Discrimination in Foreign Bankruptcy Laws Against Non-Domestic Claims

K. H. Nadelmann

Follow this and additional works at: http://repository.law.miami.edu/umialr

Recommended Citation
Available at: http://repository.law.miami.edu/umialr/vol5/iss2/4

This Article is brought to you for free and open access by Institutional Repository. It has been accepted for inclusion in University of Miami Inter-American Law Review by an authorized administrator of Institutional Repository. For more information, please contact library@law.miami.edu.
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 draft² 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,

¹Research 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, in the past the United Kingdom has been opposed to a single administration in all cases, insisting on a more flexible approach. Through marshalling of the assets the equal treatment of all creditors can be secured also in multiple administrations.

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. Where, however, the substantive law is homogeneous, experience has shown success in elaboration of bilateral treaties and regional conventions. More recently, from various sides the suggestion has come to work on a treaty between Canada and the United States. While closer cooperation between the neighbors can be secured by better coordination of the rules on assumption of jurisdiction, the possibility is certainly worth exploring.

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. 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. 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. 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. Priority may go to branch creditors in the case of the bankruptcy of a local branch of a foreign enterprise. 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. 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. In the bankruptcy in Argentina, the claims payable in Argentina will be paid first. The new law makes existence of assets in Argentina a sufficient basis for assumption of bankruptcy jurisdiction.
The provision previously in force\(^\text{20}\) which goes back to the Commercial Code of 1859 for the Province of Buenos Aires\(^\text{21}\) and today is still the law in Uruguay,\(^\text{22}\) Paraguay,\(^\text{23}\) and Peru,\(^\text{24}\) 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\(^\text{25}\) that the provision was taken from Massé's *Droit Commercial*, is unfounded. The treatise has no such general rule.\(^\text{26}\) 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.\(^\text{27}\)

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.\(^\text{28}\) 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.\(^\text{29}\) 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.\(^\text{30}\) 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 which has a chapter on bankruptcy. Fifteen Latin American States have ratified the Code Convention. Of the Montevideo group, only Peru has become a party. For bankruptcy the draftsmen did not follow the Montevideo system which they found unsatisfactory. 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. 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. This provision was not in the Argentine draft. The promoters of "priority" succeeded in getting it into the text at the session. 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. Uruguay, Argentina, and Paraguay have ratified the new Treaties.

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 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. In their own supporting statement, the draftsmen had stressed "practical reasons" for continuation of the old system, reserving their doctrinal views.

In doctrine, the priority system had long been the subject of attacks. Whatever the respective doctrinal merits of the theories of "unity" and
FOREIGN BANKRUPTCY LAWS

"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. 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. These efforts merit support from insiders and outsiders as well. Free markets must live with the rest of the world. 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 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.

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. 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

2The 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.
3From 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).
7The treaty law is discussed in Nadelmann, Bankruptcy Treaties, supra note 4.
10In 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. Antan, Private International Law 442 (Edinburgh 1967).
11The 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).
12See Nadelmann, Assumption of Bankruptcy Jurisdiction over non-Residents, 41 Tul. L. Rev. 75 (1966); transl. in 42 Diritto Fallimentare I 267 (1967).
13This is statutory law e.g. in Austria. See Nadelmann, International Bankruptcy Law: Its Present Status, 5 U. Toronto L. J. 324, 329, 18 References J. 104 (1944).
15This 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.
FOREIGN BANKRUPTCY LAWS


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

18Art. 4(2).

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


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

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

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

24Ley 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.

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

26See 2 G. Massé, Le Droit Commercial dans ses Rapports avec le Droit des Gens et le Droit Civil, No. 899 (Paris 1848).


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

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


36Art. 20.

37For 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.


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

40Nota al Poder Ejecutivo acompañando el Proyecto de ley 19.551, reproduced in (1972) Anales de Legislacion Argentina, Boletin Informativo No. 15.


43Draftsmen 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).

44See 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. Viceo, 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).

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


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


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

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