6-1-1973

# Discrimination in Foreign Bankruptcy Laws Against Non-Domestic Claims

K. H. Nadelmann

# DISCRIMINATION IN FOREIGN BANKRUPTCY LAWS AGAINST NON-DOMESTIC CLAIMS

KURT H. NADELMANN*

In the field of international trade, when things do not go according to plan, baffling complications may arise. What goes under the name of international bankruptcies, furnishes an illustration. When a debtor with assets and creditors in more than one country becomes insolvent, however high the profession of adherence to the principle of equal treatment for all creditors, at some places in some way the local assets land in the hands of local creditors. The fact is no secret. When an English enterprise of world-renown developed financial difficulties recently, the run on assets outside the United Kingdom started promptly. Had the situation not been straightened out,[1] the world would have watched a financial as well as a legal disaster, a demonstration of the breakdown of international legal cooperation in an important field.

Thus the governments of the Six who in 1957 formed the European Economic Community used sound judgment when, in 1963, they decided to work on a bankruptcy convention which would secure effect in all states of bankruptcy adjudications made in one of them. The equal distribution of the assets located in the Market would be secured. But drafting of the Convention proved difficult. Rules on assumption of jurisdiction had to be agreed upon and problems of choice of law settled. The legal systems of the Six differ considerably. For example, the rules on voidance of preferences obtained by individual creditors after the debtor had become insolvent are not the same and agreement on which of the involved laws to apply proved impossible. An effort had to be made to unify the substantive rules, which was not found easy either. After eight years of work, the Committee of Experts which had been appointed released a draft[2] which was sent to the governments for their comments. Today the draft's future is not clear. Further work may make it acceptable to all Six,

*Research Scholar Emeritus, Harvard Law School; Member, National Bankruptcy Conference.

but the system used may not be suitable for application to the relations with one new member, the United Kingdom. Leaving aside problems arising from the great differences between the Continental and English, Scottish and Irish bankruptcy systems,[3] in the past the United Kingdom has been opposed to a single administration in all cases, insisting on a more flexible approach.[4] Through marshalling of the assets the equal treatment of all creditors can be secured also in multiple administrations.[5]

If regional work on a treaty is difficult, drafting a bankruptcy convention for international application would be still harder. The many attempts made all have failed.[6] Where, however, the substantive law is homogeneous, experience has shown success in elaboration of bilateral treaties and regional conventions.[7] More recently, from various sides the suggestion has come to work on a treaty between Canada and the United States.[8] While closer cooperation between the neighbors can be secured by better coordination of the rules on assumption of jurisdiction,[9] the possibility is certainly worth exploring.[10]

The more difficult question is how to produce more satisfactory conditions on the international level. The most serious problems arise from rules allowing local creditors to obtain more than their equal share.[11] Such rules may be open or concealed. If the local law denies effects to a foreign bankruptcy, the preference may come from lack of a proceeding to bring the local assets to equal distribution.[12] If the local law allows the foreign trustee to claim local assets, a condition may be payment of attachments or garnishments obtained before receipt of the trustee's request.[13] Straight priority rules for domestic claims continue to exist. They are found primarily in the laws of some Latin American States. Many variations exist. For example, priority may be granted to local claims when bankruptcy is declared abroad as well as at home.[14] Priority may go to branch creditors in the case of the bankruptcy of a local branch of a foreign enterprise.[15] Whether the local branch was run as a separate enterprise, may or may not make a difference. A recent development in the field requires reexamination of the entire situation.

In April 1972, Argentina enacted a new law on bankruptcy, Law No. 19.551.[16] The law provides that a bankruptcy declaration abroad is a sufficient basis for a bankruptcy declaration in Argentina. The debtor, or a creditor with a claim due in Argentina may request it.[17] In the bankruptcy in Argentina, the claims payable in Argentina will be paid first.[18] The new law makes existence of assets in Argentina a sufficient basis for assumption of bankruptcy jurisdiction.[19]

The provision previously in force[20] which goes back to the Commercial Code of 1859 for the Province of Buenos Aires[21] and today is still the law in Uruguay,[22] Paraguay,[23] and Peru,[24] says that "the bankruptcy also declared by the courts in the Republic shall not take into account the creditors belonging to the foreign bankruptcy, except if a surplus remains after payment in full of the creditors in the Republic." What is meant by creditors of the foreign bankruptcy is unclear. Presence of assets was insufficient for assumption of bankruptcy jurisdiction. The claim made on occasion[25] that the provision was taken from Massé's *Droit Commercial,* is unfounded. The treatise has no such general rule.[26] Massé cites with approval the case of a debtor with houses in London and on the Continent where the Court of Appeal in Brussels denied effect to the bankruptcy declaration in England.[27]

Turning to the provision in the new Argentine bankruptcy law, its background is no mystery. Attention needs to be given to the Montevideo Treaty system. In 1889, a South American Congress on Private International Law was held in Montevideo. Among the treaties prepared is the Treaty on International Commercial Law which has a chapter on bankruptcy.[28] For jurisdiction a distinction is made between an insolvent debtor who has independent houses in different states and other insolvent debtors. In the first case, as many bankruptcies may be declared as houses; in all other instances, the court of the debtor's commercial domicile has exclusive jurisdiction. Requests to take protective measures go to other states in which assets are located, and the bankruptcy decree is published locally. Creditors with claims payable in the state are given the right to ask for a local adjudication. The local proceeding is conducted independently. The local law produces priority for the local claims.

A controversy developed over whether the right to ask for a local bankruptcy is general or restricted to the case of independent commercial houses. The language is ambiguous and arguments can be made in both directions.[29] The source for the provision identifying claims by the place of payment is said to be a provision to the same effect in the chapter "Succession after Death" in the Treaty on International Civil Law. Assets are split territorially, claims payable in the state having to be paid out of the local assets.[30] The Treaties were ratified by Uruguay, Argentina, Paraguay, Peru, and Bolivia. Colombia acceded some time later.

To celebrate the fifty years of the Montevideo Treaty system, a Second South American Congress on Private International Law was called for 1939. Before dealing with the Congress which sat until 1940, attention

must be called to the existence in Latin America of another treaty system. In 1928, at the Sixth International Conference of American States held in Havana, the participating States (except the United States which abstained) approved the Bustamente Code on Private International Law[31] which has a chapter on bankruptcy.[32] Fifteen Latin American States have ratified the Code Convention.[33] Of the Montevideo group, only Peru has become a party. For bankruptcy the draftsmen did not follow the Montevideo system which they found unsatisfactory.[34] The Code provides for a single bankruptcy adjudication at the commercial domicile of the debtor with effect in all States. Only if the debtor has entirely different separate establishments in several States, may there be as many bankruptcies as establishments.

The Second South American Congress which convened in Montevideo in 1939, was used to bring the Treaties of 1889 up to date. Structural changes were opposed by Uruguay. The old Treaty on International Civil Procedure lacked rules on the insolvency of non-merchants. An insolvency chapter was added to the Treaty of 1940.[35] The court of the domicile of the debtor is given jurisdiction but local proceedings may be requested in any state in which assets are located. Claims payable in such a state must be paid first. Even if a local bankruptcy is declared, the priority of claims must be applied in the domiciliary proceeding.[36] This provision was not in the Argentine draft. The promoters of "priority" succeeded in getting it into the text at the session.[37] At the demand of Uruguay, over the objections of Argentina, a corresponding provision was added to the Treaty of 1940 on International Terrestrial Commercial Law.[38] Uruguay, Argentina, and Paraguay have ratified the new Treaties.[39]

The influence of the Montevideo Treaty system 1940 version on the new provision in the Argentine bankruptcy law is evident. Parties to a treaty may for their interrelations provide as they please. If a rule is made applicable generally, as in the new law, a different situation is created. A reaction may come from abroad. The Official Report on the new law does not say whether such a possibility was weighed. What the Report[40] says, is that the new provision is "adapted" to the domestic tradition; and the right to ask for a local bankruptcy on the basis of mere presence of assets is noted.[41] In their own supporting statement, the draftsmen had stressed "practical reasons" for continuation of the old system,[42] reserving their doctrinal views.[43]

In doctrine, the priority system had long been the subject of attacks.[44] Whatever the respective doctrinal merits of the theories of "unity" and

"plurality" of bankruptcy, changed economic conditions need to be taken into account. In 1859, a practical argument could be made in favor of linking local claims with local assets in the case of existence of a local establishment. Today the lack of stability of all assets makes their allocation on a fictional basis such as the place of payment of debts legally as well as economically indefensible.[45] The realities of present-day life are not taken into account. Furthermore, the trends in the direction of creation of separate legal entities have made the problem of 1859 largely academic.

But the "practical advantage" argument used by the supporters is definitely real, although it is predicated on the assumption of apathy on the part of the rest of the world. If, abroad, treatment of claims from Argentina is made subject to the "Argentina rule," the system backfires. With the windfall gone, the true merit of the system must be considered. The odds are that it will not survive the test.

Introduction into the domestic legislation of a "reciprocity" clause is recommended. Availability of a broadly phrased general clause allowing "reciprocal" treatment in all cases of discrimination of creditors abroad is desirable for a variety of reasons. Keeping a "balance" becomes possible. Aside from the immediate reasons, the possibility of other countries following the Argentine example must be contemplated. Advance notice is given. Also, pressures made for revision of the Montevideo system will be helped. The priority is in direct opposition to the considerable efforts made to create a Latin American Free Market after the European model.[46] These efforts merit support from insiders and outsiders as well. Free markets must live with the rest of the world.[47] By some, criticism of what was done in 1889 at Montevideo is considered a sacrilege. Abandonment of rules which have become dated will not affect the historic contribution made by the Montevideo Treaties of 1889 to unification of the rules of private international law. A beneficiary of the work done at Montevideo, the Hague Conference on Private International Law would not be alive today and prospering [48] had it stuck to the Mancini doctrine of the supremacy of the law of nationality which was embraced by the Conference during its first period.[49]

Giving claims from countries with priority systems parallel treatment at home, is a response whose justice cannot be questioned. The result if disliked can be terminated by abandonment of the discriminatory rule.[50] Automatic response should be provided for widely, and rules and practices in violation of the principle of equal treatment of all unsecured claims will be on the way out.

## NOTES

[1]Cf. Rolls-Royce (Purchase) Act 1971, [1971] Stat., ch. 9.

[2]The French text appeared in the volume "Les problemes internationaux de la faillite et le Marché Commun" (Cedam: Padova, 1971) containing the proceedings of a round table on the draft held in Milan in June 1971.

[3]From the standpoint of English law the draft is discussed in Hunter, The Draft Bankruptcy Convention of the European Economic Communities, 21 Int'l & Comp. L. Q. 682 (1972).

[4]See statement read at the Hague Conference of 1925 on Private International Law, reproduced in Nadelmann, Bankruptcy Treaties, 93 U. Pa. L. Rev. 58, 86 (1944), reprinted in K. H. Nadelmann, Conflict of Laws: International and Interstate 299, 328 (Nijhoff: The Hague, 1972); transl. in 10 Revista de la Escuela Nacional de Jurisprudencia (Mexico), No. 37 105 (1948).

[5]The problem is considered in Nadelmann, The Common Market Bankruptcy Convention Draft: Foreign Assets and Related Problems, in K. H. Nadelmann, Conflict of Laws, supra note 4, at 340; French version in 6 Rivista do diritto internazionale privato e processuale 501 (1970), transl. in 145 Revista Jurídica Argentina La Ley 705 (1972).

[6]For the pre-war efforts see Nadelmann, Bankruptcy Treaties, supra note 4. Efforts made by the International Law Association at the Edinburgh 1954 Conference were a complete failure. See Report of the 46th Conference 193-257; cf. Report of the 47th—Dubrovnik 1956—Conference 434-446.

[7]The treaty law is discussed in Nadelmann, Bankruptcy Treaties, supra note 4.

[8]See notably Report of the Canadian Study Committee on Bankruptcy and Insolvency Legislation 60-62 (Information Canada: Ottawa, 1970).

[9]Discussed in Honsberger, The Need for a Rapprochement of the Bankruptcy Systems of Canada and the United States 18 McGill L. J. 147 (1972).

[10]In Quebec, effect is denied to foreign bankruptcy adjudications. Osgood v. Steel, 16 Lower Can. L. J. 141 (B.R. 1872); Pacaud v. Tourigny and the Niagara District Mutual Fire Insurance Company, 10 Que. L. Rep. 54 (1884), cited with approval in Defa v. Bayless, [1964] B.R. 205, 208. In the common law Provinces, the liberal conflicts rules of the English courts are followed. See Honsberger, supra note 9, at 151. This may include though Galbraith v. Grimshaw, [1910] A.C. 508, considered in Re Universal Auto Bonders Ltd., 24 W.W.R. 600, 13 Dom. L. Rep. 2d 459 (Alta. 1958), where the House of Lords denied a Scottish trustee in bankruptcy assets garnished in England, although the garnishment was void under Scottish law and would have been voidable in the case of a bankruptcy declaration in England. See J. H. C. Morris, Conflict of Laws 348 (1971); A. E.Anton, Private International Law 442 (Edinburgh 1967).

[11]The author has dealt with the subject many times. See e.g. Nadelmann, Legal Treatment of Foreign and Domestic Creditors, 11 Law & Contemp. Probl. 696 (1946), reprinted in Selected Readings on Conflict of Laws 1073 (M. Culp. ed. 1956).

[12]See Nadelmann, Assumption of Bankruptcy Jurisdiction over non-Residents, 41 Tul. L. Rev. 75 (1966); transl. in 42 Diritto Fallimentare I 267 (1967).

[13]This is statutory law e.g. in Austria. See Nadelmann, International Bankruptcy Law: Its Present Status, 5 U. Toronto L. J. 324, 329, 18 Referees J. 104 (1944).

[14]See Nadelmann, Concurrent Bankruptcies and Creditor Equality in the Americas, 96 U. Pa. L. Rev. 171 (1947), 22 Referees J. 51 (1948); transl. in 25 Annuario di Diritto Comparato e di Studi Legislativi 105 (1950). Cf. Nadelmann, Creditor Equality in Inter-State Bankruptcies, 98 U. Pa. L. Rev. 41 (1949); transl. in 55 Revista Jurídica Argentina La Ley 1028 (1949), 2 Boletín del Instituto de Derecho Comparado de México, No. 5, 65 (1949).

[15]This rule was introduced into the Mexican Bankruptcy Law of 1943. See S. A. Bayitch & J. L. Siqueiros, Conflict of Laws: Mexico and the United States 181

(1968); Nadelmann, Once Again: Local Priorities in Bankruptcy, 38 Am. J. Int'l L. 470 (1944). Cf. Honduras Commercial Code of 1940 art. 1057-1060. And see Costa Rica Bankruptcy Act of 1901, arts. 9, 10. G. Ortiz Martin, Derecho Internacional Privado 453 (1947).

[16]Ley de concursos, B. O., May 8, 1972, [1972] Anales de Legislación Argentina, Boletín informativo No. 15. Cf. Bayitch, Inter-American Legal Developments, 4 Lawyer of the Americas 474, 478 (1972).

[17]See 1 S.A. Argeri, La Quiebra y demás procesos concursales 170, 179-80 (La Plata 1972).

[18]Art. 4(2).

[19]Art. 2(1), cl. 5. See Argeri, supra, at 140, 159.

[20]Ley de Quiebras No. 11.719 of 1933, § 7(2). See C. A. Lazcano, Derecho Internacional Privado 523 (1965); W. Goldschmidt & J. Rodrigues-Novas, American-Argentine Private International Law 80 (1960).

[21]See Almancio Alcorta, Fuentes y Concordancias del Código de Comercio § 1531 (1887).

[22]Código de Comercio, art. 1577. See E. Scarano, Tratado de la Quiebra 210 (1939).

[23]Ley de Quiebras No. 154 of Dec. 13, 1969, art. 8. See Argeri, La Nueva Ley de Quiebras de Paraguay, Jus — Revista de la Província de Buenos Aires, No. 18, 5, 17 (1971).

[24]Ley de Quiebras, No. 7.566 of 1932, art. 26(2). See 2 M. García Calderón, Repertorio de Derecho Internacional Privado 307 (1962). Furthermore, debts contracted abroad are admitted on an equal basis only to the extent to which the funds were employed in an enterprise in Peru (art. 26(3)). Cf. Costa Rica Civil Code of 1896, arts. 980, 983; Nicaragua Civil Code of 1904 arts. 2334, 2337.

[25]See 2 F. Orione, Exposición y crítica de la ley de Quiebras 323 (1935); R. Fernández, Fundamentos de la Quiebra 727 (1937).

[26]See 2 G. Massé, Le Droit Commercial dans ses Rapports avec le Droit des Gens et le Droit Civil, No. 809 (Paris 1848).

[27]No. 810, discussing Appeal Brussels, June 6, 1816, Outhwaites Freres, London and Brussels, reported in Merlin, Répertoire de Jurisprudence, *voce* Faillite, section II, ch. II, art. X, No. 2.

[28]Treaty, arts. 35-48, Actas y Tratados Celebrados por el Congreso Internacional Sud-Americano de Montevideo 842 (Montevideo 1911). Transl. in T. Esquivel Obregón, Latin-American Commercial Law 685 (1921); Ph. J. Eder, American-Colombian Private International Law 86, 89 (1956).

[29]Compare Gonzalo Ramírez, El Derecho Procesal Internacional en el Congreso Jurídico de Montevideo 61 et seq. (Montevideo 1892), with L. Segovia, El Derecho Internacional Privado y el Congreso Sudamericano de Montevideo 147 et seq. (Buenos Aires 1889). Cf. Alcorta, El Profesor Meili y el régimen de la quiebra en el Congreso Sud-Americano de Montevideo, 14 Jurisprudencia Argentina: Doctrina 66 (1924), commented on in Nadelmann, Professor Meili etc., 84 Zeitschrift des Bernischen Juristenvereins 175 (1948), transl. in 12 Boletín de la Facultad de Derecho y Ciencias Sociales de la Universidad Nacional de Córdoba (Argentina) 83 (1948). An excellent presentation of the controversy is Quintín Alfonsín, Quiebras — La Doctrina de Montevideo y los Tratados de 1889 y 1940 (Montevideo 1943).

[30]Treaty on International Civil Law, arts. 46-48, Actas y Tratados, supra note 28, at 827. See Ramírez, supra note 29, at 79. Transl. of Treaty in Eder, supra note 28, at 79, 83. See Nadelmann, Insolvent Decedents' Estates, 49 Mich. L. Rev. 1129, 1145 (1951).

[31]Text in 86 L.N.T.S. 362; 4 M. Hudson, International Legislation 2340 (1931); The International Conferences of American States 1889-1928 367 (1931).

[32]Arts. 414-422. See 3 A.S. de Bustamente y Sirvén, Derecho Internacional Privado 275 (3rd ed. 1943).

[33]Some of the ratifications have been with broad reservations. See Nadelmann,

The Need for Revision of the Bustamente Code on Private International Law, 65 Am. J. Int'l L. 782 (1971).

[34]See A. S. de Bustamente y Sirvén, La Comisión de Jurisconsultos de Río de Janeiro y el Derecho Internacional, No. 187 (Havana 1927).

[35]Text in Segundo Congreso Sudamericano de Derecho Internacional Privado, Acta Final 41 (2d ed. Montevideo 1940); transl. in 37 Am. J. Int'l. L. Supp. 116 (1943).

[36]Art. 20.

[37]For history see Videla Aranguren, El concurso civil de acreedores en el Congreso de Montevideo 1939-40, 4 Revista Argentina de Derecho Internacional 200, 342 (1941); Nadelmann, Concurrent Bankruptcies, supra note 14, at 181.

[38]Art. 48(2). Text in Segundo Congreso, supra note 35, at 61; transl. in 37 Am. J. Int'l L. Supp. 132 (1943). See Videla Aranguren, Las quiebras en el Congreso de Montevideo 1930-1940, 5 Revista Argentina de Derecho Internacional 363, 447, 450 (1942).

[39]See Pan American Union, Status of Inter-American Treaties and Conventions (Dep't of Legal Affairs 1969).

[40]Nota al Poder Ejecutivo acompañando el Proyecto de ley 19.551, reproduced in [1972] Anales de Legislacion Argentina, Boletín Informativo No. 15.

[41]Exposicion de Motivos, Pt I, Tit. I. § 9. See W. Goldschmidt, Derecho Internacional Privado 514 (1970).

[42]See Algeri, Consideraciones sobre el anteproyecto de ley de concursos mercantiles, formulado por la comisión especial en el año 1969, [1970] Jurisprudencia Argentina — Doctrina 414, 425. A group in Cordoba had urged broadening of the priority. See Kaller de Orchansky, Regimen de la quiebra extranacional, 129 Revista Jurídica Argentina La Ley 1179, 1187 (1968).

[43]Draftsmen were Carlos C. Malagarriga, Francisco Quintana Ferreira, Horacio P. Fargosi, and Hector Alegria. On the earlier priority rule Professor Malagarriga had commented: " . . . if it cannot be considered inspired by high principles of private international law, it must be respected as in defense of foreign trade and as an understandable reciprocity toward identical hostility of foreign legislations." 9 Código de Comercio Comentado, Note 41 to Art. 6 of the Bankruptcy Law of 1902 (art. 1383 of the Commercial Code)(Carlos C. Malagarriga ed. 1922).

[44]See Carlos Alberto Alcorta, Regimen internacional de la quiebra, 14 Jurisprudencia Argentina, Doctrina 130 (1924), reprinted in 2 Revista Argentina de Derecho Internacional 354 (1931); cf. 4 C. Vico, Curso de Derecho Internacional Privado 31, 34 (2d ed. 1939); Orione, Igualdad en el tratamiento de los acreedores en las quiebras internacionales, 1 Revista de la Facultad de Derecho y Ciencias de Eva Peron 79, 87 (La Plata 1954).

[45]Persons in the know suggest that, to avoid the expenses, the treaty is hardly ever applied and that matters are settled out of court.

[46]See Vieira, Le Droit International Privé dans le Dévelopment de l' Integration Latino-Americaine, 130 Hague Academy of International Law, Recueil des Cours 351, 395 (1970 II); Vieira, La Asociación latino-americana de libre comercio y el derecho privado internacional, in 2 Anuario del Instituto Hispano-Luso-Americano de Derecho Internacional 176 (1963).

[47]This aspect is considered in Nadelmann, The Common Market Bankruptcy Convention Draft: Foreign Assets and Related Problems, supra note 4, at 358.

[48]See Table, Status of Hague Conventions on Private International Law, 19 Am. J. Comp. L. 587 (1971). Cf. Nadelmann, La décima sesión y la sesión extraordinaria de la Conferencia de la Haya de Derecho Internacional Privado, 126 Revista Jurídica Argentina La Ley 897 (1967). Argentina and Brazil have since joined the Hague Conference as members.

[49]See de Winter, Nationality or Domicile?, 128 Hague Academy, Recueil des Cours 347, 378 et seq. (1969 III).

[50]Or limitation to situations where the foreign law has the same rule. See Malagarriga, supra note 43.