of proceedings”⁸³ and reduce confusion from “competing choices of laws”⁸⁴. Given that United States courts are behaving in a territorial manner, instead of reducing administrative costs arising from multiple proceedings, Chapter 15 may lead to “a bankruptcy proceeding in every country in which the debtor has assets, and perhaps even more”⁸⁵. LoPucki illustrates this point,

To decide whether a home country's bankruptcy law would distribute the local assets substantially in accordance with the local bankruptcy code, the ancillary court must determine how the home country's court would distribute the assets. To make this determination, the ancillary court must hear testimony on the foreign law. If it then decides to surrender the assets conditionally, it must negotiate an agreement with the court of the home country. If it instead decides not to surrender the assets, it either may distribute the assets itself or let another local court distribute them. For a debtor that operates in dozens of countries, modified universalism may necessitate dozens of complex proceedings.⁸⁶

Further, territorial application of Chapter 15 can also result in uncertainty as creditors are unable to predict whether or not and to what extent the United States court will respect the priority rules of the foreign proceeding.⁸⁷ Professor LoPucki provides an example,

⁸³ Bebchuk & Guzman, *supra* note 4 at 778. (“The case against the grab rule and in favor of universalism typically points to the reduction in costs associated with a single adjudication and distribution of the bankrupt entity's assets.”)

⁸⁴ Westbrook, *supra* note 5 at 421. (“Territorialism produces distributions that are a function of local priorities and the presence of a greater abundance of assets in one jurisdiction than in another... The distributions are always unpredictable and often unfair.”)

⁸⁵ LoPucki, *supra* note 19 at 729.

⁸⁶ LoPucki, *supra* note 19 at 729.

⁸⁷ LoPucki, *supra* note 19 at 729. (“First, the regime or regimes that will ultimately distribute the debtor's assets may depend on the country in which the assets are located at the time of bankruptcy. To illustrate, assume that Debtor Corporation, a Swiss corporation, has \$ 1 million in assets. If those assets are located in Switzerland at the time of the bankruptcy, Swiss law will govern the distribution. If they are located in the United States, the choice of law will depend on whether the Swiss distribution would be substantially different than the U.S. distribution. If it would, the United States will refuse to surrender the assets.”)

(A)ssume that Debtor Corporation, a Swiss corporation, has \$ 1 million in assets. If those assets are located in Switzerland at the time of the bankruptcy, Swiss law will govern the distribution. If they are located in the United States, the choice of law will depend on whether the Swiss distribution would be substantially different than the U.S. distribution. If it would, the United States will refuse to surrender the assets. Ultimately, those assets will be distributed under U.S. law. Second, for the lender to predict the regime applicable to distribution at the time of the loan, the lender must guess what intercountry differences in bankruptcy law the forum court will consider substantial.⁸⁸

Having to anticipate which foreign priority rules a United States court adds another layer of transaction costs for foreign creditors. To correctly anticipate whether a United States court will respect their home country priority rules, these creditors will have to engage United States lawyers. Some foreign creditors may not be able to afford these added transaction costs and will be at distinct disadvantage with respect to eventual distributions.

IV. CONCLUSION

This paper has reported empirical evidence that when deciding Chapter 15 cases, United States courts seldom grant Entrustment without Qualifications when United States creditors may be adversely affected. Despite Chapter 15, United States courts in international bankruptcy cases continue to act territorially as a result of their power to order discretionary relief relating to the distribution of Local Assets. Further, this paper has argued that Chapter 15 is not as universalist as its proponents claim it to be and that application of Chapter 15 has been as hypocritical as its predecessor, Section 304. Chapter 15 allows United States courts to proclaim universalism while acting according to local preference.

This hypocrisy proves a setback rather than a step forward for international cooperation in insolvency law. It leads to an inability for other Model Law countries to distinguish between cases where the United States is cooperating and cases where it is not cooperating.⁸⁹ Unable to distinguish between cooperation and defection, the courts of other

Ultimately, those assets will be distributed under U.S. law. Second, for the lender to predict the regime applicable to distribution at the time of the loan, the lender must guess what intercountry differences in bankruptcy law the forum court will consider substantial.”)

⁸⁸ LoPucki, *supra* note 19 at 729.

⁸⁹ Tung, *supra* note 18 at 582. (“Reciprocity also depends on states’ ability to distinguish cooperation from defection in order to respond appropriately...Can universalist obligations be sufficiently specified such that foreign courts decisions may accurately be interpreted as cooperation or defection?”)

Model Law countries may decide not to reciprocate and hence apply their own domestic laws in a territorialist manner.

Moreover, purported efficiency gains from universalism, if proven to exist, are invalidated by United States courts behaving in a territorial manner. Instead of reducing administrative costs arising from multiple proceedings, Chapter 15 may lead to “a bankruptcy proceeding in every country in which the debtor has assets, and perhaps even more”⁹⁰. This arises out of the inability for creditors to predict whether or not and to what extent the United States court will respect the priority rules of the foreign proceeding.⁹¹

This should lead scholars and policy makers who support Chapter 15 to reconsider their positions. Most are in agreement that universalism is a worthy goal to reach.⁹² However, as argued in this paper, proponents of modified universalism, as a way of getting to universalism in its pure form, should recognize that there are considerable obstacles and costs that arise from this route.

Moreover, scholars and policymakers should examine other possible routes toward full universalism that would be less harmful than modified universalism.⁹³ Such routes should

⁹⁰ LoPucki, *supra* note 19 at 729.

⁹¹ LoPucki, *supra* note 19 at 729. (“First, the regime or regimes that will ultimately distribute the debtor’s assets may depend on the country in which the assets are located at the time of bankruptcy. To illustrate, assume that Debtor Corporation, a Swiss corporation, has \$ 1 million in assets. If those assets are located in Switzerland at the time of the bankruptcy, Swiss law will govern the distribution. If they are located in the United States, the choice of law will depend on whether the Swiss distribution would be substantially different than the U.S. distribution. If it would, the United States will refuse to surrender the assets. Ultimately, those assets will be distributed under U.S. law. Second, for the lender to predict the regime applicable to distribution at the time of the loan, the lender must guess what intercountry differences in bankruptcy law the forum court will consider substantial.”)

⁹² LoPucki, *supra* note 24 at 2251. (“Westbrook and I agree that traditional universalism would present no great problem in a world in which the bankruptcy and priority laws of all countries were essentially the same. We disagree on whether an international convention could establish a traditionally universalist system without first eliminating the sharp differences that exist among the bankruptcy systems of the various countries. As I see it, the results of such a premature attempt at universalism would be rampant forum shopping by multinational companies and their financiers for favorable systems and the rise of offshore bankruptcy havens that would specialize in providing such systems. Choosing universalism prematurely may be choosing, in effect, to have most multinational bankruptcies take place in secret in Bermuda or the Cayman Islands - under laws made by the legislatures of those countries.”)

⁹³ One alternative is “cooperative territoriality” as proposed by LoPucki. LoPucki, *supra* note 24 at 2219-2220. (“In a territorial system, the necessary international cooperation takes place in each case. That is, “parallel” bankruptcy proceedings are initiated in each country in which the corporate group has substantial assets. Each court appoints a “representative” for the estate of each entity filing in its jurisdiction. Those representatives then negotiate a solution to the debtor’s financial problems. If the estates are worth more in combination than they are separately, it will be in the interests of the representatives to combine them...For example, assume that a financially distressed entity has assets in the United States and Canada. The entity would file in both countries, an estate would be created in each, and the courts of each country would appoint a representative of the estate in that country. Unless the representatives agreed otherwise, the U.S. assets

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recognize that different priority rules between countries are a substantial roadblock towards meaningful cooperation because they discourage national courts from allowing domestic creditors from being subject to foreign priority rules. Hence, a possible cooperative endeavor to examine would be one that promotes priority rule convergence between countries. Perhaps, it is only when there is sufficient convergence that universalism can be achieved. Yet, if scholars and policymakers continue to believe that meaningful cooperation has been achieved through Chapter 15 and the Model Law, truly meaningful forms of cooperation may be neglected and unexplored.

would be distributed in accord with U.S. law and the Canadian assets would be distributed in accord with Canadian law. In this context, "U.S. law" would include U.S. conflicts rules, but bankruptcy conflict rules generally direct that the court look to local law in the distribution of a bankruptcy estate. The result is that the priority rules of the country where an asset is located typically determine the key issue in any bankruptcy case - who shares in the asset and in what proportion. The system of territoriality described here is not one that I propose. It is the system currently operating in the world. Thus, it is the system that should be compared to the form of modified universalism that Westbrook would implement without waiting for the adoption of an international convention.")