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Article

***625** UNIVERSALISM AND CHOICE OF LAW

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This article discusses choice-of-law analysis in a multinational bankruptcy case [FN1] and sets forth a basic structure for such an analysis. It discusses the issues in the context of United States bankruptcy law and uses the decision in an important recent case in the United States to illustrate.

It is not unusual in multinational bankruptcy cases to see bankruptcy proceedings opened in more than one country as to the same debtor because of the need to seize the debtor's assets in each jurisdiction. Parmalat, Enron, and Dow Corning are among the best-known of many recent examples. The traditional doctrine applied in such instances was "territorialism" or "the grab rule," which contemplated that each country would seize such assets as it could and distribute them according to the local bankruptcy law. However, the modern approach is "universalism." [FN2] In its ideal form, universalism envisions a single bankruptcy proceeding in the debtor's "home country." [FN3] A single court would make a unified worldwide distribution to creditors through *626 liquidation or reorganization.

Because a pure form of universalism is not immediately achievable, many universalists have adopted "modified universalism," in which the courts seek a result in multinational cases as close as possible to a unified worldwide administration and distribution. [FN4] Although achieving a unified result is a goal limited by practical questions (like confidence in the home-country court) and the constraints of local bankruptcy law, a substantial portion of the benefits of universalism can be obtained by a best approximation. Among those benefits are a greater level of predictability in the extension of credit and a far greater likelihood of successful rescue of a business. The United States is one of the countries increasingly committed to universalism. [FN5] One of the consequences of an embrace of universalism is the need for a substantially more sophisticated understanding of choice-of-law issues. That is the subject of this article. [FN6]

In any contentious [FN7] multinational bankruptcy case the court must perform a choice-of-law analysis to determine the validity and distribution priority of each party's claims. The required choice-of-law analysis is bifurcated. The court must

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distinguish between two issues: 1) what is the value of the claim, if any; and 2) what is the priority of the claim in the distribution of the proceeds of the insolvency proceeding. The distinction is crucial because the first issue is typically governed by nonbankruptcy law, while the second is governed by bankruptcy law. [FN8] In a multinational bankruptcy, it will often be the case that one country's law will govern the existence and amount of the claim, while another legal regime will govern its priority of distribution in bankruptcy (among other issues). In a territorialist jurisdiction, the court will always choose its own bankruptcy law as to the second issue, whatever choice it makes as to the first one. In a country with a modern bankruptcy system that has adopted some form of universalism, the court may be required to *627 choose the bankruptcy law of another jurisdiction to govern distribution.

I. The Illustrative Case

The case is *Lernout & Hauspie Speech Products N.V v. Stonington Partners, Inc.* [FN9] Lernout was a company incorporated and managed in Belgium, but within the year before bankruptcy Lernout had acquired and merged with two United States companies. [FN10] The result was that more than half of Lernout's asset value was located in the United States on Bankruptcy Day. The acquisitions had been made through grants of Lernout stock, allegedly accompanied by fraudulent misrepresentations about the finances of the company. When accounting questions began to emerge, its stock collapsed and it filed two bankruptcies the same day--a Chapter 11 in the United States and a Concordat in Belgium. [FN11] The Belgian proceeding was later converted to a liquidation.

The key point in the case was a true conflict between United States and Belgian bankruptcy law with regard to the priority in payment to be given to claims for stock fraud brought by the former owners of certain of the United States companies acquired by Lernout (the Stonington claimants). The Stonington claimants alleged that they had been defrauded by the debtor when they accepted the debtor's stock in exchange for the companies they had owned. They claimed substantial damages. United States bankruptcy law subordinates such claims to all other unsecured claims, with the effect that such claims would receive *628 nothing in the Lernout proceeding. [FN12] Belgian law, by contrast, treats such claims just like all other unsecured, non-priority claims, entitled to receive pro rata distribution after priority claims had been paid. Thus the stock-fraud claimants, who were mostly United States persons, would receive nothing under United States law, but would get some distribution under Belgian law. Conversely, the other unsecured creditors would receive greatly reduced distributions if the Belgian rule were applied. It appears that most of the assets were under the de facto control of the American court.

In an unreported opinion, the bankruptcy court held that the United States subordination rule should apply to the Stonington claims worldwide and granted an injunction against re-litigation of that point in the Belgian court. The holding was affirmed by the district court on appeal. [FN13] The decision was squarely based on the bankruptcy court's choice-of-law ruling: that United States bankruptcy law controlled both bankruptcy proceedings on the issue of priority (subordination) for the stock-fraud claims. [FN14] On appeal, the Third Circuit reversed and remanded the case to the bankruptcy court for a fresh review. Although the appellate court made several important rulings, this article will confine itself to one issue: the choice of law governing the rights of the stock-fraud claimants in bankruptcy. [FN15] The appellate court found that the bankruptcy court's choice-of-law analysis was fundamentally flawed and must be reconsidered. [FN16]

On remand, the debtor presented a liquidating Chapter 11 plan, [FN17] which it

later revised, allocating the assets of the company between the United States and Belgian proceedings. [FN18] The original allocation not only had given most of the assets to the United States proceeding, but had left too little for the Belgian court to pay even priority claims. After negotiation with the Belgian curators, the plan was amended to provide more funds for the payment of the Belgian priority claims. It appears that the quid pro quo for the re-allocation may have been the silent acquiescence of the curators in the revised plan, which still gave most of *629 the assets to the United States proceeding. The bankruptcy court approved the plan. [FN19] In approving the plan, the bankruptcy court relied upon its prior ruling with regard to choice of law: United States distribution rules applied to distributions in the United States proceeding. (In light of the appellate decision, it eschewed its earlier claim that the United States rules applied worldwide.) On that basis, the court found that the Stonington claimants were entitled to no recovery from the United States bankruptcy proceeding. The District Court affirmed the bankruptcy court's approval of the liquidating plan. [FN20] The stock-fraud claimants, apparently exhausted by the struggle, did not appeal further.

The great bulk of the value of the debtor company was to be distributed under the United States plan. [FN21] In approving the plan, the bankruptcy court emphasized that any claimant was free to claim in Belgium as well, but the allocation of assets meant any non-priority claim in that proceeding would be worthless. The result was approval of a largely territorialist result. The problem with that approach, as explained above, is that the United States is substantially committed to modified universalism. Modified universalism instructs courts to interpret and apply each country's bankruptcy law so as to achieve a result as close to that of a universalist proceeding as is legally possible and practical in a given case. [FN22] The plan approved in Lernout, by contrast, is of the sort that would produce dramatically different results depending on where the assets happen to be found at the time of bankruptcy—one of the basic defects of territorialism. If, for example, the accounting questions in that case had remained unrevealed for another two or three years, the assets might well have shifted substantially away from the United States. In the dynamic, globalizing world in which we live, plants might have been thrown up quickly in South Korea or China, or manufacturing and technical support might have been outsourced to any of a number of other countries. [FN23] A lender, investor, or customer *630 would have been hard put to predict where the asset-center of the company would be at the end of even so-short a time.

II. The Choice-of-Law Method

Two of the reasons that have persuaded most American experts to favor a form of universalism in insolvency matters are the need for predictability and the related question of expectations. [FN24] Given the rapid movement of assets around the world today, no rule can provide a reasonable prediction about the results of a bankruptcy case except a universalist system applying the bankruptcy law of the center of the debtor's main interests. Such a rule is far from perfectly predictable, but it is the only rule that provides any real predictability at all.

Related to predictability is the recognition of expectations. Creditors (and others) dealing with a business should expect that a general default by the business will be dealt with under the laws of the home country of the business. To respond to that expectation a court must choose a single applicable bankruptcy law. [FN25]

In any bankruptcy case, whether purely domestic or multinational, every pre-petition claim [FN26] presents two issues that are distinct conceptually, although often hard to distinguish in the field [FN27]: first, the validity and amount of a

claim under applicable nonbankruptcy law; second, the distribution right, or priority in payment, which will apply to that claim in the distribution of the value that has been realized by the bankruptcy administration. A simple example is the claim of a person who suffered bodily injury by the debtor's act before the debtor's bankruptcy. The necessary elements of a claim in tort (delicto) will be governed by nonbankruptcy law, as will the measure of recoverable damages and any limitations upon damages. Following United States usage, the amount of the claim so calculated under nonbankruptcy law is the "allowed" amount; that is, the sum that the claimant would have been awarded in an ordinary lawsuit outside of bankruptcy. [FN28] However, the *631 amount of money to be distributed to the injured person in bankruptcy will depend upon the priority rules established by the law applicable to the debtor's bankruptcy. In a system that gives a special priority to other sorts of claims (for example, taxes and employee wages), there may be nothing left to distribute to the injured claimant. On the other hand, if a particular bankruptcy law gave priority to personal-injury claims, then the claim might be paid in full.

As it happens, United States courts, because of its federal system, have considerable experience with this problem in the context of two separate bodies of law. Generally, state law controls the allowed amount of a claim, but federal bankruptcy law governs the distribution priorities. A similar dichotomy exists as to property interests. State law is often applied in the delineation of a claimed property interest, while the effect of that property interest in bankruptcy is governed by bankruptcy law. This intersection of laws frequently arises in connection with security interests, which are governed outside of bankruptcy by state law, but carry with them enormous advantages in priority and even collateral control in a bankruptcy proceeding. [FN29] Their enforcement and priority in bankruptcy arise from the intersection of state and federal law.

Precisely the same sorts of difficulties are presented in multinational cases, because the law defining a claim or a property interest may often be the law of a different country than the law governing the bankruptcy proceeding itself. Thus, a bankruptcy court in a multinational case is required to draw a line between the nonbankruptcy law governing the existence and scope of a claim or a property interest and the bankruptcy law governing the distributional effects thereof in the bankruptcy. In choosing the law that defines the claim or property interest asserted under nonbankruptcy law and its validity vel non under that law, the *632 court should consider the usual choice-of-law factors like place of contracting, the parties' choice of law, and so forth. But as to distribution rules and other rules governing bankruptcy, it must choose the applicable bankruptcy law by focusing upon the debtor's affairs as a whole on a worldwide basis, looking to factors such as principal place of business, principal location of assets, residence of most creditors, center of financial interests, and the like.

Having established the general framework, we turn our attention to the Lernout case to carry the analysis through.

III. The Choice of Law Analysis in Lernout

The first step in a case like Lernout is much like the relatively simple one that served as our first example. The tort of stock fraud and the entitlement to damages for those defrauded—the "allowed" claim—would be governed by nonbankruptcy law, while the distribution to be made on account of the allowed claim would naturally be determined by bankruptcy law. Applying either a center of gravity theory or the traditional "place of the wrong" theory, [FN30] the applicable law of fraud might well be found in the United States. [FN31] To that point the original ruling of the lower courts applying American law seems easy to defend. [FN32] The

difficulty comes with the next question: which bankruptcy law should be applied to determine the priority in distribution of this type of claim?

In a territorialist court, the answer is simple: the court should apply its own bankruptcy law governing distribution of the assets controlled by that court. Each nation's bankruptcy court will do the same and that will be that. But for a court committed to any form of universalism, the problem is more difficult. Because the objective is to distribute the debtor's worldwide assets in a manner as close to a single, coherent distribution as possible, the universalist court must consider which bankruptcy law would apply in one global distribution.

If the debtor's principal place of business ("center of main interests" [\[FN33\]](#)) and principal assets are in the same jurisdiction, it seems *633 obvious that the bankruptcy law of that jurisdiction should be the one applied in all but the rare case. The same conclusion seems compelled where the assets are scattered among a number of jurisdictions: the principal place of business should provide the controlling bankruptcy law. The right answer may be somewhat less clear where the debtor's center of main interests and its principal assets are in different jurisdictions. That was the situation in *Lernout* because the company's American acquisitions in the year before bankruptcy had produced an asset base in the United States that exceeded its European assets. Under some circumstances and as to some issues, contacts of that sort might have supported application of United States bankruptcy law. [\[FN34\]](#)

The problem with the *Lernout* decisions is that these factors played no part whatsoever in the court's choice-of-law decision. Instead, both the bankruptcy and district courts looked to factors like the place of the wrong and the parties choice of law in their merger agreement. [\[FN35\]](#) Those choice-of-law factors would have been highly relevant to the determination of the validity and amount of the stock-fraud claim under nonbankruptcy law. If, for example, United States and Belgian law had differed in some element of the tort of fraud or in the calculation of damages, those factors would have been key. However, as to the proper bankruptcy rule—the rule of priority in distribution of a limited number of assets to general creditors of equal entitlement—those factors were largely irrelevant. As to that decision, the policy choice lay between satisfying local policies by a territorial distribution of whatever assets could be locally seized or satisfying the larger purposes of bankruptcy law by choosing a single law to govern distribution worldwide, within practical *634 constraints. Given the steady movement of United States law toward modified universalism, the single-law approach should have been adopted. In this case, that law should probably have been Belgian.

The emerging international rule in multinational bankruptcy cases focuses on the center of the debtor's main interests. Up to now, that standard has been adopted primarily as a choice-of-forum rule rather than a choice-of-law rule, but it is necessary to use it for both purposes to achieve the goals of universalism. [\[FN36\]](#) Given a company like *Lernout*, which engaged in classic Nineties-style mergers around the world, no other rule would give predictability. The center of gravity of the company's assets might shift from month to month, [\[FN37\]](#) while most creditors and other concerned parties would naturally assume that Belgian law would govern a worldwide company whose formal legal connections, management, and financial dealings were concentrated in Belgium.

Directly analogous is a Nineteenth Century case in the United States Supreme Court in which the Court enforced the terms of a Canadian reorganization plan for a Canadian company against New York bondholders, even though payment to the

bondholders was to be in New York and New York law was the proper law of the contract. It explained that the bondholders should have known that Canadian law was likely to govern the general default or insolvency of a Canadian company. [FN38] That conclusion is even more natural in the modern, globalizing world.

In Maxwell, the most important modern choice-of-law case in this area, with precisely the same sort of division of management and assets as in Lernout (principal management and financing in the United Kingdom, principal assets in the United States), it was held that the foreign bankruptcy law applied. [FN39] The picture is complicated by an equivocal opinion in the Court of Appeals and by the fact that the issue before the court in Maxwell was application of the preference power, but on the whole the case is a powerful precedent favoring application of Belgian law in Lernout. [FN40]

*635 On that basis, a court committed to a form of universalism would be wrong to approve a plan such as the one approved in Lernout. Not only was it a territorialist plan, but it denied the stock-fraud claimants the benefit of the Belgian distribution rules to which, on the above analysis, they were entitled and would reasonably have expected to see applied in the bankruptcy of a Belgian company.

IV. Procedures for Implementation

There remain some difficult questions of procedure in cases like Lernout. In the United States, as in most countries, it is unclear if distributions can be made under foreign bankruptcy rules or if local law should be understood to require that the local rules be applied to any distribution made by the local court. [FN41] That is, if a United States court finds that a foreign bankruptcy-distribution rule applies, may it distribute the proceeds of assets to creditors under the foreign rules, or is it bound by its own distribution rules unless it dismisses its own proceeding and sends the assets to the foreign court? The holding in the Maxwell case permits a United States court to keep its own avoiding powers in abeyance, but does not say whether the American court may apply the avoiding powers of another country within the confines of a United States full-bankruptcy proceeding. [FN42] The increasing use of liquidating plans in Chapter 11 cases may suggest a solution, [FN43] because such plans permit substantially more flexibility in distributions than under the Chapter 7 priority rules. [FN44] Thus a United States court might take *636 Maxwell one step farther and say that it could apply the Belgian rule in the United States proceeding. [FN45]

On the other hand, the court in a case like Lernout might decide Belgian bankruptcy law should control distribution, but might be unsure whether or not it could override the United States distribution rule in a full Chapter 11 bankruptcy proceeding. It might believe that United States law would have to be followed in making a distribution in a United States Chapter 11 proceeding, even though another bankruptcy law should be applied through choice-of-law principles. In that situation, the court may dismiss the United States bankruptcy under section 305 of the Code, and act ancillary to the foreign proceeding under section 304. [FN46] This approach will often make sense in such situations. If the bankruptcy law of the other jurisdiction is to apply, it is obviously best understood and applied by the other court. [FN47]

The excellent opinion of the Third Circuit in Lernout captured many of the essential points suggested in this article. The appellate court pointed out that the courts below had failed to consider "the nature of the respective countries' policies and the principles animating the laws, so as to determine which country actually had a stronger interest in its policies being advanced." [FN48] It went

on to say that cases such as this one require "a qualitative assessment that can only occur if there is some understanding, and explication, of the way in which the allowance, or subordination, of the claims at issue would advance or detract from each nation's policy regarding insolvency proceedings and distributions to creditors." It also related the choice-of-law decision to the need for cooperation. [\[FN49\]](#)

The court of appeals did not, however, identify a general commitment to universalism as a starting point for analysis, nor did it require the courts below to look at the case from a global perspective. Like the courts in Maxwell, it was cautious about large pronouncements, focusing its attention on the case before it, as common law courts do. Nonetheless, its analysis and conclusions were consistent with the *637 method proffered in this article and its policy concerns point in the same direction. Inherent in its instructions to the lower courts is the idea that a single bankruptcy distribution rule is to be chosen.

Particularly important is the Third Circuit's emphasis on the interests of the international system as a factor in making that choice. One important choice-of-law method in the United States is known as "interest analysis," and its basic logic greatly influences the application of other approaches, like "significant contacts." [\[FN50\]](#) Interest analysis emphasizes the importance of the common interest of the states involved in a smoothly functioning international system. [\[FN51\]](#) There could be no better conclusion for this article than the admonition of the court of appeals in Maxwell, "[i]t should be remembered that the interest of the system as a whole--that of promoting 'a friendly intercourse between the sovereignties,'--also furthers American self-interest, especially where the workings of international trade and commerce are concerned." [\[FN52\]](#)

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[\[FN1\]](#). I use the term "bankruptcy" following United States usage, meaning an insolvency-type proceeding involving a business debtor that is a legal entity. See American Law Institute, Transnational Insolvency Project, Principles of Cooperation in Transnational Insolvency Cases Among the Members of the North American Free Trade Agreement 2 (American Law Institute 2003) [hereinafter A.L.I. Principles]. Although individual bankruptcies present fascinating questions in the multinational context, they are not addressed in this article.

[\[FN2\]](#). See, e.g., Andrew T. Guzman, [International Bankruptcy: In Defense of Universalism](#), 98 Mich. L. Rev. 2177, 2179, 2181 (2000); Jay Lawrence Westbrook, [A Global Solution to Multinational Default](#), 98 Mich. L. Rev. 2276 (2000) [hereinafter Global Solution]; but see Lynn M. LoPucki, [Cooperation in International Bankruptcy: A Post-Universalist Approach](#), 84 Cornell L. Rev. 696 (1999); Frederick Tung, [Fear Of Commitment In International Bankruptcy](#), 33 Geo. Wash. Int'l L. Rev. 555 (2001).

[\[FN3\]](#). See generally, Hannah Buxbaum, [Rethinking International Insolvency: The Neglected Choice-of-Law Rules and Theory](#), 36 Stanford J. Int'l L. 23, 60 (2000) (arguing for a single jurisdiction internationally following the logic of domestic practice).

[\[FN4\]](#). See A.L.I. Principles, *supra* note 1, at 8.

[FN5]. See American Law Institute, Transnational Insolvency Project, International Statement of United States Bankruptcy Law 73-74 (2003) [hereinafter U.S. Statement].

[FN6]. For a survey of choice-of-law cases in the insolvency area, see Richard Coulson, 32 Denver J. Int'l. L. & Pol'y. 275 (2004) (review of cases noting lack of application of federal common law choice-of-law principles in this area).

[FN7]. In many multinational cases, the parties and their representatives see the need for cooperation and come to agreements that permit them to avoid resolution of difficult choice-of-law issues. These agreements are often embodied in "protocols." See A.L.I. Principles, supra note 1, at 66-67 and Appendix C (samples of protocols). Where agreement is not possible, however, these legal issues must be resolved by the courts.

[FN8]. In a unitary state, the court need only distinguish which statute governs each issue. In a federated state, one issue may be governed by regional law and the other by a national bankruptcy law.

[FN9]. [Lernout & Hauspie Speech Products N.V. v. Stonington Partners, Inc.](#), 268 B.R. 395 (D. Del. 2001) [hereinafter "Lernout I"], rev'd, 310 F.3d 118 (3d Cir. 2002) [hereinafter "Lernout II-Circuit"], on remand [In re Lernout & Hauspie Speech Products N.V.](#), 301 B.R. 651 (Bankr. D. Del. 2003) [hereinafter "Lernout III-Remand"]. To clarify, the first decision by the bankruptcy court in this litigation was unreported. Thus, this article describes as "Lernout I" the first reported opinion, the district court decision that affirmed the unreported decision of the bankruptcy court. "Lernout II-Circuit" is the reversal of that district court decision by the Court of Appeals. The further decision by the bankruptcy court on remand after the appeal is called "Lernout III-Remand." Finally, the district court decision affirming Lernout III will be called "Lernout IV-Affirmance." [In re Lernout & Hauspie Speech Products N.V.](#), 308 B.R. 672 (D. Del. 2004).

[FN10]. This statement of the facts of the case is very similar to that in a second paper about the Lernout case, Jay L. Westbrook, *The Duty to Seek Cooperation in Multinational Insolvency Cases, in Financing and Refinancing Companies in the Perspective of Insolvency: International Legal Debate* (University of Geneva, 2004) (forthcoming), available at <http://www.unige.ch/droit/insolvency-symposium2004/wp.htm> (last visited February 23, 2005), reprinted in *Annual Review of Insolvency Law, 2004* (2005) (Canada).

[FN11]. There is some confusion about the timing, but the Belgian case was filed no later than the next day. The first Concordat filing was rejected and it was refiled weeks later. The second filing was accepted, but after the court rejected the debtor's plan for payment, it was converted into a liquidation. See Lernout III-Remand. The reason for the rejection of the payment plan by the Belgian court was that the plan followed the United States rule and provided nothing for the stock-fraud claimants.

[FN12]. See [11 U.S.C. § 510\(b\) \(2000\)](#). The effect of subordination is that all prior claims must be paid in full before anything is paid to the holders of subordinated claims, meaning in most cases such claimants will receive no payment at all.

[FN13]. Lernout I, supra note 9.

[FN14]. Id. at 400.

[FN15]. The author has written a second article on Lernout, focusing on cooperation between courts. Westbrook, *supra* note 10.

[FN16]. Lernout II-Circuit, *supra* note 9, at 131.

[FN17]. The United States Bankruptcy Code permits the use of a Chapter 11 "reorganization" plan for the purposes of liquidation as well as for reorganization. [11 U.S.C. § 1123\(b\)\(4\) \(2000\)](#).

[FN18]. The allocation was justified by a rather conclusory affidavit filed by Lily Chu, an expert retained by the debtor. Lernout III-Remand, *supra* note 9, at 654-55.

[FN19]. See Lernout III-Remand, *supra* note 9, at 654.

[FN20]. See Lernout IV-Affirmance, *supra* note 9.

[FN21]. The plan's allocation did not prefer United States persons as such, but rather preferred all those who filed claims in the United States proceeding and were eligible to receive distributions under the United States bankruptcy distribution rules, regardless of their nationality or residence. In fact, the Stonington claimants included a number of United States persons. See generally Jay Lawrence Westbrook, [Choice of Avoidance Law in Global Insolvencies, 17 Brook. J. Int'l. L. 499, 513-14 \(1991\)](#) (territorialism benefits not only local creditors, but sophisticated multinationals, because in most countries the effect is to favor the local rules, but not necessarily the local creditors as such, because most countries do not formally discriminate against foreign creditors). For a summary of the plan, see Lernout III-Remand, *supra* note 9, at 654-55.

[FN22]. See Global Solution, *supra* note 2, at 2277.

[FN23]. Lernout had a substantial Korean operation. Indeed, it was there that the accounting problems first surfaced. Mark Maremont et al., How High-Tech Dream Shattered in Scandal at Lernout & Hauspie, *Wall St. J.* (December 7, 2000).

[FN24]. See Global Solution, *supra* note 2, at 2282-99. See also Guzman, *supra* note 2, at 2208.

[FN25]. To the extent that a nation's commitment is to modified universalism, this proposition is one of several that are subject to pragmatic considerations in a particular case, although such considerations should be viewed skeptically.

[FN26]. By "pre-petition claim," I mean claims that arose before the bankruptcy proceeding was opened, as opposed to claims incurred in the administration of the proceeding itself.

[FN27]. See Ian F. Fletcher, *Insolvency in Private International Law* 84 (1999); Donald T. Trautman, Jay Lawrence Westbrook & Emmanuel Gaillard, *Four Models for International Bankruptcy*, 41 *Am. J. Comp. L.* 573, 583-86 (1994).

[FN28]. [11 U.S.C. § 502\(a\) \(2000\)](#).

[FN29]. See generally, Jay Lawrence Westbrook, [The Control of Wealth in Bankruptcy, 82 Tex. L. Rev. 795 \(2004\)](#). A well-known example of the intersection of state and federal law concerning security interests is a case in the United States Supreme

Court, [Fidelity Fin. Servs. v. Fink, 522 U.S. 211 \(1998\)](#), where a security interest was properly registered under state law, and therefore would ordinarily be enforceable in federal bankruptcy court, but was subject to attack as a "preference" because it was registered during the ninety-day preference period prior to the debtor's bankruptcy. The problem was one of delay in registration after the security interest was created. State law allowed a thirty-day delay in registration of the interest, but federal preference law allowed only twenty days. The secured party had registered within the state "grace period" but outside of the federal one. The question was which law controlled and the Bankruptcy Code language was ambiguous. The details of the analysis are not important to the current discussion, but in the end the Court concluded that federal law controlled and the security interest was "avoided" (made ineffective) in the bankruptcy case. The interesting point for us is the very close overlap between the two bodies of law. A crucial part of American commercial law could be seriously crippled by incoherent distinctions in this area, yet the task of making those distinctions is by no means easy.

[FN30]. Russell J. Weintraub, *Commentary on the Conflict of Laws* §§ 346-48 (4th ed. 2000).

[FN31]. For most purposes, there is no federal law of tort in the United States, so the court would have to determine which state tort law would apply. However, in the case of fraud involving securities, there is, in effect, a federal tort law that could be applied to determine both liability and damages. E.g., Securities Exchange Act of 1934 § 10(b), [15 U.S.C. § 78j\(b\) \(2000\)](#).

[FN32]. Lernout I, *supra* note 9, at 400. That point may also be trivial, because it is likely that Belgium would give the Stonington claimants similar rights. See *supra* note 11 and accompanying text.

[FN33]. This phrase has become the international standard. See U.N. Comm'n on Int'l Trade Law, *Model Law on Cross-Border Insolvency with Guide to Enactment*, art. 2(b) (U.N. Sales No. E.99.V.3 1998); European Union Regulation on Insolvency Proceedings, *Official Journal of European Communities* 160, art. 3 § 1 (June 30, 2000); Title VIII, S. 256, H.R. 685, 104th Cong., 1st Sess. (2005) (proposed Chapter 15 of the Bankruptcy Code).

[FN34]. The location of assets may be linked to other specific factors that may affect the choice-of-law decision in a particular circumstance. In Lernout, if there had been many United States creditors that had extended credit to the American companies before the acquisition then the analysis as to the appropriate worldwide distribution rule might change. In that situation, those creditors could argue they had lent to American companies and expected American law to apply in case of general default. Indeed, in the appellate opinion in Maxwell, the court noted that the presence of many unpaid creditors of the United States subsidiaries might have changed the analysis. Maxwell Communication Corp. v. [Societe Generale \(In re Maxwell Communication Corp.\)](#), 93 F.3d 1036, 1052 (2d Cir. 1996). Thus the chosen rule might vary if the location and nature of the assets was a crucial point. However, the bankruptcy and district courts in Lernout never considered these factors at all. It is also worth emphasizing that the locus of the assets might have shifted decisively in a short time. See *supra* text accompanying note 23.

[FN35]. *Id.*

[FN36]. Jay Lawrence Westbrook, [Theory and Pragmatism in Global Insolvencies:](#)

[Choice of Law and Forum, 65 Am. Bankr. L.J. 457, 488 \(1991\).](#)

[FN37]. See supra text accompanying note 23.

[FN38]. *Canada Southern Ry. Co. v. Gebhard*, 109 U.S. 537-39 (1883).

[FN39]. *Maxwell Communication Corp. v. Societe Generale (In re Maxwell Communication Corp.)*, 170 B.R. 800 ((Bankr. S.D.N.Y. 1994), aff'd [186 B.R. 807 \(S.D.N.Y. 1994\)](#), aff'd [93 F.3d 1036 \(2d Cir.1996\)](#)).

[FN40]. There would have been a case to be made for applying United States law in Maxwell by analogy to the definition of "foreign proceedings" in subsection 101(23), which provides four bases for finding a foreign proceeding entitled to United States deference (that is, finds it to be the home country of the debtor): residence, domicile, principal place of business, and location of principal assets. With the principal assets of Lernout being in the United States, one could have argued that the application of United States bankruptcy law would be consistent with the statute, although it was equally consistent to look to the principal place of business. As noted, the court chose the principal place of business.

[FN41]. There are substantial differences in priority rules around the world despite a pattern of preference for certain creditors, like secured parties, employees, and tax authorities. See generally Ulrik Rammeskov Bang-Pedersen, [Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests](#), 73 *Am. Bankr. L.J.* 385 (1999); Jay Lawrence Westbrook, *Universal Participation in Transnational Bankruptcies*, *Making Commercial Law, Essays in Honour of Roy Goode* 419 (Ross Cranston ed., 1997); Jay Lawrence Westbrook, [Universal Priorities](#), 33 *Tex. Int'l. L.J.* 27 (1998).

[FN42]. The limited extant authority suggests that foreign avoiding powers cannot be asserted in a full United States bankruptcy. See *Choice of Avoidance Law*, supra note 21, at 564 n. 99. One wonders if that rule will prevail, given that logically it would seem such actions by a foreign trustee would not be so different from any other lawsuit "related to" a pending bankruptcy under [section 1334\(b\) of Title 28 of the U.S. Code](#) and arising under a foreign law. On the other hand, it seems reasonably clear that the United States may apply foreign bankruptcy avoiding powers within a section 304 ancillary proceeding. See *id.*

[FN43]. See Elizabeth Warren & Jay L. Westbrook, *Remembering Chapter 7*, 23- *May*, *Am. Bankr. L.J.* (2004).

[FN44]. The DIP in Lernout used the device of a liquidating plan. See supra note 9 and accompanying text.

[FN45]. The court should, of course, seek cooperation with the other courts involved regardless of the law chosen or the procedure followed. See U.N. Comm'n on Int'l Trade Law, *Model Law On Cross-Border Insolvency With Guide To Enactment*, arts. 25-26, U.N. Sales No. E.99.V.3 (1997). See generally, A.L.I. Principles, supra note 1. This author has recently written another article concerning lack of cooperation in the Lernout case. See Westbrook, supra note 10.

[FN46]. See e.g., [In re Board of Directors of Multicanal S.A.](#), 314 B.R. 486 (Bankr. S.D.N.Y. 2004).

[FN47]. In that circumstance, the court has the authority under § 304 to transfer the assets to the control of the Belgian court for distribution under Belgian law.

[11 U.S.C. § 304\(b\)\(2\) \(2000\)](#).

[FN48]. Lernout II-Circuit, supra note 9, at 131.

[FN49]. Id. at 133 (citing Maxwell). See generally, Westbrook, supra note 10.

[FN50]. See e.g., McDougal, Felix & Whitten; American Conflicts Law, 337, 340-41 (5th ed. 2001).

[FN51]. See Jay L. Westbrook, Extraterritoriality, Conflicts of Laws, and the Regulation of Transnational Business, 25 Tex. Int'l L.J. 71, 79-82 (1990) (describing systemic values in international choice-of-law).

[FN52]. [Maxwell, 93 F.3d at 1053](#) (citation omitted).

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