

**LEADING THE FOREIGN CORPORATION  
TO A FRESH START  
IN THE UNITED STATES**

by

Judith Elkin  
Judith.Elkin@haynesboone.com  
Scott Everett  
Scott.Everett@haynesboone.com  
**Haynes and Boone, LLP**

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## I. INTRODUCTION

"Give me your tired your poor,  
Your huddled masses yearning to breathe free,  
The wretched refuse of your teeming shore.  
Send these, the homeless, tempest-tossed to me,  
I lift my lamp beside the golden door!"

*Emma Lazarus (1849-1887)*

Since the late 1800s, the Statue of Liberty has stood over the United States as a savior of the poor and downtrodden. The sculptor intended the work to be an immense and impressive symbol of human liberty. As this guardian of the lowly and oppressed approached its historic 100th birthday, it was in need of restoration. Congress therefore authorized and funded a major renovation of the national shrine that improved access, repaired existing structural problems, and refurbished this hallmark of our heritage. Millions of Americans now visit it each year, and this protector also stands as a beacon to foreigners—those wretched refuse looking for a fresh start.

Yes, the Bankruptcy Act and Code—Mecca to the financially tempest-tossed all around the world for over a century. Countless individuals from overseas have sought the benefits and protections of the American bankruptcy system, including its award of a discharge of indebtedness to the honest but unfortunate debtor. But is this financial freedom available only to individuals, or may foreign companies also seek shelter here from their creditors? That is, may a foreign corporation, headquartered in a foreign country, initiate a full-fledged bankruptcy case in the United States? Yes. The company need only establish that it has a residence, place of business, or property within the United States. Sounds simple, right? Actually, that determination can be a tricky one, and even if the company establishes its

credentials, there is no guaranty that a bankruptcy court will retain jurisdiction over the case. Sometimes the foreign corporation must seek bankruptcy protection in its own country and file a more limited, ancillary proceeding in the U.S.

## II. HISTORY

Section 109 of the Bankruptcy Code, the current source of eligibility requirements for relief under the Bankruptcy Code, was derived in large part from section 2a(1) of the Bankruptcy Act of 1898. Section 2a(1) provided in relevant part that a bankruptcy court may "[a]djudge persons bankrupt who have had their principal place of business, resided, or had their domicile within their respective territorial jurisdictions for the preceding six months, or for a longer portion of the preceding six months than in any other jurisdiction, or who do not have their principal place of business, reside, or have their domicile within the United States, but have property within their jurisdiction . . . ."

With a few exceptions noted in the next paragraph, the eligibility requirements for relief under section 2a(1) of the Bankruptcy Act were similar to those under § 109 of the Bankruptcy Code. Therefore, cases construing section 2a(1) are generally authoritative in the interpretation of § 109. *Bank of Am., N.T. & S.A. v. World of English, N.V.*, 23 B.R. 1015, 1019 (N.D. Ga. 1982) ("These requirements [under § 109] were also found in § 2(a) of the Bankruptcy Act. Therefore, cases construing the meaning of the requirements under the Act will be useful in any analysis of 11 U.S.C. § 109.").

Two differences to note: First, whereas a person's "*principal* place of business" in the United States was a ground for relief under section 2a(1), § 109 requires only that

a person have a "place of business" in the United States. Second, whereas having property in the United States was a ground for relief under section 2a(1) only if the debtor did not have a domicile, residence, or principal place of business here, § 109 affords a debtor relief if the person has property in the U.S. irrespective of the other eligibility requirements.

### III. SECTION 109 REQUIREMENTS

Section 109 of the Bankruptcy Code defines who may be a debtor under the various chapters of the Bankruptcy Code. Section 109(a) provides that a person may be a debtor under the Bankruptcy Code if the person "resides or has a domicile, a place of business, or property in the United States . . . ." 11 U.S.C. § 109(a). Although a "person" is defined generally as an individual, partnership, or corporation, 11 U.S.C. § 101(41), other legal entities have also been found to be a "person" and thus an eligible debtor. *See, e.g., In re Midpoint Dev., LLC*, 313 B.R. 486 (Bankr. W.D. Okla. 2004) (concluding that state limited liability company is a "person" and thus an eligible debtor). Foreign corporations are therefore generally eligible for relief under the Bankruptcy Code.

Section 109(b)-(g) then limits who may be a debtor under the Bankruptcy Code. Any person is eligible for relief under Chapter 7 (liquidation) except for railroads, insurance companies, and certain banking institutions. 11 U.S.C. § 109(b). *See In re Agency for Deposit Ins., Rehabilitation, Bankruptcy and Liquidation of Banks*, No. 03 Civ. 9320(JSR), 03 Civ. 9321(JSR), 2004 WL 414831 (S.D.N.Y. Mar. 4, 2004) (noting that Yugoslavian bank was not eligible to be a debtor under § 109). Any person eligible for relief under Chapter 7, except for stockbrokers or commodity brokers, may file for relief under Chapter 11, the business reorganization bankruptcy. 11 U.S.C. § 109(d). Chapters 9, 13, and 12 of the Bankruptcy Code are limited to certain

domestic municipalities, individuals with regular income, and family farmers, respectively. 11 U.S.C. § 109(c), (e), (f).

To summarize, a foreign corporation that is not a railroad, insurance company, or a banking institution and that has a residence, domicile, place of business, or property in the United States may file a Chapter 7 bankruptcy. A foreign corporation that is not a railroad, insurance company, banking institution, stockbroker, or commodity broker and that has a residence, domicile, place of business, or property in the United States may file a Chapter 11 bankruptcy.

#### **A. DOMICILE**

A person that has a domicile in the United States may be a debtor under the Bankruptcy Code. A corporation's domicile is the state of incorporation. *Underwood v. Hilliard (In re Rimsat, Ltd.)*, 98 F.3d 956, 960 (7<sup>th</sup> Cir. 1996) (citing *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519, 588, 10 L.Ed. 274 (1839); Restatement (Third) of the Foreign Relations Law of the United States § 213 (1987)). Therefore, a foreign corporation, incorporated in a foreign country, must have a residence, place of business, or property in the United States to qualify for relief under § 109. *See GMAM Investment Funds Trust I v. Globo Comunicacoes e Participacoes S.A. (In re Globo Comunicacoes e Participacoes S.A.)*, No. 04 Civ. 2818(VM), 2004 WL 2624866, at \*9 (S.D.N.Y. Nov. 17, 2004) (noting that foreign debtor with no residence, place of business, or property in the U.S. may still qualify for relief under § 109 if it has property in the U.S.).

## **B. RESIDENCE**

A person that resides in the United States may be a debtor under the Bankruptcy Code. Questions regarding corporate residence arise in a variety of diverse contexts such as jurisdiction, attachment, taxation, and bankruptcy, and must be treated individually in connection with the statutes in which the term is used. *Pennsylvania Ins. Guar. Ass'n v. Charter Abstract Corp.*, 790 F.Supp. 82, 85 (E.D. Pa. 1992). See, e.g., 28 U.S.C. § 1391(c) (providing that "[f]or purposes of venue under this chapter, a defendant that is a corporation shall be deemed to reside in any judicial district in which it is subject to personal jurisdiction at the time the action is commenced.").

The concept of a corporation's "residence" is a slippery one, however, and bankruptcy courts that have considered petitions for relief by foreign debtors have grabbed on to the (somewhat) more concrete determination of whether the foreign corporation has a place of business or property in the United States. See *GMAM Investment Funds Trust I v. Globo Comunicacoes e Participacoes S.A. (In re Globo Comunicacoes e Participacoes S.A.)*, No. 04 Civ. 2818(VM), 2004 WL 2624866, at \*9 (S.D.N.Y. Nov. 17, 2004).

## **C. PLACE OF BUSINESS**

A person that has a place of business in the United States may be a debtor under the Bankruptcy Code. Bankruptcy courts construing the place-of-business requirement for foreign debtors were given guidance by the early opinion of *In re Carnera*, 6 F.Supp. 267 (S.D.N.Y. 1933). In *Carnera*, an Italian boxer who frequently fought in the United States filed a voluntary petition in New York. For several months prior to the petition date, the debtor lived in a hotel where he received his mail, negotiated fights and

exhibitions, paid trainers and sparring partners, and kept correspondence files and a typewriter used by his manager for business use. The court concluded that the hotel was the debtor's principal place of business for the greater part of the six months preceding the petition date: "It does not matter that there was no sign on the door or that there were no office boys moving around. [The debtor] and his staff had business, and the place where most of that business was carried on was his quarters at the Hotel Victoria." *Id.* at 269.

A case that followed *Carnera* in eschewing the notion that a debtor need have a formal place of business in the U.S. to qualify for bankruptcy relief was *In re Brierley*, 145 B.R. 151 (Bankr. S.D.N.Y. 1992).<sup>1</sup> The debtor in *Brierley* was one of the many entities related to Maxwell Communication Corporation, which was the subject of dual insolvency proceedings in the United States and England. The debtor had an accountant working in the New York office of Arthur Anderson on behalf of the joint administrators of the Maxwell companies. The accountant worked in Arthur Anderson's offices and reported to a partner at Arthur Anderson. The accountant's employment agreement with the debtor deemed her an independent contractor, although that was done on the advice of tax attorneys. The debtor's name did not appear in the building directory or on any signs. However, the accountant worked full-time for the debtor, was paid by the debtor, communicated regularly with the debtor's personnel in England, and kept in her office certain books and records of the debtor. Moreover, the debtor's location in New York was widely broadcast to third parties having

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<sup>1</sup> The issue before the court was whether the eligibility requirements for § 109 also applied to a foreign debtor seeking relief pursuant to a § 304 ancillary proceeding. The court determined that they did not, but noted that even if § 109 applied to a § 304 proceeding, the debtor met those requirements. The court's comments, while dicta, are still instructive.

business with the debtor. Therefore, "by virtue of [the accountant's] continuous presence and employment and the substantial activities conducted here by [the debtor, the debtor] has a place of business in this district, notwithstanding that its premises are contained within the larger premises of Arthur Anderson." *Id.* at 162.

Recently, the court in *In re Paper I Partners, L.P.*, 283 B.R. 661 (Bankr. S.D.N.Y. 2002) discussed the place-of-business requirement. The partnership debtors were formed under the laws of Delaware and Turks and Caicos, respectively. The debtors, contesting involuntary Chapter 7 bankruptcies, argued that § 109 was not satisfied because their respective partnership formation agreements provided that their principal place of business was in Luxembourg; according to the debtors, only "administrative" functions were performed in the United States. The court first noted that the statute requires merely "a place of business" in the United States, not a "*principal* place of business" in the United States. Second, the incantation in the organization documents of Luxembourg as their place of business was not determinative. Each debtor operated through its general partner (the same entity), which conducted substantial, substantive business of the debtors in the New York office of the general partner. Both partnership debtors, therefore, were eligible to be debtors under the Bankruptcy Code by virtue of their having a place of business in the United States. *Id.* at 672-74.

The debtors in *Carnera, Brierley, and Paper I Partners* did their business on land. But the wretched refuse also come by sea. In *In re Spanish Cay Co., Ltd.*, 161 B.R. 715 (Bankr. S.D. Fla. 1993), a Bahamian corporation whose principal asset was an island in the Bahamas filed for Chapter 11 relief in Florida. The debtor's president sold island lots and island club memberships and conducted the advertising, marketing, and other business affairs of the debtor, all from a

houseboat in Florida. The court held that the debtor qualified for relief under § 109 because, among other things, it had a place of business in the U.S. The court rejected a creditor's argument that the debtor's place of business should not be recognized under § 109 because the business was unlawful in that the debtor had failed to comply with applicable state laws regulating business entities: "This Court refuses to deny the debtor eligibility under Section 109 on these grounds."<sup>2</sup> *Id.* at 721. The creditor also urged the court to deny § 109 relief on the ground that any advertising and marketing activities were actually conducted by affiliates of the debtor and not by the debtor itself. However, because the debtor "or" its related entities undoubtedly conducted business activities in Florida and because there was a "continuity of interest" between the debtor and the related entities, the debtor had a place of business in Florida. *Id.* at 721-22.

The wretched refuse also came by sea in *In re Global Ocean Carriers Ltd.*, 251 B.R. 31 (Bankr. D. Del. 2000). The fifteen affiliated debtors in *Global Ocean* were involved in the shipping industry and were headquartered in Athens, Greece. All but one of the debtors were incorporated in Cyprus, Singapore, or Liberia. To establish their eligibility for Chapter 11 relief, the Debtors presented evidence that, among other things, some of the Debtors' vessels visited U.S. ports on a regular basis. The court determined, however, that "[h]aving some business in the United States (and even being physically present in the United States for 30% of the year) is insufficient to constitute having a place of business in the United States." *Id.* at 37.

To summarize, a foreign corporation need not have a formal office or signs in the U.S. to have a place of business

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<sup>2</sup> Would an alien drug dealer conducting the "business" of selling cocaine in the U.S. qualify for relief under § 109?

here. The cases thus far have found sufficient a corporation's having nontransitory employees or representatives conducting the company's affairs in the U.S. and representing that fact to third parties. A court may even treat related entities doing business here as one huddled mass for purposes of § 109's place-of-business requirement, even if that huddled mass fails to comply with U.S. business laws.

#### **D. PROPERTY**

A person that has property in the United States may be a debtor under the Bankruptcy Code. A foreign corporation with real property in the U.S. would have little difficulty demonstrating its entitlement to relief under § 109, as such property is both easily locatable and quantifiable. But what about tangible and intangible personal property? How much property is "sufficient" to warrant bankruptcy protection? And exactly where is intangible personal property such as a savings account?

Courts have conflicting answers to the question of whether a peppercorn will suffice to warrant bankruptcy relief. In *In re Kava Bowl*, 41 B.R. 244 (Bankr. D. Haw. 1984), an American Samoan corporation filed for Chapter 11 protection in the District of Hawaii. Even though the debtor had some cash and accounting records in Hawaii, the court dismissed the case for lack of jurisdiction, noting that "[t]he 'property' which [the debtor] maintains in Hawaii is not even property in the sense that there is no value to the records to any entity other than [the debtor]. This 'property' is not sufficient for jurisdiction . . . ." *Id* at 247.

A contingent peppercorn in New York likewise is not sufficient for jurisdiction. *In re Head*, 223 B.R. 648 (Bankr. W.D.N.Y. 1998). Several non-U.S. citizens filed for Chapter 11 or 13 relief in the U.S. on the basis that they had done extensive business in the U.S. and that "doing business in"

the U.S. should be considered the same as having "property" in the U.S. Concluded the court, "No amount of doing business in the United States will, of itself, provide a basis for eligibility under § 109." *Id.* at 651-52. The court also rejected the debtors' arguments that the debtors' substantial "debts" in the U.S. were the equivalent of having property in the U.S. Finally, the court rejected the argument that the debtors had property in the U.S. in the form of contingent claims against the surplus of a trust fund held for the benefit of a third party: "[T]here is a difference between having property in the United States and having some type of remote or inchoate claim against property that is in the United States. . . . Whatever interest the [debtors] might have in the fund is too tenuous, too inchoate, and too contrived." *Id.* at 652.

A noncontingent peppercorn will suffice in New York, however. In *In re McTague*, 198 B.R. 428 (Bankr. W.D.N.Y. 1996), a U.S. citizen that had resided in Canada for eleven years filed for Chapter 7 relief in New York on the basis that she had \$194 in a bank account in New York. The U.S. Trustee filed a motion to dismiss, arguing that such property was too insignificant to support bankruptcy jurisdiction. Asked the court, "[W]ould \$100 be enough? Would \$10 be enough? Would \$.10 be enough? Would a peppercorn be enough? . . . The Court today holds that it is without authority to examine the requisite quantity under 11 U.S.C. § 109(a) . . . ." *Id.* at 429.

And where was the debtor's intangible peppercorn? The court determined that the debtor's property was in New York, where the deposit account was "located": "[A]t least two courts have held that such an account is property 'in' the district in which the deposit account is located, even though bank deposits may be viewed as being 'in' the place of residence of the depositor for certain other purposes." *In re McTague*, 198 B.R. at 431-32.

One of the courts referred to in *McTague* was the court in *In re Berthoud*, 231 F. 529 (S.D.N.Y. 1916), *appeal dismissed*, 238 F. 797 (2<sup>nd</sup> Cir. 1916). In that case, an involuntary petition was filed against an individual debtor who did not have his principal place of business, residence, or domicile in the United States, but instead had \$30,000 in a bank account "in" New York. "The whole structure of the [bankruptcy] act indicates that under certain circumstances the proceeding was a sort of proceeding in rem." *Id.* at 532. In concluding that the obligation of the New York bank to pay its depositor, the debtor, was property in New York, the court noted that the situs of personal property--

largely depends upon the question involved in its ownership. Courts and legislatures have placed the situs sometimes at the domicile of its owner, and sometimes at the place where the property is found. . . .

I think that Congress in the Bankruptcy Law did not intend that there should be any fine distinctions. The Bankruptcy Law has set up a comprehensive machinery, whereby property throughout the United States with the aid of ancillary jurisdiction may be gathered in by the original court.

. . . "In other words, a bankruptcy proceeding is a kind of equitable attachment, which should be held to reach whatever assets any available judicial process can reach."

*Id.* (quoting *In re San Antonio Land & Irrigation Co.*, 228 F. 984 (S.D.N.Y. 1916)). *See also In re San Antonio Land & Irrigation Co.*, 228 F. 984, 990 (S.D.N.Y. 1916) (concluding in dicta that a Canadian debtor corporation's stock in a

wholly-owned subsidiary, which was pledged to a New York trust company, its interim bond certificates for another wholly owned subsidiary, which were pledged to the same New York trust company, and its balance of \$8.06 in an account at the trust company, were all "property" in New York within the meaning of the Bankruptcy Act).

The second court referred to in *McTague* was the court in *Bank of America, N.T. & S.A. v. World of English, N.V.*, 23 B.R. 1015 (N.D. Ga. 1982). That court likewise had to determine whether two foreign debtor corporations' money in a California branch bank constituted "property in the United States" within the meaning of § 109. A secured creditor urged the court to follow the federal law of taxation when determining the location of the debtors' property. Under federal tax law, bank accounts are treated as personal property having its situs at the domicile of the owners, and for purposes of determining whether a tax lien is properly filed and valid, the situs of personal property subject to a lien is the residence of the taxpayer at the time the notice of lien is filed. *Id.* at 1021 (citing the IRC). The court found the creditor's reliance on federal tax law misplaced, as that law was concerned with providing a location of lien notice filing that could be easily identified and determined by third parties dealing with the taxpayer. *Id.*

For purposes of determining the location of personal property in bankruptcy cases, the court, relying on *Berthoud* and *San Antonio Land & Irrigation Co.*, concluded that "courts, when determining the situs of personal property, [should] examine who has control over such property." *Id.* at 1023. In the present case, a California branch bank had control over the debtors' assets in the form of bank accounts and certificates of deposit. Therefore, the debtors qualified for relief under § 109. *See also In re Paper I Partners, L.P.*, 283 B.R. 661, 674 (Bankr. S.D.N.Y. 2002) (concluding that Delaware and Turks and Caicos partnerships had property in

the United States because their shared general partner had original documents for each debtor in the general partner's New York office); *In re Global Ocean Carriers Ltd.*, 251 B.R. 31, 39 (Bankr. D. Del. 2000) (holding that the foreign corporate debtors had property in the United States in the form of funds in various bank accounts: "[T]he bank accounts constitute property in the United States for purposes of eligibility under section 109 of the Bankruptcy Code, regardless of how much money was actually in them on the petition date."); *In re Iglesias*, 226 B.R. 721 (Bankr. S.D. Fla. 1998) (holding that a Chapter 7 Argentine debtor's bank account at a local Florida bank was property in Florida under § 109 and not at the residence of the depositor, Argentina); *In re Spanish Cay Co., Ltd.*, 161 B.R. 715 (Bankr. S.D. Fla. 1993) (concluding that a Bahamian debtor corporation's marketing and advertising materials and other improvements and equipment located on a houseboat in Florida, as well as the debtor's bank account in the U.S., were all "property in the United States" within the meaning of § 109).

A recent case involves Avianca, the Columbian national airline. *In re Aerovias Nacionales de Columbia S.A. Avianca*, 303 B.R. 1 (Bankr. S.D.N.Y. 2003). The debtor was an airline organized under the laws of Columbia, with 28 U.S.-based employees compared to more than 4000 in Columbia. A few U.S. creditors moved to dismiss on the grounds that Avianca should be required to file a proceeding in Columbia. The Court determined that the debtor was eligible under § 109 because the debtor (i) had offices in Miami, (ii) flew from Columbia to two U.S. airports (New York and Miami), (iii) leased its planes primarily from lessors who either were based or did substantial business in the U.S., (iv) had significant structured debt governed by N.Y. law, and (v) on any given day, had significant property in the U.S. in the form of airplanes and airport rights. The Court concluded that there was more than the peppercorn of a small bank account to justify the filing of the debtor in the

U.S.

Bank-account cases do raise some interesting issues: First, who has control over a bank account in a multi-state or multi-national bank? Only the branch office that the debtor visited or called when opening the account? For example, what if a Swiss debtor opened a bank account at the Zurich branch of Ameri-Swiss Bank. If the debtor may access his account at the Dallas office of Ameri-Swiss, the corporate headquarters where the bank is managed, may the debtor file for bankruptcy in Dallas?

Second, an involuntary petition under 11 U.S.C. § 303 may be filed only against a person eligible for relief under Chapter 7 or 11, and as noted above, such a debtor qualifies merely by having property in the United States. If a bank account is viewed simply as an "IOU" of the bank, does this mean that any foreign debtor is eligible for relief under the Bankruptcy Code, voluntarily or involuntarily, so long as someone in the United States owes him money? *Cf. J&L Plumbing & Heating, Inc.*, 186 B.R. 388, 392 (Bankr. E.D. Pa. 1995) ("If accounts receivable are indeed the debtor's principal asset, such accounts would seem to generally be more properly pursued in the locus of the accounts debtor.").

Foreign corporations with bank accounts and subsidiaries in the U.S. should carefully read *GMAM Investment Funds Trust I v. Globo Comunicacoes e Participacoes S.A. (In re Globo Comunicacoes e Participacoes S.A.)*, No. 04 Civ. 2818(VM), 2004 WL 2624866 (S.D.N.Y. Nov. 17, 2004). In *Globo*, creditors filed an involuntary bankruptcy petition in the United States against a Brazilian holding company whose employees, headquarters, and principal place of business were all in Brazil and whose principal assets were outside the United States. The company, however, allegedly maintained a bank account in the United States and owned a Delaware

corporation that itself owned interests in three Delaware partnerships. The bankruptcy court dismissed the involuntary petition after determining, among other things, that the holding company was not an eligible debtor under § 109. On appeal, the district court had little trouble concluding that the holding company would be an eligible debtor under § 109 if the holding company did indeed own the bank account and the Delaware subsidiary as alleged. *Id.* at \*9. The district court remanded the case, directing the bankruptcy court to determine whether the holding company owned the bank account and subsidiary, and if it did, whether abstention might nonetheless be appropriate under § 305 of the Bankruptcy Code. *The key lesson Globo teaches is that a foreign corporation with its principal place of business and principal assets all outside the U.S. may nevertheless be subject to an involuntary bankruptcy petition in the U.S. if the company has a U.S. bank account or a U.S. subsidiary.*

One final query: What if a foreign debtor has no residence, domicile, or place of business in the United States, and no property in the United States except for the unearned portion of the retainer paid to American bankruptcy counsel shortly before the petition date? The *Global Ocean Carriers* case suggests that the retainer may be sufficient to establish § 109 eligibility. The foreign corporate debtors in that case argued that they were eligible for Chapter 11 relief because, among other things, they had an interest in the retainer paid by the debtors to the debtors' American bankruptcy counsel. The court was convinced:

We agree. The retainers were paid on behalf of all the Debtors and, therefore, all the Debtors have an interest in those funds. It is not relevant who paid the retainer, so long as the retainer is meant to cover the fees of the attorneys for all the Debtors, as it clearly was in these cases. Thus, we conclude that the

Debtors do have sufficient property in the United States to make them eligible to file bankruptcy petitions under section 109 of the Bankruptcy Code.

*In re Global Ocean Carriers Ltd.*, 251 B.R. at 39.

The foreign debtors otherwise qualified for relief pursuant to § 109 because they had other property in the United States, so the outcome of *Global Ocean Carriers* is unremarkable. But the proposition established by *Global Ocean Carriers*—that a mere retainer paid to American bankruptcy counsel is sufficient to establish § 109 eligibility—promises to expand exponentially the number of eligible debtors.

To summarize, a foreign corporation need not have real property or tangible personal property in the United States to qualify for relief under § 109. Intangible personal property, such as a bank account (or possibly even a retainer), will also suffice, and the courts have determined that the location of such property is the situs of the account debtor. Courts disagree on how much property is enough to satisfy § 109, or even whether the courts should make that determination. This split in the cases is more theoretical than practical, however, because the wretched refuse seeking bankruptcy protection here on the basis of a peppercorn will often be sent packing back to the teeming shore.

#### IV. THE WRETCHED REFUSED

Even the early cases such as *Berthoud* recognized that a foreigner's technical compliance with the eligibility requirements under U.S. bankruptcy law is no guaranty that the wretched refuse will enjoy the benefits and privileges of the American bankruptcy system. Recall that the debtor in *Berthoud* did not have his principal place of business, residence, or domicile in the United States, but instead had \$30,000 in a bank account in New York. Although the court determined that the debtor had property in the United States within the meaning of section 2a(1) of the Bankruptcy Act, the court finished with these comments: "In arriving at the conclusions here stated, it must not be understood that the court will necessarily take jurisdiction if the creditors, as well as the alleged bankrupt, are all aliens residing abroad. It may very well be that the court would decline jurisdiction . . . . [T]hat question is left open until such time as the fact does appear." *In re Berthoud*, 231 F. 529, 534 (S.D.N.Y. 1916).

By what authority may a bankruptcy court deny relief to a foreign corporation that qualifies for relief under § 109? The court may (i) dismiss the bankruptcy case "for cause" pursuant to 11 U.S.C. § 707(a) or 1112(b); (ii) abstain from exercising jurisdiction over the bankruptcy case pursuant to § 305; or (iii) in appropriate instances in certain dual insolvency proceedings, retain jurisdiction over the case yet apply the substantive law of the foreign insolvency proceeding.

**A. DISMISSAL FOR CAUSE PURSUANT TO § 707(a) OR § 1112(b)**

Sections 707(a) and 1112(b) of the Bankruptcy Code permit a bankruptcy court to dismiss a Chapter 7 liquidation bankruptcy or a Chapter 11 reorganization bankruptcy "for cause." 11 U.S.C. §§ 707(a), 1112(b). Two of the cases discussed above dismissed or threatened to dismiss the debtors' respective bankruptcy cases because the debtors had few ties to the United States and simply desired to drag their foreign creditors to an inconvenient forum.

The court in *McTague*, which determined that a "peppercorn" satisfied § 109, noted that "the small quantity relied on by the Debtor here invites further inquiry under other provisions of the Code, such as sections 305 and 707." *In re McTague*, 198 B.R. 428, 429 (Bankr. W.D.N.Y. 1996). *See also In re Head*, 223 B.R. 648, 653 (Bankr. W.D.N.Y. 1998) (holding alternatively that a nonenumerated "cause" for dismissal under § 1112(b) existed when the non-U.S. citizens filed in the U.S. for the purpose of avoiding forum selection clauses in their contracts with Lloyd's of London requiring disputes to be resolved in England: "In essence, they have sought to use the bankruptcy courts of the United States as a 'flag of convenience' by which they endeavor to hammer Lloyd's into submission.").

Note carefully that financially healthy foreign debtors who file for Chapter 11 relief solely to obtain benefits designed for troubled companies may find their cases dismissed, as happened recently to a domestic debtor. *See In re Integrated Telecom Express*, 384 F.3d 108 (3d Cir. 2004) (dismissing Chapter 11 case filed by financially sound company solely to limit claims on a long-term lease under Bankruptcy Code § 502(b)(6)).

**B. ABSTENTION PURSUANT TO § 305**

Section 305 permits a court to dismiss or suspend a bankruptcy case if–

- (1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or
- (2) (A) there is pending a foreign proceeding; and  
(B) the factors specified in section 304(c) of this title warrant such dismissal or suspension.

11 U.S.C. § 304.

The factors considered under § 304(c) include the following:

- (1) just treatment of all holders of claims against or interests in such estate;
- (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
- (3) prevention of preferential or fraudulent dispositions of property of such estate;
- (4) distribution of proceeds of such estate substantially in 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.

11 U.S.C. § 304(c).

The court in *McTague* aptly described the practical problems with retaining jurisdiction over a bankruptcy case when the debtor and his creditors have few ties to the U.S. Recall that the debtor, a U.S. citizen that had resided in Canada for eleven years, filed for Chapter 7 relief in New York on the basis that she had \$194 in a bank account in New York. The debtor owed approximately \$17,000 in unsecured debt to American credit card companies. The debtor also had three secured Canadian creditors: her mortgage lender, her home equity lender, and her automobile lender.

Although it may be true that orders of this Court have 'extraterritorial effect,' it is fundamental that those orders can be enforced in a foreign nation only to the extent that the foreign nation grants those orders 'full faith and credit' as a matter of comity, treaty, or convention. Similarly, although it is true that the federal courts have 'exclusive jurisdiction of all of the property, wherever located, of the debtor,' 28 U.S.C. § 1334(e), this Court would need the aid of a foreign court to the extent that an exercise of that jurisdiction would require, for example, a recordable court order to clear title to real property located in a foreign country or to enjoin persons located in a foreign country from taking certain actions there.

Totally apart, then, from the question of how the Chapter 7 Trustee would administer any asset in this case other than the \$194, any order of discharge that this Court might eventually grant this Debtor would not be enforceable in Canada except to the extent

that Canadian courts are moved by comity to grant it 'full faith and credit.' However, presuming that she is able to return here to seek further relief, the Debtor could seek to punish American creditors in this Court for any 'extraterritorial' violation of the discharge order. In other words, to say that the discharge order has 'extraterritorial effect,' . . . is merely to say that extraterritorial violations of the order may be punished in the United States if the violating party is otherwise subject to this Court's jurisdiction. Beyond that, the 'extraterritorial effect' of the discharge order is a matter for consideration by the foreign court.

*Id.* at 430-31.

The court in *Spanish Cay Co.* applied § 305 to the wretched refuse that came by sea. *In re Spanish Cay Co., Ltd.*, 161 B.R. 715 (Bankr. S.D. Fla. 1993). Recall that the debtor was a Bahamian corporation whose principal asset was an island in the Bahamas. Most of the debtor's creditors were Bahamian entities over which the court would have no personal jurisdiction. Moreover, the loan documents entered into by the debtor and its creditors specifically provided that Bahamian law would apply to the transactions. The creditor moving for dismissal argued that the court should abstain from exercising jurisdiction over the case pursuant to 11 U.S.C. § 305. The court first determined that abstention under § 305(a)(1) was not warranted because dismissal would not be in the interest of *both* the creditors and the debtor. Because Bahamian law did not provide for reorganization, a dismissal of the debtor's Chapter 11 case would result in a liquidation in the Bahamian proceedings.

The court then determined, however, that dismissal

was warranted under § 305(a)(2) because both the debtor and its creditors reasonably expected that Bahamian insolvency law would govern their disputes. Although the section technically did not apply because there was not then pending a Bahamian liquidation proceeding, the court lifted the automatic stay to permit a secured creditor to commence such insolvency proceedings in the Bahamas, upon the commencement of which the court would dismiss the case pursuant to § 305(a)(2). *See also GMAM Investment Funds Trust I v. Globo Comunicacoes e Participacoes S.A. (In re Globo Comunicacoes e Participacoes S.A.)*, No. 04 Civ. 2818(VM), 2004 WL 2624866 (S.D.N.Y. Nov. 17, 2004) (directing bankruptcy court to determine on remand, among other things, whether court should abstain from involuntary bankruptcy petition against Brazilian holding company; factors to consider include (a) whether bankruptcy court could exercise jurisdiction over substantial creditors; (b) whether Brazilian courts would render decisions inconsistent with the bankruptcy court's judgments; (c) whether debtor purposefully availed itself of the U.S. forum; and (d) whether most creditors support the bankruptcy, as opposed to only a few disgruntled creditors); *In re Cenargo Int'l, PLC*, 294 B.R. 571, 574-76 (Bankr. S.D.N.Y. 2003) (noting, in connection with a fee application for work performed prior to abstention, that the court previously suspended the debtors' Chapter 11 cases in deference to English administration proceedings because the debtors' offices were in England, the debtors and their affiliates were organized under English law, the debtors and their affiliates conducted their business primarily in England, and none of the debtors conducted business in the U.S.); *In re Paper I Partners, L.P.*, 283 B.R. 661 (Bankr. S.D.N.Y. 2002) (refusing to abstain under § 305(a) when the debtor partnerships formed under Delaware and Turks and Caicos laws had unsatisfied creditors, and the only parties requesting abstention were the debtors' equity holders); *In re Xacur*, 219 B.R. 956, 969-70 (Bankr. S.D. Tex. 1998) (abstaining from an involuntary bankruptcy filed

against a Mexican citizen and domiciliary when his Mexican creditors could still pursue bankruptcy relief in Mexico and when it appeared that Mexican courts would refuse to recognize the enforceability of U.S. bankruptcy court orders in Mexico); *In re Kava Bowl*, 41 B.R. 244 (Bankr. D. Haw. 1984) (concluding that an American Samoan corporation had no property in the U.S. under § 109, but noting that even if it had jurisdiction, it would abstain from retaining jurisdiction because the debtor was already undergoing receivership proceedings in American Samoa: "Because it now finds the laws of American Samoa not to its liking, it cannot now choose to place itself within the jurisdiction of the Bankruptcy Court in the District of Hawaii, to the detriment of the creditors who have transacted with [the debtor] as an American Samoan Corporation.").

The cases where dismissal is found to be inappropriate provide a useful guide to the factors to be considered. In the December 2003 opinion in *In re Aerovias Nacionales de Columbia S.A. Avianca*, the Court highlighted the conjunctive standard of § 305(a)(1), and provided a lengthy analysis of why, in that case, dismissal was inappropriate in favor of a hypothetical Columbian insolvency proceeding. Avianca had filed chapter 11 primarily to restructure its burdensome leases. This fundamental and well recognized benefit of chapter 11 was unavailable under applicable Columbian insolvency statutes. The movants could not show that Avianca would be better served by dismissal, even if they had been able to prove that creditors might be better off in a Columbian proceeding. The Court then cited numerous reasons why creditors themselves were better served by the U.S. proceeding, including the cooperation among the multinational creditors and the ability of the U.S. court to obtain jurisdiction over most of the major creditors in the case. Furthermore, unlike most of the cases where proceedings by foreign debtors are dismissed, there was no evidence that the U.S. proceeding had been filed to

obtain an unfair advantage for any one creditor or interest holder, but rather the motivation had been the perceived fairness to all constituencies of the Bankruptcy Code over the untested impact of the relatively new Columbian statute.

One final case on dismissal. *In re Ionica PLC*, 241 B.R. 829 (Bankr. S.D.N.Y. 1999). The administrators of the debtor, a British telecommunications company, requested and received from the British court where insolvency proceedings were pending permission to file a Chapter 11 petition in the United States. Their goal was not to reorganize the debtor's defunct business, but instead to take advantage of favorable U.S. bankruptcy provisions to challenge the claims of the debtor's corporate parent through either equitable subordination or substantive consolidation. The debtor's only assets in the United States were securities used to secure the debt to its senior noteholders. After the debtor filed its Chapter 11 petition, the debtor's corporate parent moved to dismiss the bankruptcy case, arguing in part that the legal concepts of equitable subordination and substantive consolidation were not recognized in the United Kingdom. If the Chapter 11 case were dismissed and the debtor's assets distributed solely under English law, the corporate parent would receive more and the other general creditors would get less. According to the debtor's parent, this would create a conflict in distributional schemes violative of § 304(c)(4).

The bankruptcy court disagreed, noting that the unavailability of these claims did not make the British law repugnant to our own and did not prevent the distribution scheme from being substantially in accordance with U.S. bankruptcy law. Nevertheless, the court granted the motion to dismiss because all of the other relevant § 304(c) factors weighed in favor of dismissing the petition: The insolvency laws of the United Kingdom (i) have long been found worthy of comity (except in Belgium); (ii) do not discriminate against foreign creditors; (iii) do not prejudice or

inconvenience American creditors in processing their claims; and (iv) do not foster preferential or fraudulent transfers of property. *Id.* at 836.

For an interesting nonbankruptcy case concerning abstention on comity grounds, see *United Feature Syndicate, Inc. v. Miller Features Syndicate, Inc.*, 216 F. Supp.2d 198 (S.D.N.Y. 2002) (refusing to decide on the poorly developed record before it whether the court would abstain from litigation against insiders of a Canadian corporation in bankruptcy proceedings in Canada).

### **C. RETENTION OF JURISDICTION AND APPLICATION OF FOREIGN LAW**

In certain dual insolvency proceedings, where a foreign debtor has instituted full-fledged bankruptcy proceedings both here and over there, a court may elect to apply the substantive law of the foreign proceeding. Authority for this legal maneuvering derives from the principle of comity, discussed in greater detail below in connection with the *Maxwell* case. See *Maxwell Communication Corp. v. Societe Generale (In re Maxwell Communication Corp.)*, 93 F.3d 1036, 1047 (2<sup>nd</sup> Cir. 1996) (when debtor filed parallel reorganization proceedings in the U.S. and Great Britain, court applied comity analysis and refused to apply preference laws of the U.S. to prepetition transfers because most of the events and transactions had strong ties to Great Britain and only minimal ties to the U.S.).

## V. EXTRATERRITORIALITY OF THE BANKRUPTCY CODE

Congress has the power and authority to enforce its laws outside the territorial limits of the United States. *Equal Employment Opportunity Comm'n v. Arabian Oil Co. and Aramco Servs. Co.*, 499 U.S. 244, 111 S.Ct. 1227 (1991). However, there is a presumption against extraterritorial application of a U.S. statute, and a clear expression from Congress is required for a statute to reach nondomestic conduct. *Maxwell Communication Corp. v. Societe Generale (In re Maxwell Communication Corp.)*, 93 F.3d 1036, 1048 (2<sup>nd</sup> Cir. 1996). The difficult issue is determining whether Congress has made that "clear" expression in a given statute.

The Ninth Circuit recently addressed this issue in the bankruptcy context. In *Hong Kong and Shanghai Banking Corp., Ltd. v. Simon (In re Simon)*, 153 F.3d 991 (9<sup>th</sup> Cir. 1998), the debtor and guarantor on a corporate loan from a Hong Kong bank filed a Chapter 7 bankruptcy. The bank filed a proof of claim for an unrelated loan, but not for the guarantee. After the debtor was granted a discharge, the bank sought a declaration that the discharge and discharge injunction were effective only within the U.S., and that the bank could enforce the guarantee in Hong Kong. Both the bankruptcy and district courts determined that enforcement of the discharge injunction was *not* an extraterritorial application of a U.S. statute: Although the injunction was not directly enforceable in Hong Kong, it was enforceable in the U.S. district court through the imposition of sanctions, followed by collection efforts against the bank's assets in the U.S.

The Ninth Circuit court began its analysis by noting the presumption that "the legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States." *Id.* at 995

(quoting *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949)). With that presumption in mind, to determine Congressional intent, a court should then look to the language of the statute, similarly phrased legislation, and the overall statutory scheme. If these inquiries are inconclusive, then legislative history and administrative interpretations should be consulted. Thereafter, if congressional intent cannot be determined, the presumption against extraterritoriality of a statute will not apply where (1) the failure to extend the statute to a foreign setting will have a negative impact in the U.S.; or (2) the regulated conduct is intended to, and does, have substantial effects within the U.S.

The Court of Appeals first concluded that because the bankruptcy and district courts have exclusive in rem jurisdiction over estate property, which consists of all the debtor's property interests "wherever located," 11 U.S.C. § 541(a), the "district court properly concluded that as to actions against the bankruptcy estate, Congress clearly intended extraterritorial application of the Bankruptcy Code." *Id.* at 996. This portion of the opinion is somewhat confusing, for as noted above, according to the Circuit narrative, the lower courts determined that enforcement of the discharge injunction was *not* an extraterritorial application of a U.S. statute. The Circuit appears to have attributed to the district court both (1) a finding that the discharge injunction *did not* apply extraterritorially; and (2) a finding that the discharge injunction *did* apply extraterritorially. In any event, the *result* was that the discharge injunction enjoined the bank from pursuing collection efforts against bankruptcy estate property, regardless of its geographic location.

The court next noted that permitting a creditor to participate in a bankruptcy (by filing a proof of claim) and then disregard bankruptcy court orders would have a significant effect within the U.S., so the presumption against

extraterritorial effect did not apply. This portion of the opinion is also confusing. According to the court, the significant-effect analysis is supposed to be employed only when the statute itself is not clear, and the court had just determined that the statute *was* clear. Nevertheless, according to the court, by filing a proof of claim and participating in the bankruptcy process, the bank forfeited any right to claim that the bankruptcy court lacked the authority to issue its injunction. The bank would therefore be subject to sanctions in the bankruptcy court were it to pursue collection activity in Hong Kong, and such imposition of sanctions would not be "an *improper* extraterritorial application of United States laws." *Id.* at 997 (emphasis added).

Finally, comity did not require the court to vacate the bankruptcy court's injunction. The court distinguished *Maxwell Communication Corp. v. Societe Generale (In re Maxwell Communication Corp.)*, 93 F.3d 1036, 1050 (2<sup>nd</sup> Cir. 1996), which involved an international insolvency jointly managed by the U.S. and Great Britain. A conflict in the preference laws of those countries existed such that a different result would ensue depending on which law applied. Because the prepetition transactions occurred solely in Great Britain, the *Maxwell* court deferred to the proceedings in Great Britain in the interest of international comity. In *Simon*, by contrast, no competing bankruptcy proceedings existed in Hong Kong and no true conflict existed between the laws of the U.S. and Hong Kong. The court noted that the discharge injunction applied only to the debtor's creditors who participated in the bankruptcy, including the bank, but not to the courts in Hong Kong. The only bankruptcy was initiated in the U.S. and the bank participated without objection in that proceeding. Comity simply was not an issue.

A recent bankruptcy opinion out of Florida raises

some interesting issues regarding extraterritoriality. In *In re Iglesias*, 226 B.R. 721 (Bankr. S.D. Fla. 1998), the Chapter 7 trustee sought to have the debtor's case dismissed because the Argentine debtor's bank account at a local Florida bank was not "property in the United States." See 11 U.S.C. § 109(a) (providing in part that "only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title."). The court determined that "[t]he situs of the property is not to be determined by general doctrines which may be applicable in matters like the law of inheritance, but rather by power of efficient control." *In re Iglesias*, 226 B.R. at 723. The court held that the property was in Florida and not at the residence of the depositor, Argentina. Therefore, venue in the Southern District of Florida was appropriate.

The *Iglesias* opinion leaves one to wonder whether an involuntary petition could have been filed against the Argentine debtor. An involuntary petition under 11 U.S.C. § 303 may be filed only against a person eligible for relief under Chapter 7 or 11, and as noted above, such a debtor qualifies merely by having property in the United States. If the bank account is viewed simply as an "IOU" of the bank, does this mean that any foreign debtor is eligible for relief under the Bankruptcy Code, voluntarily or involuntarily, so long as someone in the United States owes him money? Surely the *Iglesias* holding cannot extend that far.

Two bankruptcy courts have recently ruled expansively regarding their jurisdiction over foreign parties and the extraterritorial application of the automatic stay. In *Nakash v. Zur (In re Nakash)*, 190 B.R. 763 (Bankr. S.D.N.Y. 1996), Joseph Nakash was a member of the board of directors of the North American Bank, Ltd. ("NAB"), an Israeli banking institution that was declared insolvent. This did not meet with universal acclaim, and The Official Receiver of the State of Israel (the "Receiver") obtained a

\$160 million judgment against Nakash and others in Israel as damages for negligence, breach of fiduciary duty, and fraud relating to the failure of NAB. To secure the judgment in the United States, where many of Nakash's assets were located, the Receiver obtained an attachment order from a U.S. district court.

In response to the attachment order, Nakash filed a petition for bankruptcy relief in the U.S. The Receiver appeared as a party-in-interest in the bankruptcy proceedings by filing a proof of claim, seeking to vacate an order pertaining to the automatic stay, and objecting to Nakash's discharge and claimed exemptions.

The Receiver had instituted bankruptcy proceedings in Israel against Nakash prior to the commencement of the U.S. bankruptcy. Although those proceedings were dismissed, the order of dismissal was reversed on appeal. After obtaining approval from an Israeli court, the Receiver then filed a second involuntary proceeding against Nakash in Israel without informing the U.S. court.

In the U.S. bankruptcy proceeding, Nakash requested that the court find that the Receiver violated the automatic stay by filing the Israeli bankruptcy. *See* 11 U.S.C. § 362(a) (staying actions against property of the estate); § 541(a) (defining property of the estate to encompass all interests of the debtor in property, "wherever located and by whomever held," as of the commencement of the case).

Before determining whether the automatic stay applied extraterritorially, the court had to find that it had in personam jurisdiction over the Receiver. *See Fotochrome, Inc. v. Copal Co., Ltd.*, 517 F.2d 512, 516-17 (2<sup>nd</sup> Cir. 1975) (concluding that the automatic stay does not affect a foreign arbitration proceeding against a debtor where the court had no in personam jurisdiction over the creditor who instituted

the proceeding). The *Nakash* court determined that the Receiver submitted himself to the court's in personam jurisdiction by appearing in the U.S. bankruptcy to file a proof of claim and to object to Nakash's discharge and claimed exemptions.

The bankruptcy court then determined that the Receiver had indeed violated the automatic stay, finding that bankruptcy courts have exclusive jurisdiction of all property, "wherever located," of the debtor as of the commencement of the bankruptcy case. 28 U.S.C. § 1334(e). This language supporting extraterritorial application of the stay was also supported by legislative history indicating that Congress intended the language "wherever located" to include property outside the U.S. Extraterritorial application of § 362 was also consistent with one of the purposes of the stay--to preserve the estate by preventing the occurrence of "uncoordinated proceedings against the debtor in different courts." The commencement of the Israeli bankruptcy violated the stay because it was clearly an act against the debtor Nakash and property of his bankruptcy estate.

The bankruptcy court rejected the Receiver's argument that his actions in filing the Israeli bankruptcy were taken on behalf of the State of Israel and were thus protected from review by an American court by the Act of State Doctrine, which prohibits the examination of one government's acts by the courts of another sovereign nation. Instead of acting as a sovereign, the Receiver was acting as a private creditor attempting to enforce its judgment.

Similarly, the court rejected the Receiver's argument that international comity required the court to refrain from finding a violation of the automatic stay. Any conflict that may have arisen between the Receiver's rights as a creditor under United States bankruptcy law and the Receiver's duties under Israeli law could have been avoided had the Receiver

notified the United States court prior to instituting the Israeli bankruptcy proceeding. An examiner had previously been appointed by the U.S. court to develop a protocol for harmonizing and coordinating cross border proceedings. The protocol, executed on May 23, 1996, requires the Israeli and American courts to respect each other's respective jurisdiction to the extent possible under the laws of each nation, and provides that both courts shall be consulted regarding actions to be taken outside the United States and Israel and for the courts to maintain contact in an attempt to avoid conflicting rulings. The court found that the Receiver had subverted this process by secretly instituting the Israeli bankruptcy with full knowledge of the pendency of the automatic stay in the United States.

In *Schwinn Plan Comm. v. AFS Cycle Co. Ltd. (In re Schwinn Bicycle Co.)*, 192 B.R. 461 (Bankr. N.D. Ill. 1996), Schwinn Bicycle Co. ("Schwinn"), an Illinois company, sent certain purchase orders for custom made bicycles to China Bicycles Company (Holdings) Limited ("China Bike") at China Bike's Hong Kong offices. China Bike, a long time supplier of bicycles to Schwinn, informed Schwinn that it could not accept these particular orders, but suggested that its affiliate, Regal International Development Co., Ltd. ("Regal"), could fill the orders. Apparently, Schwinn never negotiated directly with Regal; rather, Regal accepted the purchase orders forwarded to it by China Bike. Regal delivered the bicycles to Schwinn in Hong Kong for shipment to the U.S. in accordance with the "FOB Hong Kong" term of the purchase orders. Regal was paid \$3.7 million through two documentary letters of credit from an Illinois bank which were procured by Schwinn for the benefit of Regal.

Less than ninety days after Regal was paid, Schwinn filed a petition for bankruptcy relief in the U.S. Schwinn's Plan Committee filed a complaint against Regal to recover

the two payments as preferential transfers.

Regal moved to dismiss the preference action on the grounds that the bankruptcy court lacked personal jurisdiction over Regal. Regal, a Hong Kong corporation, had no offices, employees, agents, assets, records, or telephone numbers in the U.S., nor did it send any representatives to the U.S. in connection with the Schwinn purchase order. Regal claimed that it did not file a proof of claim or otherwise participate in the bankruptcy proceeding so as to submit itself to the jurisdiction of the bankruptcy court. *See International Shoe v. Washington*, 326 U.S. 310, 316, 66 S.Ct. 154, 158 (1945) (concluding that a court can constitutionally exercise in personam jurisdiction over a defendant outside the territory of the forum state if the defendant has certain minimum contacts with the forum "such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'").

The court, applying the traditional "minimum contacts" test, concluded that Regal had sufficient contacts with the U.S. to support jurisdiction. Regal sold bicycles to an American corporation knowing that the bicycles would be resold on the American consumer market. Thus, it was reasonably foreseeable that Regal might be forced to defend an action in American courts arising out of that debtor-creditor relationship. The court noted that had Schwinn not paid for the goods, Regal would have been entitled to file a claim against Schwinn in the United States bankruptcy proceeding: "A foreign company cannot enter into a major debtor-creditor commercial relationship with a United States corporation and be entitled to use advantages that our bankruptcy system provides for all creditors without submitting itself to jurisdiction when the result may be detrimental to it." *In re Schwinn Bicycle Co.*, 192 B.R. at 473.

The court did not view the "FOB Hong Kong" term in the purchase order as evidencing Regal's lack of contacts with the United States. Even though the risk for the loss of the bicycles shifted before the goods entered the U.S., the contract could not be considered as having been totally performed outside the U.S. For instance, Schwinn retained the right to reject the nonconforming bicycles upon their delivery to its place of business in the United States.

Next, the court determined that it was "fair and reasonable" to exercise personal jurisdiction over Regal. Because Regal was a large company, transacting millions of dollars per year in international commerce, it would not be unduly burdened by the prospect of overseas litigation. The U.S. bankruptcy court could most efficiently and effectively resolve the dispute. Several preference actions commenced by the Plan Committee were already pending there, and all of these actions shared the common issue of Schwinn's insolvency during the prepetition period. Finally, because the cause of action arose under U.S. bankruptcy law and was inextricably tied to the underlying bankruptcy, only a U.S. court would have subject matter jurisdiction over the preference action.

This case is somewhat odd in that the reported facts do not support a cause of action for the return of a preferential transfer because the payment was pursuant to a documentary letter of credit which did not involve the transfer of property of the debtor. A transfer of property of the debtor is a critical element of a preferential transfer under U. S. Bankruptcy law. *See, e.g., Kellogg v. Blue Quail Energy, Inc. (In re Compton Corp.)*, 831 F.2d 586, 589-90 (5th Cir. 1989) (concluding that a transfer of funds from a bank issuing a letter of credit to a creditor is not a preferential transfer because property of the estate is not transferred), *on reh'g*, 835 F.2d 584 (5th Cir. 1988). The parties in the *Schwinn* case settled their dispute prior to any adjudication of

the merits of the preference issue.

## VI. INTERNATIONAL COMITY

What is comity?

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

*Hilton v. Guyot*, 159 U.S. 113, 163-64, 16 S.Ct. 139, 143 (1895).

This general principle has since been echoed by other courts, with a recent reverberation coming from the Second Circuit:

The doctrine does not impose a limitation on the sovereign power to enact laws applicable to conduct occurring abroad. Instead, it guides our interpretation of statutes that might otherwise be read to apply to such conduct. When construing a statute, the doctrine of international comity is best understood as a guide where the issues to be resolved are entangled in international relations.

*Maxwell Communication Corp. v. Societe Generale (In re Maxwell Communication Corp.)*, 93 F.3d 1036, 1047 (2<sup>nd</sup> Cir. 1996) (citations omitted). "Absent a contrary legislative direction the doctrine may properly be used to interpret any statute." *Id.* at 1048. International comity applies only when

there is a true conflict between U.S. law and that of a foreign jurisdiction. *Id.* (citing, *inter alia*, *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 798, 113 S.Ct. 2891, 2910 (1993); *Societe Nationale Industrielle Aerospatiale v. District Court*, 482 U.S. 522, 555, 107 S.Ct. 2542, 2561-62 (1987) (Blackmun, J., dissenting)). For a recent case discussing the comity doctrine, see *In re Board of Directors of Multicanal S.A.*, 314 B.R. 486 (Bankr. S.D.N.Y. 2004) (concluding that involuntary petition filed by creditors against Argentinean corporation for failure to pay dollar-denominated debt sold on U.S. markets should be dismissed); and see *In re Board of Directors of Multicanal S.A.*, 307 B.R. 384 (Bankr. S.D.N.Y. 2004) (refusing to dismiss § 304 ancillary proceeding of Argentinean debtor even though creditors' rights under Trust Indenture Act would be impaired by application of Argentine law).

The doctrine of international comity should be distinguished from the presumption against extraterritorial application of a U.S. statute. The presumption against extraterritoriality requires a clear expression from Congress for a statute to reach nondomestic conduct. *Id.* International comity, by contrast, may apply to curtail the application of a statute that would otherwise apply to such conduct. In determining whether to refrain from exercising jurisdiction in the interest of comity, courts look to the following factors:

"[A]ll relevant factors, including, where appropriate," such factors as the link between the regulating state and the relevant activity, the connection between that state and the person responsible for the activity (or protected by the regulation), the nature of the regulated activity and its importance to the regulating state, the effect of the regulation on justified expectations, the significance of the regulation to the international system, the extent of other states' interests, and the likelihood of conflict with other

states' regulations.

*Id.* (citing RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 403(2) (1986)). The *Maxwell* court applied the above factors to the facts at hand, which were these:

The Debtor filed parallel reorganization proceedings in the U.S. and Great Britain, and the courts and trustees in each country were largely successful in producing a common system for an orderly liquidation of the debtor through a joint plan of reorganization and scheme of arrangement (the "Plan"). Certain European bank creditors that received prepetition payments from the debtor realized that they would be exposed to preference liability under the U.S. Bankruptcy Code, but not under the preference laws of Great Britain, which require intent on the part of the debtor to favor the transferee. The banks were ultimately unsuccessful in attempting to have the British court enjoin U.S. preference suits because the British judge declined to interfere with the U.S. court's determination of the reach of U.S. preference law. The British and American bankruptcy trustees thereafter filed preference suits against the banks, which the U.S. bankruptcy court dismissed based on the presumption against extraterritoriality and on the doctrine of international comity. The district court affirmed.

The Second Circuit first had to determine whether it should apply an international comity analysis. Recall that a comity analysis is appropriate only when (1) there is no legislative direction prohibiting a comity analysis; and (2) a true conflict exists between U.S. law and the law of a foreign jurisdiction. The Bankruptcy Code sections relied upon by the banks, such as §§ 103(a), 303(b)(4), and 304, were general in nature and did not prohibit an international comity analysis. Furthermore, a true conflict existed between the preference laws of U.S. and Great Britain because it was impossible to distribute the debtor's assets in a manner

consistent with both rules. A comity analysis was appropriate, therefore, so the court then addressed whether the U.S. preference statute should reach the prepetition fund transfers to the banks.

Conducting its comity analysis, the court noted that (1) the debtor and most of its creditors were British; (2) most of the debtor's debt was incurred in Great Britain; (3) the underlying loan documents for the bank debt were negotiated in Great Britain; (4) the underlying loan documents required disputes arising under such agreements to be resolved under British law; and (5) the fund transfers were largely to and from bank accounts maintained in Great Britain. The ties to the United States, by contrast, were minimal: A payment to one of the banks was routed through a U.S. bank, and some of the money transferred to the banks came from proceeds of the sale of the debtor's U.S. subsidiaries. Considering such minimal contacts, the United States did not have a significant interest in applying its avoidance law. Finally, in the interest of maintaining cooperation and harmonization between the bankruptcy systems of the two countries, the court did not want to risk the "selfish application" of its own preference laws when the ties to Great Britain were so strong.

The trustees' last argument was that, even if the transfers were not avoidable under § 547 for reasons of comity, the trustees could still deny distributions to the banks as unsecured creditors under § 502(d) of the Bankruptcy Code, which permits the court to disallow the claim of any transferee of a transfer avoidable under § 547. The court disagreed, concluding that § 547 did not apply at all because of comity, and thus there was no transfer avoidable under that section.

A bankruptcy court's reliance on *Maxwell* in support of its anti-suit injunction was misplaced, according to the Third Circuit in *Stonington Partners, Inc. v. Lernout &*

*Hauspie Speech Products N.V.*, 310 F.3d 118 (3d Cir. 2002). The debtor filed “dueling” reorganization proceedings in both the U.S. and Belgium. Conflicts arose concerning the applicable laws and jurisdiction for resolving the claims of a creditor that had sold its dictaphone company to the debtor in exchange for stock in the debtor. The creditor asserted its claims in the Belgian and U.S. proceedings, alleging fraud in connection with the debtor’s purchase of the dictaphone company. Under § 510(b) of the Bankruptcy Code, the creditor’s claims would be subordinated to the claims of general unsecured creditors, whereas under Belgian law they would not be subordinated. The Belgian court denied the debtor’s reorganization plan because of the unequal treatment (subordination) proposed for the creditor’s general unsecured claim. Frustrated, the debtor ran to the U.S. bankruptcy court, requesting a declaratory judgment that the creditor’s claims were subject to mandatory subordination under the Bankruptcy Code. The bankruptcy court granted much more: Determining that there was a “true conflict” between Belgian and U.S. law, and citing *Maxwell*, the bankruptcy court granted not only declaratory relief, but also an injunction prohibiting the creditor “from further prosecuting the issue of the priority, treatment, and classification of the [fraud] claims in Belgium under Belgian law” and directing that the claims be determined exclusively by the bankruptcy court under the Bankruptcy Code. *Id.* at 124. The district court affirmed.

The Third Circuit first determined that the bankruptcy court’s order enjoining the creditor amounted to an anti-suit injunction because “enjoining a party from resorting to a foreign court is equivalent to enjoining foreign proceedings.” *Id.* at 125. Citing serious concerns for comity, the court noted that it had previously adopted a restrictive approach to granting anti-suit injunctions: Only an evasion of the most compelling public policies of the U.S. would support the issuance of an anti-suit injunction. *Id.* at 127-28. The technical application of § 510(b) subordination to the

creditor's claims probably would not amount to such a compelling public policy, especially if the creditor was induced to take the shares through fraud as alleged.

The court distinguished *Maxwell* by noting that “there is a difference between *staying or dismissing one’s own proceedings* because of a foreign proceeding or judgment [as in *Maxwell*], and *enjoining those foreign proceedings*.” *Id.* at 130 (emphasis in original). With the following promising words, the Third Circuit remanded for a proper analysis by the bankruptcy court of whether an anti-suit injunction was appropriate under all of the facts and circumstances: “Given that our case law unequivocally directs courts to exercise restraint in enjoining foreign proceedings, we are skeptical as to whether an anti-suit injunction can be found to be appropriate in these circumstances.” *Id.* at 129, 133.

## VII. CONCLUSION

As the corporate world becomes a smaller place and multi-national cases become more and more prevalent, the use of the Bankruptcy Code to protect the interests of both debtors and creditors will become more common. Courts will not only have to accommodate foreign debtors and creditors in full and ancillary proceedings, but also deal with the sometimes diverse legislation of other countries dealing with insolvent entities. These conflicts will be both challenging and exciting for courts and practitioners.