INTERNATIONAL INSOLVENCY INSTITUTE

Tenth Annual International Insolvency Conference

Rome, Italy

THE 2010 III GOLD MEDAL PRIZE IN INSOLVENCY STUDIES

Tax Claims in Transnational Insolvencies:
A "Revenue Rule" Approach

By

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Los Angeles

June 7-8, 2010

TAX CLAIMS IN TRANSNATIONAL INSOLVENCIES: A "REVENUE RULE" APPROACH

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INTRODUCTION

In 2000, Professor Jay Lawrence Westbrook,[1] in calling for reform in transnational insolvencies, stressed the urgency of the issue by emphasizing the globalization of business, the potential prosperity which can result from it, and the inevitable pitfalls—namely, insolvency—which also may result.[2] Indeed, Professor Westbrook's vision proved prophetic in the coming years, as the following decade brought several insolvencies of large, multinational corporations.[3] While national insolvencies are usually neatly governed by Title 11 of the United States Code,[4] when foreign assets become involved, a conflict-of-laws problem quickly arises[5], as each

[1] Professor Westbrook, a professor at the University of Texas School of Law, is "[o]ne of the nation's most distinguished scholars in the field of bankruptcy," and the author of numerous articles in this area. UT Law Faculty – Jay L Westbrook, http://www.utexas.edu/law/faculty/profile.php?id=westbro. Professor Westbrook's scholarship and support of a universalist approach to transnational insolvencies will be a core part of this article.

[2] Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2276-77 (2000) ("One important element in [globalization's] progress is the fashioning of an international system for managing the financial crises that are one of the free market's inevitable consequences."); *see also* AM. LAW INST. & INT'L INSOLVENCY INST., PRINCIPLES FOR COOPERATION IN INTERNATIONAL INSOLVENCY CASES, MANIFESTO OF AIMS AND OBJECTIVES (2006) (noting the "raised awareness internationally of the need to address the issues associated with insolvency in a cross-border context.").

[3] *See* John A. E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 VA. J. INT'L L. 935, 936 (2005) (noting United Airlines, Parmalat and Global Crossing as examples).

[4] This Title of the United States Code will hereinafter be referred to as the "Code."

[5] Pottow, *supra* note 3, at 943; AM. LAW INST., TRANSNATIONAL INSOLVENCY PROJECT: PRINCIPLES OF COOPERATION IN TRANSNATIONAL INSOLVENCY CASES AMONG MEMBERS OF THE NORTH AMERICAN FREE TRADE AGREEMENT 1 (Council Draft, Nov. 24, 1999) [hereinafter ALI Project] ("It has become apparent that traditional legal doctrines and procedures are inadequate to the task of managing a general default across national borders.").

country has its own, often very different, laws governing insolvency.[6] The "disparities in and, in some cases, conflicts between national laws have created unnecessary obstacles to the achievement of the basic economic and social goals of insolvency proceedings."[7] Despite this mess, creditors must be paid and the estate distributed. Thus, the complex problem takes shape: When a transnational company becomes insolvent, and must pay creditors in different countries using assets located in different countries, which country's bankruptcy laws and priorities should be used?[8]

Let us proceed by way of a simple example, which will be expanded upon later. ABC Corporation does business, has creditors, and owns assets in both Country X and Country Y, with substantially more assets in Country X than in Country Y. ABC Corp. then becomes insolvent. The bankruptcy laws of Country X provide for the allocation of national assets to national creditors, with only the remainder allowed to satisfy foreign creditors. Clearly, creditors in Country X would be pleased with this solution, while those in Country Y would not. The bankruptcy laws of Country Y provide for the pooling of all assets, wherever situated, with equal allocation to all similarly situated creditors. The creditors of Country Y would be pleased with this solution, but the creditors of Country X would not be, and would prefer their own bankruptcy rules to govern. This conflict-of-laws creates tension between governments, creates uncertainty for the investors in such companies, and can create administrative costs by requiring multiple proceedings in different countries. Thus, it is vital, in this age of transnational insolvencies, to have a cross-border system in place to better deal with such events.[9]

Luckily, however, this general issue has been widely discussed and debated. Universalism, chiefly espoused by Professor Westbrook, stands on the one side, and territorialism, led by Professor Lynn LoPucki,[10] on the other. Pure universalism maintains that all of a multinational corporation's assets, wherever they may be located, must be pooled together.[11] Those

[6] For the differing bankruptcy laws of various countries, see the International Insolvency Institute's website. International Insolvency Institute: Country Resources, http://www.iiiglobal.org/e-library/58.

[7] U.N. Comm'n on Int'l Trade Law, *Draft UNCITRAL Notes on cooperation, communication, and coordination in cross-border insolvency proceedings, Notes by the Secretariat,* at 12, U.N. Doc. A/CN.9/WG.V/WP.86 (Mar. 13, 2009) [hereinafter Practice Guide].

[8] Andy Soh, *Chapter 15 of the U.S. Bankruptcy Code: An Invitation to Forum Shopping?*, 16 J. BANKR. L. & PRAC. 5, art. 9 (2007) ("It is a truism to say that insolvencies or reorganizations involving large multinational conglomerates can present extremely complex international legal problems.").

[9] Westbrook, *supra* note 2.

[10] Professor Lynn M. LoPucki is a professor at the UCLA School of Law. Lynn M. LoPucki, Professors, UCLA Law, http://www.law.ucla.edu/home/index.asp?page=601.

[11] *See, e.g.,* Liza Perkins, Note, *A Defense of Pure Universalism in Cross-Border Corporate Insolvencies*, 32 N.Y.U. J. INT'L L. & POL. 787, 789 (2000) (defining the different approaches to

assets are then administered by one court, in a single proceeding, in the debtor corporation's home country, with the rulings being effective everywhere.[12] Modified universalism, an outgrowth of pure universalism, is similar to pure universalism in that the assets of the debtor, wherever situated, are pooled together and administered by one court, but allows individual countries to evaluate the fairness of that proceeding, and to open local proceedings if necessary.[13] Territorialism, on the other hand, is a "land-grab" approach, and argues that each nation should exercise control over the assets within its borders.[14] Under this approach, no foreign deference is required, as each country applies its own laws to the assets within its jurisdiction.[15] Territorialism has also sprouted a less-extreme version, known as cooperative territorialism, through which cooperation is encouraged between nations through protocols "on an as-needed basis," and some matters can be resolved by the use of "international conventions."[16]

Emerging from the debate is a clear sense of the dominance of universalism.[17] The European Union has adopted universalist rules governing the transnational insolvencies of its member nations.[18] The United Nations committee charged with dealing with this issue proposed a "Model Law" of universalist guidelines to govern transnational insolvencies.[19] Finally, the United States, in 2005, adopted the Model Law as the new Chapter 15 of the Bankruptcy Code.[20]

It would seem, at this point, that the quandary of transnational

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transnational insolvencies).

[12] *Id.* In a theme which will be expanded upon throughout the footnotes of this article, it should be noted that the actual determination of this "home country" is the subject of much dispute, and has broad ramifications regarding whether the universalist approach is tenable. This Comment, however, will not be discussing the factors used in determining the home country.

[13] John J. Chung, *The New Chapter 15 of the Bankruptcy Code: A Step Toward Erosion of National Sovereignty*, 27 NW. J. INT'L L. & BUS. 89, 96 (2006) ("Modified universalism departs from the pure universalist ideal by accepting the right of a country to refuse (under certain circumstances) to defer to another country's court."). We will see later that this adaptation of universalism creates problems. *See* Pottow, *supra* note 3, at 954 ("Taken to its extreme, then, the discretionary safety valve of modified universalism has the potential simply to 'modify' universalism back into territorialism, because a state may refuse to defer to the controlling state when its laws are different, i.e., when there is a true conflict of laws.").

[14] Chung, *supra* note 13, at 93; Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216, 2218 (2000).

[15] Chung, *supra* note 13, at 93; LoPucki, *supra* note 14, at 2218.

[16] Chung, *supra* note 13, at 96.

[17] Robert K. Rasmussen, *Where Are All the Transnational Bankruptcies? The Puzzling Case for Universalism*, 32 BROOK. J. INT'L L. 983, 983 (2007) ("Universalism is on the march. . . . [t]he tide has seemingly turned [in favor of universalism].").

[18] Council Regulation 1346/00, Insolvency Proceedings, 2000 O.J. (L160) 1 (EC) [hereinafter EU Regulation].

[19] U.N. COMM'N ON INT'L TRADE LAW, UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT, U.N. Doc. A/52/17, U.N. Sales No. E.99.V.3 (1997) [hereinafter the "Model Law"].

[20] 11 U.S.C. § 1501 (2006).

insolvencies would be settled—either a country adopts universalism, or a country adopts territorialism. However, the various approaches work well only with private law claims—meaning, those asserted by private creditors such as banks and trade creditors.[21] The approaches, which mandate acquiescence to foreign authority, do not work well with public law claims—meaning, those asserted by a foreign government, such as a tax claim.[22] Foreign public law claims have historically been denied international enforcement,[23] and that has posed a major problem for transnational insolvency scholars. Thus, this Comment addresses the following issue: How should one country handle a tax claim asserted by a foreign country in a transnational insolvency proceeding? To clarify by way of our example from above: Recall Country X and Country Y, with ABC Corporation doing business in both, and owning substantially more assets in Country X. Suppose that the laws of Country X mandate universalism, thus treating local and foreign assets similarly, and that Country X's bankruptcy priorities give a high priority to unsecured tax claims.[24] Suppose further that Country Y, highly regarded throughout the world as a rogue nation, has filed a large and dubious tax claim, which would eat up a great deal of the pooled assets available for distribution to creditors. Alternatively, suppose that Country Y isn't considered to be a rogue nation, but imposes a 90% tax on its corporations. How should the home country deal with these claims? For various reasons, countries are uncomfortable enforcing the tax claims of foreign nations.[25] Thus, although the United States bankruptcy court may be very willing to allocate local assets to a foreign lender, it will likely be less willing to pay the foreign government its tax claims.[26] It is vital that, barring an unlikely adoption by the nations of the world of substantive international bankruptcy laws, there at least must be procedural mechanisms in place to guide the United States, its corporations and its investors, on how foreign tax claims will be allocated in bankruptcy.[27]

This Comment attempts to solve this dilemma, taking into account both the goals and objectives of the bankruptcy laws, as well as the

[21] William S. Dodge, *Breaking the Public Law Taboo*, 43 HARV. INT'L L.J. 161, 161 (2002) ("It is common to find judges . . . enforcing a foreign judgment for breach of contract.").

[22] *See generally id*.

[23] *E.g.*, Barbara A. Silver, *Modernizing the Revenue Rule: The Enforcement of Foreign Tax Judgments*, 22 GA. J. INT'L & COMP. L. 609 (1992); see also *supra* Part III for an analysis of why foreign public law claims, and in particular foreign tax claims, have been denied international enforcement.

[24] This example, and thus this topic, is highly relevant to the United States, as the Code in fact does grant a priority to unsecured tax claims. 11 U.S.C. § 507(a)(8) (2006).

[25] Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27, 36 (1998) ("The rub is that foreign revenue claims have historically been denied enforcement in all U.S. courts.").

[26] Dodge, *supra* note 21.

[27] *See infra* Part IV.

traditional concerns associated with enforcing foreign tax claims. Part I provides a background to transnational insolvencies by summarizing the existing debate between "universalism" and "territorialism," and discussing the progression of the United States' law dealing with transnational insolvencies, from the old § 304 of the Code to the current Chapter 15.[28] After establishing this foundation in transnational insolvencies, Part II then discusses the existing tax priorities in bankruptcy in select nations, and illustrates our dilemma by way of example.[29] Having this background, Part III then discusses our problem.[30] It begins by detailing general problems in attempts to enforce foreign tax claims, and the policy reasons for this lack of enforcement, and proceeds to lay the groundwork for solutions.[31] Part IV then presents and analyzes four possible alternatives.

I. TRANSNATIONAL INSOLVENCIES: A BACKGROUND

A. Theories of Transnational Insolvency Proceedings

1. Introduction

Each transnational insolvency case impacts numerous interested parties.[32] There is the insolvent company. There are investors of the company, and lenders to the company. There are customers of the company, and employees of the company. There are the governments of the nations in which the company does business. There are courts in which the case is administered, and lawyers being paid to handle the case. In order to best serve the interests of the parties involved, there are competing objectives in transnational insolvencies. The central dichotomy in objectives for transnational insolvency is between rigidity, on the one hand, and flexibility, on the other hand. A rigid scheme would be one in which a system of mandatory deference to a foreign proceeding is defined ex ante, and countries are not free to alter that scheme if they don't agree with the results. A flexible scheme would be one in which regardless of any ex ante arrangement, deference is discretionary, and countries are free to use local assets to produce a favorable outcome for local creditors.[33] Bankruptcy

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[28] *See id.*

[29] *See infra* Part II.

[30] *See infra* Part III.

[31] *See id.*

[32] *See Draft Legislative Guide on Insolvency Law Report of the Secretary General,* U.N. COMM'N ON INT'L TRADE LAW, 24th Sess., U.N. Doc. A/CN.9/WG.V/WP.54 (2000) [hereinafter Model Law Legislative Guide] (discussing the interests, as well as social and political concerns, which are present in transnational insolvencies).

[33] Some authors use "rigid" and "flexible" in the opposite manner. However, in this Comment, the terms "rigid" and "flexible" will refer to the types of systems as defined here. I believe that

scholars have crafted four different approaches for the administration of transnational insolvencies, each approach dealing with the struggle between rigidity and flexibility in a unique way. As we will see, each approach has benefits and weaknesses. An understanding of rigidity and flexibility as they apply to transnational insolvencies, as well as of the policy gains and losses of rigidity and flexibility, will be essential to our later discussion of the treatment of foreign tax claims in transnational insolvencies.

2. Pure Universalism

At one extreme is pure universalism, promoting a very rigid scheme. Universalism states that the bankruptcy law to be applied should be that of the debtor's home jurisdiction.[34] All of the assets of the insolvent corporation, in whichever country they are situated, should be pooled together and administered by the court of the home country.[35] Local courts in other countries are expected, under universalism, to recognize and enforce the judgment of the home country's court.[36] A simple example can illustrate this concept. Recall Country X and Country Y, as well as ABC Corporation. Assume that both countries employ universalism, and that Country X is the undisputed home country of the debtor. All of the assets of the debtor, both from Country X and Country Y, would be pooled, and would be administered according to the laws of Country X. Thus, if Country X's bankruptcy laws recognize a high priority for employee claims, but disfavor secured lenders, then employee creditors in both countries would enjoy the benefits of this law, while secured lenders in both countries would suffer the detriment, regardless of the law of Country Y.[37] Country Y would be obligated then to recognize and enforce this administration. This is an example of cross-priority, which makes priorities governing the home country applicable to all foreign and domestic creditors.[38] While this

adhering to my proposed use of the words most accurately describes the systems that the words are used to define, and will best reduce confusion and promote consistency.

[34] John A. E. Pottow, *The Myth (and Realities) of Forum Shopping in Transnational Insolvency*, 32 BROOK. J. INT'L L. 785, 787 (2007). Of course there is much debate over the ease of determining what the debtor's "home" jurisdiction is, exactly,, and whether that question has the potential to undermine the entire premise of universalism. A detailed examination of this problem is beyond the scope of this article, but will be touched upon in discussing the benefits of territorialism. *See id*. at 792 ("Instead, [universalism] opted for COMI (Center of Main Interests) [as its "home jurisdiction"], a more fact-dependent, 'standardish' criterion.").

[35] Edward S. Adams & Jason Fincke, *Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism*, 15 COLUM. J. EUR. L. 43, 48 (2008) ("[A] single court, that of the debtor's home country, has jurisdiction over a debtor's assets, wherever located, and distributes them in accordance with the law of that country.").

[36] *Id.*

[37] Assuming universal cross-priority, as will be explained *supra* Part II.B.

[38] Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 706 (1999) (citing Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX.

example is overly simplistic, it is a valid demonstration of the ultimate goal—which has thus far proven to be unrealistic—of many universalists.[39]

Proponents of universalism point to its many perceived benefits. Universalists argue, quite correctly, that allowing for multiple bankruptcy cases in multiple jurisdictions will drain the debtor's estate.[40] While our two-country example may be simplistic, imagine the waste of resources involved in a large, multinational corporation with assets in ten countries. Having a proceeding in each country will "multiply the costs of participation and administration."[41] In order to achieve the maximum possible return for creditors and investors, universalists argue that we should allow for only one proceeding, which will minimize the costs expended.[42] Next, proponents of universalism argue that this system increases predictability.[43] Looking at a proposed investment ex ante, in a non-universalist approach, lenders will prefer to invest in countries where the (soon-to-be insolvent) corporation has the greatest asset to debt ratio, thus giving it the best chance for recovery in the event of default.[44] This will slow the growth of corporations in other countries where the ratio is skewed more toward debt, and will hinder economic growth due to the lack of availability of funds. By contrast, in a universalist regime, because lenders will know, ex ante, where a potential bankruptcy case will be administered, and that the laws of that country will apply to all of the debtor's assets, they will lend freely to all countries of the corporation, thus promoting growth.[45] Proponents of universalism thus argue that not only does their approach increase predictability, but that this predictability encourages foreign investment, and stimulates the growth of multinational corporations.[46] Investors and creditors who can forecast the asset distribution upon bankruptcy will be able to rely upon known laws to

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INT'L L.J. 27, 38 (1998) ("[A] home-country court . . . should grant national treatment, or cross-priority, to all claims falling within a defined priority category . . . without regard to nationality, residence, or other indicia of 'foreignness' . . . .")).

[39] Adams & Fincke, *supra* note 35, at 48 ("Most advocates of universalism do not advance the pure form of universalism because of the practical recognition of the enduring differences among political and economic systems, legal regimes, and court systems, as well as among enforcement of those regimes.").

[40] Adams & Fincke, *supra* note 35, at 49; Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT'L L. 1, 6-10 (1997).

[41] Adams & Fincke, *supra* note 35, at 49.

[42] Perkins, *supra* note 11, at 805-806.

[43] Chung, *supra* note 13, at 94 (stating as a benefit of universalism that it supports "overall clarity and certainty to all parties").

[44] LoPucki, *supra* note 38, at 708 ("[i]n a purely universal regime, lenders invest based only on the expected return of the project, while in a partly or fully territorial regime, lenders' incentives will be skewed to investment where the debtor's asset-to-debt ratio is the best.").

[45] *Id.*

[46] LoPucki, *supra* note 38, at 708 (bringing the universalist argument related to encouragement of foreign investment).

protect their money. Without such ability, foreign investment will be decreased, as the risk of being wiped out in a bankruptcy will make foreign investment much too risky a proposition.

Additionally, proponents of universalism argue that the potential for forum shopping will be decreased under their approach.[47] We don't want a corporation to be able to look at a map of all the countries in which the corporation has even minimal assets, and choose the country with laws most beneficial to the debtor, or most beneficial to a preferred creditor. Universalists argue that unlike territorialism, under which different laws apply to different states, and a debtor can easily move and manipulate its assets to find a "bankruptcy haven," universalism mandates a single forum with a single set of laws—thus removing the possibility of foul play in order to shop for the most pro-debtor site.[48] The problem with this argument is that the "home country" determination under universalism is a murky "Center of Main Interests" (hereinafter the "COMI"), which is fact-specific, based on standards, and can often be manipulated by forum-shopping debtors.[49] However, there are numerous ways out of this problem, and a definition of COMI could indeed be constructed as to avoid such manipulation.[50] Lastly, proponents of universalism will argue in favor of fairness. By adopting a system of universalism, all creditors who are similarly situated, no matter their nationality, will be treated the same.[51]

Thus, based on all of the aforementioned benefits, proponents of universalism believe that having one bankruptcy case, administered in the court, and using the bankruptcy laws, of the home country (however that may be determined), will best help all parties involved. However, due to its strict requirement of non-COMI countries to blindly defer to their neighboring states' courts at all times, a system of pure universalism has

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[47] This issue has sparked heated debate, and has had various law review articles written solely about it. *See generally* Pottow, *supra* note 34, at 787; Soh, *supra* note 8.

[48] Mihailis E. Diamantis, *Arbitral Contractualism in Transnational Bankruptcy*, 35 SW. U. L. REV. 327, 336-37 ("A purely territorialist regime would allow for rampant forum shopping. . . . [T]he debtor has a multiplicity of laws from which to choose.").

[49] Pottow, *supra* note 34, at 792 ("Instead, [universalism] opted for COMI (Center of Main Interests) [as its "home jurisdiction"], a more fact-dependent, 'standardish' criterion."); Diamantis, *supra* note 48, at 336-37 ("Prior to filing for bankruptcy, a debtor could manipulate the standards used to determine its home country to select the most advantageous jurisdiction."). At the margin, however, the determination of the debtor's COMI has no objective definition, and thus can be seen as a serious impediment to universalism, as the lack of a definitive home country proceeding can obstruct the goals of a predictable, rigid system.

[50] Diamantis, *supra* note 48, at 338 ("It seems preeminently possible that the universalist could construct the definition of a corporation's home country in such a way as to reduce the possibility for forum shopping."). A deeper discussion of the standards used to determine the COMI, as well as possible manipulations of it, is beyond the scope of this Comment.

[51] Westbrook, *supra* note 25, at 35 ("It seems to me that both legal and practical arguments, as well as basic notions of fairness, argue strongly in favor of national treatment by way of cross-priority for all these priorities under U.S. law.").

been viewed as idealistic, yet unrealistic, and has therefore not been adopted in the United States.[52]

3. Modified Universalism

Modified universalism, while embracing the core aspect of universalism in its preference for one main proceeding, allows for countries other than the home country to "evaluate the fairness of the home-country procedures and to protect the interests of local creditors."[53] Thus, while modified universalism accepts the premise of collection and distribution of assets worldwide, it allows for some flexibility in an otherwise rigid scheme by permitting secondary proceedings to be opened on a case-by-case basis.[54] By allowing for non-recognition of foreign judgments, modified universalism has allowed for countries to protect the interests of local creditors from detrimental foreign law.[55] Procedurally, the debtor's home country asserts jurisdiction over all of the debtor's assets worldwide, and appoints a foreign representative to administer those assets.[56] However, the representative will often need to open a secondary proceeding in the foreign country in order to administer the foreign assets, and thus the foreign court has limited discretion[57] to decide to what extent to cooperate with the foreign representative.[58] Such a system is much more readily implementable. Giving United States courts some discretion to look out for its own public policy is a much more palatable solution than blindly enforcing all foreign judgments using local assets. However, these gains come with certain downsides,[59] as the benefits of having only one proceeding are sacrificed. While some (mainly proponents of territorialism)

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[52] Diamantis, *supra* note 48, at 344 ("Most theorists believe that universalism would be more difficult to implement than territorialism.").

[53] Perkins, *supra* note 11, at 791 (quoting Maxwell Communication Corp. Plc v. Barclays Bank, 170 B.R. 800, 816 (Bankr. S.D.N.Y. 1994)).

[54] *Id.*

[55] LoPucki, *supra* note 38, at 728 ("Probably the most important advantage of modified universalism over pure universalism is the ability to refuse cooperation that would prejudice U.S. creditors."). Despite the availability to solve reciprocity problems, this has not been how modified universalism has been interpreted in the United States, as the courts have generally refused to use reciprocity by a foreign nation as a pre-requisite to enforcing that nation's laws. Cunard Steamship Co. Ltd. v. Salen Reefer Servs. AB, 773 F.2d 452, 460 (2d Cir. 1985) ("[W]hile reciprocity may be a factor to be considered, it is not required as a condition precedent to the granting of comity."). However, the potential for refusal of enforcement of foreign law, however rare that refusal may actually be, makes modified universalism more acceptable than pure universalism.

[56] LoPucki, *supra* note 38, at 726.

[57] Limited, because if the foreign proceeding is determined to be a "main" proceeding, as will be discussed *supra* Part I.B, certain actions by the court are mandatory, according to the Model Law, and Chapter 15. *See supra* Part I.C.

[58] LoPucki, *supra* note 38, at 726.

[59] LoPucki, *supra* note 38, at 728-29 (see the section entitled "Problems").

would argue that these sacrifices eviscerate all of the supposed advantages of universalism and makes it a failed approach,[60] many universalists see modified universalism as a necessary compromise, the best possible solution, and a positive move toward "the ultimate goal."[61] In spite of the compromise, "modified universalism takes a worldwide perspective, seeking solutions that come as close as possible to the ideal of a single court, single-law resolution"[62] and its overwhelming acceptance[63] has been a victory for universalists.

4. Pure Territorialism

On the other end of the spectrum, promoting extreme flexibility, lies territorialism. Territorialism, in its pure form, allows the commencement of bankruptcy proceedings in every country in which there are both assets and creditors, and, in what essentially becomes a "land grab," allows each country to distribute the assets located in that country to local creditors, often favoring local creditors.[64] By way of simple example, assume that Country X and Country Y both hold assets of ABC Corporation, with $800,000 residing in Country X, and $200,000 residing in Country Y. Creditors in Country X have claims totaling $1.6M, while creditors in Country Y, of the same class as those in Country Y, hold claims totaling $1.0M. Under territorialism, the court in Country X would "grab" the $800,000 in local assets and distribute it to local creditors, thus giving them a return of $0.50 on the dollar. The court in Country Y would be left with distributing only $200,000 to its holders of $1.0M in claims, thus giving a return of only $0.20 on the dollar. By contrast, under universalism, the $1.0M in assets would be pooled and distributed to all creditors equally, thus giving each creditor a return of just under $0.40 on the dollar.

There are several benefits to pure territorialism, although this theory seems to have fallen out of favor recently.[65] First, this approach guards

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[60] *Id.* at 728 ("In doing so, however, [modified universalism] sacrifices nearly all of the supposed advantages of universalism.").

[61] Jay Lawrence Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles, and the EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1, 9 (2002) ("Modified universalism [proposes] . . . a pragmatic development of universalism, moving toward the ultimate goal within the practical limits established by the markets and by local laws at any particular time and place.").

[62] Jay L. Westbrook, TRANSNATIONAL BANKRUPTCIES (Pre-Publication Draft), AALS Workshop on Bankruptcy, *available at* http://www.aals.org/profdev/bankruptcy/westbrook1.pdf.

[63] Rasmussen, *supra* note 17, at 983 ("Universalism is on the march. . . . [t]he tide has seemingly turned [in favor of universalism].").

[64] Perkins, *supra* note 11, at 789.

[65] *See* LoPucki, *supra* note 38, at 742 (noting that "territoriality" has developed a bad reputation, and suggesting a system of cooperative territoriality).

against potentially biased foreign courts,[66] as the flexibility permits a country to keep local assets in-state and prevent harm to its local creditors.[67] Suppose that a multinational corporation files bankruptcy in Country Y, and the laws of Country Y disadvantage creditors of Country X, while benefiting those of Country Y. The bankruptcy court of Country X will, using the flexibility of territorialism, open a local proceeding to protect these creditors, instead of subjecting them to both the unfriendly laws of the foreign country, and to the often unfamiliar and inconvenient foreign land, language, and court.[68] Second, territorialism furthers the goal of national sovereignty.[69] Bankruptcy laws, more than simply legal guidelines, define a country's policies and essence.[70] Allowing countries to be flexible and to apply national law in a situation in which deference to foreign law will defeat that country's policies regarding insolvency will promote the national sovereignty of nations over their assets and companies.[71] Third, territorialism is the simplest approach, removing the need for any cooperation with other courts or countries.[72] Fourth, its proponents argue that it, not universalism, best diminishes the risk of forum shopping.[73] Lastly, territorialists take aim at the murky COMI standard of universalism as inviting confusion and thus removing most, if not all, of the supposed benefits of universalism.[74] After all, if investors cannot determine, ex ante,

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[66] Perkins, *supra* note 11, at 790; Jonathan L. Howell, *International Insolvency Law*, 42 INT'L LAW. 113, 115 (2008) ("The territorial approach allows a domestic court to shield local creditors from biased foreign courts and suspect foreign law.").

[67] Perkins, *supra* note 11, at 789-90 ("Under a territorial regime . . . bankruptcy proceedings may be commenced in every jurisdiction . . . as local courts aim to spare local creditors the inconvenience and possible prejudice of litigating their claims in a distant court under foreign laws.").

[68] *Id.*

[69] John A. E. Pottow, *Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to "Local Interests"*, 104 MICH. L. REV. 1899, 1915 (2006).

[70] Frederick Tung, *Fear of Commitment in International Bankruptcy*, 33 GEO. WASH. INT'L L. REV. 555, 573 (2001) ("Differences in social policy embedded in states' various bankruptcy regimes are not difficult to detect."). Tung then cites priorities as an example, stating that in the United States, grain producers and fishermen enjoy priority over general creditors in certain cases, which demonstrates a distinct United States social policy which is not shared by other nations. *Id.*

[71] Pottow, *supra* note 69, at 1915 (noting as a reason to allow flexible guidelines the "application of local law for local law's sake – that is, the vindication of regulatory sovereignty that flows from the simple fact that the sovereign exercises her might to regulate bankruptcy assets.").

[72] Perkins, *supra* note 11, at 790.

[73] Diamantis, *supra* note 48, at 336-37. The biggest concern that universalists have with territorialism in the forum-shopping arena is that a debtor corporation will transfer assets on the eve of bankruptcy in order to position those assets in the most favorable country. However, territorialists respond that because 1) restrictions are in place to prevent such transfers, and 2) treaties and conventions could recover transferred assets, forum shopping has not been, and should not be, a concern in territorialism. Additionally, whereas in a universalist regime, individual states would engage in a "race to the bottom" to enact the most debtor-friendly statutes in order to attract businesses, this concern would not apply in a territorialist regime, where each state would administer the assets in its jurisdiction, no matter the COMI of the debtor. *Id.*

[74] *Id.* at 336-45 (comparing universalism to territorialism, and bringing up the COMI as a point of contention in many instances). *See also* LoPucki, *supra* note 14, (raising four questions that

where a corporation's COMI is, the predictability and encouragement of foreign investment purportedly strengthened by universalism won't be realized, and potential litigation over the COMI can remove the alleged administrative efficiency of universalism.

5. Cooperative Territorialism

However, despite benefits of territorialism, the movement has been roundly attacked for its complete lack of international cooperation,[75] and Professor LoPucki has thus championed a system known as "cooperative territoriality," which encourages some cooperation between countries, albeit in the territorialist model.[76] As in pure territorialism, each country's court would administer the assets located within that country,[77] thus preserving the ability to safeguard national law and local creditors, much like modified universalism preserves the core aspects of pure universalism. However, unlike in pure territorialism, the separate and equal proceedings would serve as bases for cooperation by the nations in a variety of matters,[78] and such cooperation would be aided by the elimination of the universalist-imposed tension of requiring one country to submit to another country's judgments.[79] In each case, parallel bankruptcy proceedings would take place in each country in which the debtor has assets, and each country would then appoint a representative.[80] If the representatives determine that the estate would be worth more combined than separate, they would then negotiate a cooperative solution to the insolvency.[81] While similar to modified universalism in its support of international cooperation, this approach starts from a territorialist base and allows for discretionary cooperation, while modified universalism starts from a universalist, mandatory base and allows for occasional discretion. Although the territorialist goals would be mildly sacrificed by encouraging cooperation, countries will still wield much

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"universalists cannot answer," with all four related to the determination of the COMI).

[75] See Howell, *supra* note 66, at 115 for a discussion of disadvantages of pure territorialism. The main argument against such an approach is that forcing numerous countries to all open their own proceedings will be "overly burdensome for the debtor and multinational creditors, result in duplicative proceedings, and unnecessarily dissipate judicial resources." *Id.*

[76] LoPucki, *supra* note 38, at 742 ("The territoriality I advocate is 'cooperative' in two senses.").

[77] *Id.* at 742-43.

[78] *Id.* at 750. Some of the kinds of cooperation hoped for by LoPucki are the establishment of procedures for replicating claims filed in any one country in all of them, the joint sale of assets, and the return of assets which have been the subject of avoidable transfers. *Id.*

[79] *Id.* ("Cooperative territoriality . . . eliminates the tension between countries by vesting each with bankruptcy power congruent with its sovereignty.").

[80] LoPucki, *supra* note 14, at 2219.

[81] *Id.* This will also keep down costs for the debtor and will be efficient, according to territorialists, as the representatives will determine the value of the estate both combined and separate, and will be able to determine whether or not efficiency will be enhanced through cooperation. *Id.*

discretion to protect their interests, and territorialists thus see their approach, rather than modified universalism, as the best compromise between pure universalism and pure territorialism.

Having discussed the essential dichotomy between universalism and territorialism, two results are clear. First, despite concerns with a universalist approach, modified universalism has become accepted by most of the world,[82] and its benefits are deemed to outweigh its weaknesses.[83] Second, it is clear that in the attempt to craft a solution to this struggle, proponents of both sides have agreed that an extreme view is not realistic—both universalists and territorialists now espouse the "modified" version of their theories in the hopes of finding acceptance.[84] Thus, there will often be a need for more than one proceeding,[85] and the procedural issues implicated will be discussed in the next subpart.

B. Procedural Aspects of Transnational Insolvencies

To understand the next subpart, which discusses the legal evolution of universalism, it is important to briefly explain two procedural aspects. First, there is a fundamental difference between a foreign "main" proceeding, which takes place in the COMI of the debtor, and a foreign "non-main" proceeding, which does not take place in the debtor's COMI. Much of the legislation which will be discussed shortly, which purports to adopt modified universalism, mandates deference to the foreign proceeding

[82] *See* EU Regulation, *supra* note 18; Model Law, *supra* note 19; 11 U.S.C. § 1501 (all examples of legislation, or model legislation, supporting a modified universalist approach).

[83] See Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 464-66 (1991), arguing that despite some disadvantages of universalist principles, such as possible harm to local creditors, two plausible arguments support a universalist approach. First is the idea of the "rough wash." This argument states that a "universalist rule will roughly even out benefits and losses for local creditors, who will gain enough from foreign deference to the local forum in one case to balance any loss from local deference to the foreign forum in another." The other argument is the "transactional gain." This argument, going beyond the "zero net gain or loss" argument of the rough wash, states that the "increased predictability of the results of default would significantly reduce the costs of borrowing and other credit for multinationals. . . . [and this] would benefit the local citizens of any given country far more than any net loss they might suffer in particular defaults." *Id.* However, as discussed earlier, the benefits of universalism can be best realized if there is a clear COMI. Without this, there can be predictability concerns over the debtor's COMI, as there is no determinative way to assess this at the margin.

[84] ALI Project, *supra* note 5, at 11 ("Modified universalism is universalism tempered by a sense of what is practical at the current stage of international legal development, while modified territorialism represents a movement away from territorialism in recognition of the increasing integration of the world economy.").

[85] Whether in modified universalism, in which sometimes countries will open a proceeding aside from the main proceeding in the COMI, or in cooperative territorialism, in which each country opens its own proceedings.

only when that proceeding is a foreign "main" proceeding.[86] A foreign "non-main" proceeding is not mandated deference, and thus can undermine a universalist regime through non-recognition and the grabbing of local assets.[87] Thus, a determination of the debtor's COMI is essential, and its potential difficulty to assess is central to universalism's critics' arguments.[88]

Second, once a foreign "main" proceeding is recognized, there are two types of "secondary" proceeding that another country can open. The first type is where there are main and ancillary proceedings. The "main" proceeding, in the COMI of the debtor, will administer most of the case.[89] However, if there are assets in other jurisdictions which need to be administered, "ancillary" proceedings can be opened in other countries, which do not administer a full case, but simply deal with one (or some) aspects of the case.[90] This procedural approach is consistent with modified universalism, as the countries defer to most of the decisions of the main proceeding, with only certain aspects being administered through an ancillary proceeding.[91] On the other hand, there can be parallel cases, in which local cases are filed "in more than one jurisdiction and an effort is made to administer the two local cases in harmony."[92] While parallel proceedings could occur in a modified universalist regime, they are more consistent with a cooperative territorialist approach,[93] as neither side is called either "main" or "ancillary," thus safeguarding the integrity of local law and national sovereignty. The countries administering the parallel proceedings would attempt to enter into protocols "reflecting an agreed cooperative approach to the administration of the two cases."[94]

With this background of (1) theoretical approaches to administering transnational insolvencies, (2) the policy concerns underlying these approaches, and (3) the procedural mechanisms available to actually administer the case, we can delve beyond this elementary level and attempt

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[86] *See* 11 U.S.C. § 1520.

[87] 11 U.S.C. § 1521. A non-main proceeding, however, can be given deference through judicial discretion.

[88] *See supra* notes 49 and 50 (discussing the potential of litigation regarding the COMI to negate the benefits of universalism); *see also infra* note 170 (discussing the *Bear Stearns* litigation over the COMI).

[89] ALI Project, *supra* note 5, at 11.

[90] *Id.* In the United States, Chapter 15 grants foreign debtors the right to open an ancillary proceeding in the United States to cooperate with the main proceeding in a foreign home country. U.S. Courts | Bankruptcy | Basics, http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter15.htm.

[91] ALI Project, *supra* note 5, at 13.

[92] John A. Barrett, ET AL., *Risks and Problems of Forum Selection in a Cross Border Insolvency Case*, 2009 NORTON ANN. REV. OF INT'L INSOLVENCY 4.

[93] ALI Project, *supra* note 5 at 13.

[94] *Id.*; Barrett, *supra* note 92.

to see how the law has actually dealt with this, and also attempt to devise a solution to the problem with taxation.[95]

C. Evolution of Transnational Insolvency Law

1. Pre-Bankruptcy Code — "Comity"

> 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.[96]

Such is the Supreme Court's definition of "comity," which, before the enactment of the 1978 Bankruptcy Code, was the standard upon which transnational insolvencies were decided in the United States.[97] Unfortunately, as the Court's definition of "comity" shows, there are no hard standards for when to defer to another country. The standard simply "allows" for recognition, after an accounting for by the United States court of various duties, obligations, and rights.[98] Thus, comity is sometimes "in the eye of the beholder,"[99] is no longer the legal standard,[100] and, due to the obvious deficiencies in ex ante predictability, is hardly a rigid standard and has been discarded in favor of statutes.

2. Section 304 — "Official" Comity

In 1978, with the adoption of the Bankruptcy Code, the legislature codified the principle of "comity" in § 304, which has since been repealed. The legislative history of § 304 shows an intent to provide the court with maximum flexibility, which ultimately led to its repeal, as the appropriate balance between flexibility and rigidity was not struck. Congress noted

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[95] Rasmussen, *supra* note 17, at 987 ("Stated somewhat simplistically, universalism seeks cooperation through ex ante commitments whereas cooperative territorialism seeks cooperation on an ex post basis."). This discussion of universalism, territorialism, and the type of commitment needed—especially the difference between ex ante and ex post commitments—will provide guidance when analyzing solutions for tax problems.

[96] Hilton v. Guyot, 159 U.S. 113, 164 (1895).

[97] Barrett, *supra* note 92.

[98] *Id.* ("[T]he understanding of . . . [comity] might differ greatly from judge to judge.").

[99] Quaak v. Klynveld Peat Marwick Goerdeler Bedrijfsrevisoren, 361 F.3d 11, 19 (1st Cir. 2004) ("And to complicate matters, comity, like beauty, sometimes is in the eye of the beholder.").

[100] See *infra* Part I.C.6 in discussion of Chapter 15.

that "[p]rinciples of international comity and respect for the judgments and laws of other nations suggest that the court be permitted to make the appropriate orders under all of the circumstances of each case . . . ."[101] Section 304(a) allowed "a case ancillary to a foreign proceeding" to be filed in the United States by a foreign representative of an insolvent multinational corporation with assets both in the United States and in another country.[102] The court would then, under § 304(b), have broad power to act with regard to local property of the debtor, including the power to enjoin the commencement of actions or judgments against the debtor, order turnover of the property to the foreign representative, or take other necessary action.[103] This was ostensibly a victory for universalism, as the enactment of § 304 finally gave a foreign representative statutory authority to open an ancillary proceeding in the United States, and finally gave United States courts statutory guidelines on appropriate relief in such cases.[104] However, the power given in subsections (a) and (b) was made discretionary in § 304(c), as relief was not automatic—rather, the governing court had to decide whether relief was appropriate based on six

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[101] In re Toga Mfg., Ltd., 28 B.R. 165 (Bankr. E.D. Mich. 1983) (quoting 125 H.Rep. No. 95-595, 95th Cong., 1st Sess. 324-325 (1977); S.Rep. No. 95-989, 95th Cong., 2d Sess. 35 (1978)).

[102] 11 U.S.C. § 304(a) (repealed in 2005). The full text of the repealed § 304 is as follows:

(a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.

(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may –

(1) enjoin the commencement or continuation of –

(A) any action against –

(i) a debtor with respect to property involved in such foreign proceeding; or

(ii) such property; or

(B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;

(2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or

(3) order other appropriate relief.

(c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with –

(1) just treatment of all holders of claims against or interests in such estate;

(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;

(3) prevention of preferential or fraudulent dispositions of property of such estate;

(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;

(5) comity; and

(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

[103] 11 U.S.C. § 304(b).

[104] Howell, *supra* note 66, at 119-20.

murky standards, one of which was comity.[105] Thus, despite the attempt to "provide a clearer role for the U.S. bankruptcy courts in cross-border insolvencies,"[106] and to increase predictability for foreign representatives, the enactment of the Bankruptcy Code, notwithstanding its codification of what had previously simply been case law, continued to promote unpredictable, and often inconsistent, results.[107] While trying to promote a universalist regime by ostensibly recognizing foreign proceedings, courts were actually free to implement whatever type of scheme they preferred.[108] Courts with more universalist leanings could choose to rely on § 304(c)(1) or § 304(c)(5), which support the need for "just treatment of creditors" and of "comity,"[109] while those courts with more internal-looking, territorialist leanings could base a refusal to recognize a foreign proceeding on § 304(c)(2) or § 304(c)(4), which allow for judicial action to "protect" local creditors from "prejudice or inconvenience in the processing of claims in such foreign proceeding," and to distribute proceeds in accordance with the rest of Title 11, which foreign courts are unlikely to do.[110] Thus, despite the recognition by courts that "comity" was the most important factor of § 304(c),[111] and that the law was designed to promote such comity and cooperation, and to be a universalist approach, the results often did not reflect that understanding.

Let us briefly analyze some of the inconsistent results which were triggered by this failed attempt at universalism.[112] In *In re Toga Manufacturing, Limited*, the United States bankruptcy court refused to

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[105] Neil Desai, *How Insolvent Multinational Businesses Should Adjust to Congress' Creation of Chapter 15*, 7 HOUS. BUS. & TAX L.J. 138, 149 (2006) ("[B]ankruptcy courts 'define[d] the limits of their own power under § 304 . . . .' This judicial autonomy produced inconsistent and unfair results.").

[106] Paul L. Lee, *Ancillary Proceedings Under Section 304 and Proposed Chapter 15 of the Bankruptcy Code*, 76 AM. BANKR. L.J. 115, 115 (2002).

[107] Desai, *supra* note 105, at 148 ("[F]oreign representatives incurred unpredictability and failure, at times, when trying to reach a debtor's assets in the United States.").

[108] Howell, *supra* note 66, at 120.

[109] 11 U.S.C. § 304(c)(1), (5).

[110] *Id.*; Howell, *supra* note 66, at 120 ("Accordingly, courts that were reluctant to break with a territorial approach denied relief . . . [l]ikewise, courts that favored a universal approach would grant relief . . . .").

[111] In re Gee, 53 B.R. 891, 901 (Bankr. S.D.N.Y. 1985) ("Although comity is only one of six factors to be considered in determining whether to grant relief, it often will be the most significant, as here, where it serves as the crux of debtor's argument.").

[112] Kevin J. Beckering, *United States Cross-Border Corporate Insolvency: The Impact of Chapter 15 on Comity and the New Legal Environment*, 14 L. & BUS. REV. AM. 281, 292 (2008) ("Several cases of note . . . demonstrate the confusion and uncertainty of courts in balancing the factors specified under this statute."); *see also* Howell, *supra* note 66, at 120-23 (a discussion of cases showing the inconsistency of § 304); Hon. Allan L. Gropper, *Current Developments in International Insolvency Law: A United States Perspective*, 896 PLI/COMM 337, 358 (analyzing cases decided under § 304).

recognize a Canadian proceeding.[113] In stating that it must "protect United States citizens' claims against foreign judgments inconsistent with this country's well-defined and accepted policies," the court dispensed with the notion of international comity and refused to recognize the Canadian proceeding, simply because a United States creditor would have a lower priority under Canadian laws than it would under United States laws.[114] This case is a clear example of the ex post flexibility of § 304 taking precedence over goals of ex ante predictability. Another early case demonstrating the potential for territorialist outcomes under § 304, despite the legislative history supporting comity, is *Interpool Limited v. Certain Freights of the M/V Venture Star*,[115] in which the United States bankruptcy court refused to recognize an Australian bankruptcy proceeding, due to differences in law between the two countries.[116] Perhaps, though, the most egregious hijacking of the stated purpose of § 304 occurred in *Bank of New York v. Treco (In re Treco)*.[117] In *Treco*, the Second Circuit failed to recognize a foreign Bahamian proceeding due to differences between the laws of the two nations which would render the proceeding inconsistent with the provisions of the United States Code.[118] Interestingly, the court specifically promoted the need for comity and cooperation in *other* cases, and the importance of recognizing foreign proceedings in *other* cases, even agreeing that § 304 would, in most cases, "support the granting of the requested relief."[119] This, however, highlights the problem with § 304—it was too flexible—courts had a "blank check"[120] to wax eloquent about the importance of comity, yet construe some reason why their case was the "rare" exception. There were also cases under § 304 which came out the other way. In *In re Gee*, a United States bankruptcy court granted recognition of a Cayman Islands proceeding under § 304, admitting that the laws in the two countries were not carbon copies, but that the standard was simply that the conflicting laws "must be of a nature that it is not repugnant to the American laws and policies."[121] Additionally, in *In re*

[113] 28 B.R. 165 (Bankr. E.D. Mich. 1983).
[114] *Id.* at 170.
[115] 102 B.R. 373 (D.N.J. 1988).
[116] *Id.* at 380 ("Both the laws and the public policy of the United States will be violated if the case is permitted to proceed under Australian law. The claims of the creditors may have already been prejudiced . . . and this Court does not intend to stand idly by while United States' citizens and creditors are harmed.").
[117] 240 F.3d 148 (2d Cir. 2001).
[118] *Id.* at 151.
[119] *Id.* at 161.
[120] In re Culmer, 25 B.R. 621, 624 (Bankr. S.D.N.Y. 1982).
[121] In re Gee, 53 B.R. 891, 904 (Bankr. S.D.N.Y. 1985) ("[T]his court finds it appropriate to grant relief under section 304 in an effort to best assure an economical and expeditious administration of Universal's estate. It is not necessary that the [Cayman Islands law] be a carbon copy of the Bankruptcy Code; rather, it must be . . . not repugnant to the American laws and policies . . . .").

Cunard Steamship Company,[122] the Second Circuit applied a universalist approach to § 304 and granted comity and recognition to a Swedish court.[123] However, despite the occasional leaning of a United States court toward universalism under § 304, it is clear that the courts had a great deal of flexibility to analyze the § 304(c) factors, which often led to inconsistent decisions based on the court's view of public policy, or the court's ideas on comity.[124]

The lesson to be taken from § 304 is that while some flexibility is necessary to protect local interests and guard against gross injustice, too much discretion and flexibility in any regime will ultimately lead to the downfall, or repeal, of any legislation. As is colloquially stated, the exception (non-recognition) will swallow the rule, and the rule (recognition) will no longer apply. As we later analyze how to deal with foreign tax claims,[125] which is a sticky arena on many grounds, it is imperative to remember § 304, and to understand that although some flexibility is needed in a tense subject such as foreign taxes, too much flexibility will ultimately render the underlying law toothless, and will leave us back where we began.

3. UNCITRAL and the Model Law

The need for greater cooperation and unity, as opposed to isolationist territorialist policies, in administering transnational insolvencies led the United Nations Committee on International Trade Law ("UNCITRAL") to undertake a project to harmonize the procedural aspects of transnational bankruptcies.[126] UNCITRAL, in 1997, unveiled its Model Law on Cross-Border Insolvency (the "Model Law"), which was drafted as a recommendation to countries in the hope that it would be adopted.[127] The Model Law is purely procedural in nature, allowing countries to keep their

[122] 773 F.2d 452 (2d Cir. 1985).

[123] *Id.* at 459 ("[T]he facts amply support the district court's conclusion that the public policy of the United States would be best served by recognizing the Swedish proceedings.").

[124] See all preceding cases, and others discussed in the articles cited at *supra* note 112.

[125] *Supra* Part IV.

[126] *See* U.N. COMM'N ON INT'L TRADE LAW WORKING GROUP ON INSOLVENCY LAW, U.N. Doc. A/CN.9/WG.V/WP.47 (Nov. 21, 1996), *available at* http://www.cnudmi.org/pdf/english/workinggroups/wg_il/wp-47.pdf ("[T]he Commission should . . . have the . . . goal of facilitating judicial cooperation in insolvency matters, providing court access to foreign insolvency administrators and establishing rules for recognition of foreign insolvency proceedings."). As noted, the Project was intended to harmonize only procedural, and not substantive laws. Jenny Clift, *The UNCITRAL Model Law on Cross-Border Insolvency – A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency*, 12 TUL. J. INT'L & COMP. L. 307, 311 (2004).

[127] Andre J. Berends, *The UNCITRAL Model Law on Cross-Border Insolvency: A Comprehensive Overview*, 6 TUL. J. INT'L & COMP. L. 309, 320 (1998).

substantive laws of insolvency, but requiring them to allow foreign representatives of debtors to access those laws.[128] The Model Law contains in its preamble five specific goals,[129] all of which support a modified universalist approach, and do not discriminatorily consider local interests nor do they show preference for national law.[130] Substantively, the Model Law aims to allow a foreign representative of a debtor to access the court system of another state through an ancillary proceeding, and to apply for recognition of the foreign proceeding in that state.[131] The court must then quickly decide[132] whether to recognize the foreign proceeding as a foreign "main" proceeding, in which case the recognition triggers automatic effects, or a foreign "non-main" proceeding, which does not trigger automatic relief, but allows for discretionary relief[133] by the court.[134]

While a line-by-line examination of the substantive measures of the Model Law is beyond the scope of this work and ultimately unnecessary for our discussion, a quick glance at some of the ways in which the Model Law furthered the goal of universalism beyond the rudimentary approach of § 304 is helpful. First, the automatic relief granted by the Model Law upon recognition of a foreign "main" proceeding (and later by Chapter 15, which adopted the Model Law into the United States Code) promoted a much more rigid approach than did § 304,[135] which, as noted above, was entirely

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[128] Matthew T. Cronin, Note, *UNCITRAL Model Law on Cross-Border Insolvency: Procedural Approach to a Substantive Problem*, 24 J. CORP. L. 709, 710 (1998).

[129] *Id.*

[130] Model Law, *supra* note 19, at Preamble. The objectives are (1) "cooperation between the courts . . . of [the enacting] State and foreign States involved in cases of cross-border insolvency," (2) "greater legal certainty for trade and investment," (3) "fair and efficient administration . . . that protects the interests of all . . . interested persons," (4) "protection and maximization of the value of the debtor's assets," and (5) "facilitation of the rescue of financially troubled businesses . . . ." *Id.*

[131] *Id.* at art. 9.

[132] Berends, *supra* note 127, at 321 (1998) ("The general idea behind the Model Law is . . . speed, speed, and more speed. . . . [t]o put it bluntly: act first, think later.").

[133] While the Model Law, and Chapter 15, which adopted the Model Law, promote universalist goals by requiring recognition of a foreign main proceeding, there is still discretion available to the court when deciding whether to recognize a foreign non-main proceeding. Model Law, *supra* note 19, at art. 21 § 3 ("In granting relief under this article to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under the law of this State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding."). Thus, some elements of judicial discretion clearly remain, and the Model Law does not abrogate every iota of judicial discretion. However, despite this shortcoming, the Model Law is clearly a giant step forward from § 304 in that it mandates certain measures of relief to a foreign main proceeding, and thus promotes universalist goals, which § 304 did not.

[134] Model Law, *supra* note 19, at arts. 17, 20, and 21. Notice that Article 17 of the Model Law *requires* recognition if certain elements are met, unlike the discretionary scheme under § 304.

[135] Howard Seife, *New Chapter 15 to Replace Section 304, in* Pratt's Guide to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 151 (2005) *available at* http://www.chadbourne.com/files/Publication/24a899a3-6837-4d8d-979f-cef4d72fb584/Presentation/PublicationAttachment/d5f51bf9-b823-46fa-a31a-d0319261e91e/PrattsBankruptcy05-Seife.pdf ("Unlike under Section 304, a court will not have to consider the so-called Section 304(c) factors (e.g., comity, prejudice) in determining whether to grant

discretionary and allowed the court to consider numerous factors.[136] The local court may only decline to grant the mandatory relief if the "public policy exception" of Article 6 of the Model Law is implicated, which allows the enacting state to decline relief if it would be "manifestly contrary" to the public policy of the state.[137] This idea will be discussed later, but should only apply in rare circumstances, and thus provides substantially less flexibility for local courts to protect local creditors than did § 304.[138] Furthermore, Article 8 of the Model Law, entitled "Interpretation," stipulates that when interpreting the Model Law, regard should be had toward its "international origin" and the need to "promote uniformity in its application and the observance of good faith."[139] This is a clear nod toward universalism, and an obvious step forward from § 304, which set universalist ideals and territorialist ideals on equal footing.

In sum, the Model Law, due to the mandatory recognition required of its adopting countries, contains a far more rigid approach than did § 304. However, in an effort to slightly balance the framework, and provide a more flexible and implementable legislation,[140] the public policy clause was inserted, and remains a danger and a possible pitfall for the legislation.[141] "[I]t remains unclear how often and to what extent courts would utilize this escape hatch to retain control of a case or fail to abide by the terms of the Model Law."[142] Thus, in assessing the furtherance of universalist policy in the Model Law over § 304, the more rigid, mandatory nature of the Model Law was widely viewed as better promoting cooperation and predictability, and has thus far survived, and has been enacted by numerous nations.[143] In later crafting a solution to the problem of foreign tax claims, the dominance and acceptance of this rigid scheme, tempered by a public-policy exception, will lead the discussion.

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relief . . . .").

[136] Soh, *supra* note 8, at art. 9; Cronin, *supra* note 128, at 713 ("The Model Law fair, quick, and predictable access to the enacting State's laws by *requiring* a court to recognize a foreign proceeding . . . .") (emphasis in original). Discretion is present, however, when the foreign proceeding is not recognized as a foreign "main" proceeding.

[137] Model Law, *supra* note 19, at art. 6.

[138] Soh, *supra* note 8.

[139] Model Law, *supra* note 19, at art. 8.

[140] *See infra* Part IV for a discussion of why a purely universalist regime, without so much as a "public policy" escape hatch, would be unimplementable.

[141] Peter J. Murphy, *Why Won't the Leaders Lead? The Need for National Governments to Replace Academics and Practitioners in the Effort to Reform the Muddled World of International Insolvency*, 34 U. MIAMI INTER-AM. L. REV. 121, 129 (2002).

[142] *Id.*

[143] See Practice Guide, *supra* note 7, for a current list, as of 2009, of nations adopting the Model Law. Notable countries include the United States, Australia and Great Britain. *Id.*

4. ALI Transnational Insolvency Project

The emergence of the dominance of universalism, at least in its modified form, continued after the promulgation of the Model Law with the American Law Institute conducting its Transnational Insolvency Project for Cooperation in Transnational Bankruptcy Cases Among Members of NAFTA (the "ALI Project").[144] The ALI Project's stated goal was to "develop principles and procedures for managing the general default of an economic enterprise . . . in a NAFTA country and having assets, creditors, and operations in more than one NAFTA country."[145] The ALI Project hoped to advance international cooperation on a regional level, using the Model Law as a baseline.[146] In outlining its principles and goals, the drafters of the ALI Project cited predictability and the promotion of trade and investment as central objectives,[147] and noted the primacy of a modified form of universalism in the transnational insolvency arena.[148] Taking a page out of the Model Law, the ALI Project, as its first Procedural Principle,[149] mandates recognition in local courts of foreign bankruptcy proceedings within NAFTA, and states that although a public policy exception would exist, such grounds for denial would "almost never be used in a NAFTA bankruptcy."[150] Similar to this regional support in North America of modified universalism, the European Union, years earlier, enacted its own regional agreement which also closely tracked the procedural goals, objectives, and principles outlined in the Model Law and the ALI Principles.[151] Similar to the UNCITRAL Model Law, the ALI Project and the European Union legislation are two examples of the continuing dominance of universalism across the globe, and will serve as

[144] ALI Project, *supra* note 5. The American Law Institute, in conjunction with the International Insolvency Institute, are, as of the writing of this Comment, in the final stages of another transnational insolvency project, entitled "Principles of Cooperation in Transnational Insolvency Cases." That project is expected to produce drafts by June 2010.

[145] *Id.* at 2. Although the project was undertaken only within the NAFTA region, the understood objective of the project was to develop guidelines which could be used in non-NAFTA countries as well. *Id.* at 2, note 3 ("[M]any of the principles and approaches adopted herein are recommended vis a vis proceedings in non-NAFTA countries as well.").

[146] *Id.* at 9, 28. The project hoped to go further than the Model Law by recommending "close and nearly invariable cooperation among the NAFTA courts and administrators in a variety of ways . . . because of the close economic and political relationships within NAFTA, so that the principles underlying the Model Law can be carried further in practice . . . .").

[147] *Id.* at 9-10 ("One of the principal purposes of the NAFTA is to promote trade and investment on a regional basis . . . such a goal requires commercial predictability in the event of financial default . . . [c]ooperation and coordination across national lines are essential to those goals.").

[148] *Id.* at 11.

[149] *Id.* at 43.

[150] *Id.* at 45.

[151] EU Regulation, *supra* note 18. For a discussion of similarities and differences between the EU Regulation and the ALI Principles, *see* Westbrook, *supra* note 61, at 33-38.

examples of possible solutions to the problem of enforcement of foreign tax claims. The American Law Institute and the International Insolvency Institute are currently[152] working on an updated Transnational Insolvency Project to "encourage consideration of the Principles in jurisdictions across the world, subject to appropriate local modifications, and to obtain the endorsement of influential domestic associations, courts, and other groups in those jurisdictions."[153]

5. Cross-Border Protocols

In addition to official legislation, case-specific cross-border agreements, or "protocols," have increased cooperation and harmonization in transnational insolvencies.[154] These protocols, negotiated by the parties in a particular case, would, for example, "settle a particular dispute arising from different laws," or "create a legal framework for the general conduct of the case."[155] The United States has been party to numerous such protocols over the past two decades, with a number of counterparty nations[156]—most notably the first recognized major protocol, in *In re Maxwell Communications*, which, in the early 1990s, was an example of foreign courts working together in the absence of any statute mandating such cooperation.[157] Following the successful use of protocols in a number of cases, the International Bar Association developed the Cross-Border Insolvency Concordat in 1995[158] to guide future protocols.[159] The goal of the Concordat, as stated in the Preface, is that "[i]nternational commerce will be furthered by an understanding in the international business community that general principles exist which, in the event of business crisis, are recognised as an under pinning to harmonise insolvency

[152] As of Spring 2010.

[153] The American Law Institute – Transnational Insolvency – Principles of Cooperation, http://www.ali.org/index.cfm?fuseaction=projects.proj_ip&projectid=18 (last visited Jan. 21, 2010). The Project is slated to be completed in 2010.

[154] Insolvency law Developments in insolvency law: adoption of the UNCITRAL Model Law on Cross-Border Insolvency; use of cross-border protocols and court-to-court communication guidelines; and case law on interpretation of centre of main interests and establishment in the European Union, U.N. Doc. A/CN.9/580, , ¶ 18 (Apr. 14, 2005) [hereinafter UN Protocols].

[155] *Id.*

[156] E. Bruce Leonard, *Coordinating Cross-Border Insolvency Cases*, International Insolvency Institute (2001) (noting the Bahamas, Switzerland, and Israel as some recent United States protocol counterparties).

[157] 170 B.R. 800 (S.D.N.Y. 1994) (involving a cross-border protocol between the United States and Great Britain in a case where the debtor's corporate center and most of its creditors were in Great Britain, while the majority of the corporation's assets were in the United States.

[158] Cross-Border Insolvency Concordat, International Bar Association, http://www.ibanet.org/Document/Default.aspx?DocumentUid=2D55E76F-CAB1-493D-B0A9-4B4B967B353F [hereinafter Concordat].

[159] UN Protocols, *supra* note 154, at 21.

proceedings."[160] The Concordat stresses the goal of having one main proceeding,[161] and encourages cooperation among the courts of different nations, rationalizing that such cooperation will enhance value for all involved.[162] In a similar vein to the Concordat, the American Law Institute, in 2000, outlined principles for the establishment of protocols.[163] The goal of this project was to "assure the maximum benefit for the stakeholders" of the debtor through "coordination and harmonization of insolvency proceedings that involve more than one country through communications among the jurisdictions involved."[164] The emergence of protocols has been a "major step forward in the progress toward ever-increasing levels of international cooperation," and has led to courts in different countries having a "high degree of respect" for one another.[165] Despite the discretionary nature of protocols, and their non-permanence (they are generally adopted for a specific case), the spirit of cooperation that they have fostered has been a major step forward for a universalist regime.[166] Together with the Model Law and the ALI Principles, they have helped usher in the dominance of universalism, which has culminated, here in the United States, with the adoption of Chapter 15 of the Bankruptcy Code.[167]

6. Chapter 15

Chapter 15 of the Code represented the adoption, nearly verbatim, by Congress of the Model Law. The Chapter opens by quoting the Model Law's preface, stating universalist policies as the goals of the Chapter.[168] As did the Model Law, Chapter 15 requires the United States court, when requested by a foreign representative to recognize a foreign proceeding, to determine whether the foreign proceeding is a "main" proceeding or a "non-main" proceeding.[169] This determination will be based upon whether the

[160] Concordat, *supra* note 158, at Preface.

[161] *Id.* at Principle 1.

[162] *Id.* at Principle 4 and rationale.

[163] AM. LAW INST., *Transnational Insolvency: Cooperation Among the NAFTA Countries, Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases* (May 16, 2000) [hereinafter ALI Communication].

[164] *Id.* at 3.

[165] Leonard, *supra* note 156, at 5.

[166] John K. Londot, *Handling Priority Rules Conflicts in International Bankruptcy: Assessing the International Bar Association's Concordat*, 13 BANKR. DEV. J. 163, 176 (1996) ("The general trend in United States courts is toward universality, and the attempts to forge treaties among various countries are consistent with the desire to move away from territoriality."). Protocols, however, are also consistent with a cooperative territorialist approach. Londot's point is not that protocols are per se indicative of universalism, but rather that the cooperation fostered by protocols has increased support for universalism.

[167] 11 U.S.C. § 1501.

[168] *Id*.

[169] 11 U.S.C. § 1517.

foreign country is the debtor's COMI or not.[170] If a proceeding is determined to be a foreign main proceeding, the United States court, consistent with the Model Law, and in contrast to § 304, is required to recognize the proceeding, and numerous provisions of the Code will apply to the case, including an automatic stay of the debtor's assets in the United States.[171] The United States court cannot "weigh policy interests" as it was able to do under § 304,[172] and, as described earlier in discussing the Model Law, can only refuse compliance in rare cases by applying the "public policy exception."[173] Additionally important for noting the contrast in objectives and ideologies between the old § 304 and Chapter 15 is § 1507 of the Code. That section, in allowing the court to grant additional assistance using United States laws (in Title 11 and otherwise) beyond those mandated in Chapter 15, instructs the court to apply the old § 304(c) factors to determine if such additional assistance would be proper.[174] The incorporation of the § 304(c) factors, though, is limited in application in two ways. First, instead of being one of the factors, with equal importance, as it was in § 304(c), the notion of "comity" is an overriding factor in § 1507, under which all of the other factors must be weighed.[175] Secondly, unlike

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[170] *Id.* Critics of this approach argue that the Model Law and Chapter 15, while ostensibly providing rigidity by mandating recognition for foreign main proceedings, in reality only move the discretionary ball forward, and create litigation over whether a country is, in fact, a debtor's COMI. Thus, critics of this approach maintain that universalism causes the same unpredictability as territorialism, as the COMI cannot be determined in advance. *See* In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122 (Bankr. S.D.N.Y. 2007) (holding that in the Bear Stearns bankruptcy case, a foreign proceeding would not be recognized as a foreign main proceeding due to the court's determination that the Cayman Islands was not the COMI of the debtor company, despite its being registered there).

[171] 11 U.S.C. § 1520. The full text of § 1520(a), describing the immediate effects of recognition, is as follows: (a) Upon recognition of a foreign proceeding that is a foreign main proceeding—

(1) sections 361 and 362 apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States;

(2) sections 363, 549, and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the sections would apply to property of an estate;

(3) unless the court orders otherwise, the foreign representative may operate the debtor's business and may exercise the rights and powers of a trustee under and to the extent provided by sections 363 and 552; and

(4) section 552 applies to property of the debtor that is within the territorial jurisdiction of the United States.

[172] Jay Lawrence Westbrook, *Chapter 15 At Last*, 79 AM. BANKR. L.J. 713, 726 (2005) ("[A] major change is that recognition is granted to a foreign main proceeding without reference to criteria like those formerly set forth in § 304(c).").

[173] 11 U.S.C. § 1506.

[174] 11 U.S.C. § 1507.

[175] *Id.* The text of the statute states: (b) In determining whether to provide additional assistance under this title or under other laws of the United States, the court shall consider whether such additional assistance, **consistent with the principles of comity**, will reasonably assure—

(1) just treatment of all holders of claims against or interests in the debtor's property;

(2) protection of claim holders in the United States against prejudice and inconvenience in the

under § 304, where the § 304(c) factors were instrumental in deciding whether to grant any relief, the discretion under § 1507 is permitted to be used only in assessing whether "additional assistance" is available; however, these factors should not be used to limit relief otherwise mandated under Chapter 15.[176] This limitation was intended precisely to shield Chapter 15 from the uncertain application which stained § 304.[177] Indeed, the limited case law interpreting Chapter 15 has recognized the international nature of the law, and the need to interpret the law in a manner that promotes comity.[178] Thus, the adoption of Chapter 15 by the United States was a major step in the direction of universalism and of international comity.[179]

D. Conclusion

This concludes the discussion of the evolution of bankruptcy law through the past century, as well as the widely publicized debate between the more rigid universalist approach and the more flexible territorialist approach. What is important to glean from this background is: (1) the United States, along with most other countries, has clearly accepted the primacy of universalism and the need for mandated, rather than discretionary, international cooperation in insolvencies; (2) such cooperation has been widely accepted to further the goals of predictability, efficiency, and fairness in distributing the debtor's estate; (3) despite the understood need for universalism, only a system which allows for some flexibility on the part of local courts can be realistically implemented; and (4) this flexibility must be carefully monitored and limited, or, as in the case of § 304, the exception will swallow the rule and render the legislation completely discretionary. These principles will guide our discussion of foreign tax claims, which is an area of law in which countries are far less

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processing of claims in such foreign proceeding;

(3) prevention of preferential or fraudulent dispositions of property of the debtor;

(4) distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by this title; and

(5) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

Id. (emphasis added).

[176] Beckering, *supra* note 112, at 307.

[177] *Id.*

[178] *See, e.g.*, In re Tri-Continental Exchange, Ltd., 349 B.R. 627, 631-32 (Bankr. E.D. Cal. 2006) (noting, in granting recognition of a foreign main proceeding, that Congress required the interpretation of Chapter 15 to "take into account the statute's international origin and to promote applications of chapter 15 that are consistent with versions of the Model Law adopted in other jurisdictions.").

[179] Westbrook, *supra* note 172, at 719 ("Chapter 15 . . . represents an embrace of universalism by the United States . . . .").

willing to accept universalism, yet is an essential component of realizing the predictability, efficiency and fairness that so many countries and organizations are striving to achieve.

II. PRIORITIES IN BANKRUPTCY DISTRIBUTION

A. Priorities, Justifications, and Criticism

While one of the fundamental goals of bankruptcy is to provide equal treatment for creditors, it is abundantly clear that some creditors are more equal than others. The distribution scheme of many countries is governed by an intricate system of priorities, whose claimants are paid before general unsecured creditors whose class isn't lucky enough to have been chosen for a priority by the governing state.[180] Notably for us, in the United States, the eighth priority is for governmental tax claims.[181] Many other countries have similar priorities for tax claims.[182] However, many countries do not offer such priorities,[183] and this discrepancy in priorities leads to the cross-priority issue which will be discussed in the next subpart.[184]

Priorities, particularly of tax claims, have several benefits to the enacting state. One major benefit is that the tax debt is considered a communal debt, which the debtor owes, and which solvent taxpayers will have to compensate for unless a priority is granted. Thus, in an effort to protect the community at large, the estate is forced to prioritize taxes.[185] The other commonly cited benefit is based on the notion that a taxing authority is an "involuntary" creditor of the debtor corporation, as it hasn't

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[180] See, for example, 11 U.S.C. § 507(a) for the United States priority scheme.

[181] 11 U.S.C. § 507(a)(8) (2006) ("Eighth, allowed unsecured claims of governmental units . . . ."). The priority is subject to a number of restrictions which are not relevant for our purposes. *Id.*

[182] *E.g.* U.K. Insolvency Act 1986, Ch. 45, s. 175 (Eng.) ("In a winding up the company's preferential debts (within the meaning given by section 386 in Part XII) shall be paid in priority to all other debts.") (Section 386 and Schedule 6 to Section 386 then lists income tax as a preferential debt); France and Mexico also have broad tax priorities, with New Zealand and Canada offering limited priorities. Barbara K. Morgan, *Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy*, 74 AM. BANKR. L.J. 461, 500 (2000) (offering a chart showing which countries offer tax priorities in bankruptcy).

[183] Morgan, *supra* note 182, at 500. "Australia has abolished all statutory tax priorities." *Id.* at 480. "Under [German bankruptcy law] . . . tax claims . . . are treated on an equal basis with other unsecured claims." *Id.* at 492.

[184] *Supra* Part II.B.

[185] SENATE COMM. ON THE JUDICIARY, TO ACCOMPANY S. 2266, S. REP. NO. 95-989, at 14 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5800 ("To the extent that debtors in a bankruptcy are freed from paying their tax liabilities, the burden of making up the revenues thus lost must be shifted to other taxpayers."); Morgan, *supra* note 182, at 463 ("[U]nlike the claims of private commercial creditors, tax claims are for the benefit of the entire community. The priority protects the revenue base for the common good, and avoids shifting the burden of the debtor's unpaid taxes to other taxpayers.").

deliberately chosen to do business with the debtor; instead, its claim has arisen by operation of law. This is in stark comparison to other private creditors, who could perhaps have avoided their plight by refusing, ex ante, to lend money or goods to the debtor corporation.[186]

However, there are also arguments against establishing priorities in distribution, especially in the tax realm. The first is the widening gap between ordinary creditors and priority tax creditors, which is a direct result of higher taxes.[187] As the government has levied new taxes and higher tax rates, "tax claims have consumed more and more of an insolvent debtor's estate, leading to questions about the tax priority."[188] The two main arguments in favor of tax priorities have also been rebutted by opponents of such a priority. First, in response to the argument that a failure to afford the government a priority will result in the need for solvent persons and corporations to "compensate" the government for the loss, opponents of the tax priority argue that the loss to the government of one corporation not paying taxes will be minimal, while the potential harm to other creditors of the corporation of having a tax priority are often large.[189] Second, in response to the argument that the government is an involuntary creditor and thus should be entitled to priority satisfaction of its debt, opponents of the tax priority argue that the government is, in reality, at no great disadvantage, as it has other means of enforcing its debt, such as imposing penalties and high interest rates, or using statutory liens.[190] Although several states have recently reduced priorities, specifically tax priorities, in response to these arguments,[191] the problem of priorities is still a significant one in transnational insolvencies and must be addressed.[192]

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[186] Morgan, *supra* note 182, at 464 (citing HOUSE COMM. ON THE JUDICIARY, TO ACCOMPANY H.R. 8200, H.R. REP. NO. 95-595, at 190 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6150 ("A taxing authority is given preferred treatment because it is an involuntary creditor of the debtor. It cannot choose its debtors, nor can it take security in advance of the time that taxes become due.")).

[187] *Id.* at 465 (quoting Alain David, *Preferences of the Tax Authorities and Bankruptcy Law in France, in* CORPORATE INSOLVENCY AND RESCUE: THE INTERNATIONAL DIMENSION 221, 227 (Dennis Campbell and Anthony E. Collins eds., 1993) ("The balance between ordinary creditors and those holding some type of preference or security has rapidly deteriorated, naturally to the detriment of the former.")).

[188] *Id.* at 465-66.

[189] *Id.* at 467 ("Critics of the priority reject the community interest argument, contending that the debt owed to the government is unlikely to be significant in terms of total government receipts, whereas the loss to private creditors may cause substantial hardship and precipitate additional insolvencies.").

[190] *Id.*

[191] Model Law Legislative Guide, *supra* note 32, at 271 ("In some recent insolvency laws there has been a significant reduction in the number of these types of priority right, reflecting a change in the public acceptability of such treatment. A few States, for example, have recently removed the priority traditionally provided to tax claims.").

[192] The debate surrounding tax priorities stands in contrast to the overwhelming support for labor priorities, which have been enacted, in some form, in nearly every jurisdiction. *See* DR. JANIS SARRA,

B. The Concept of Cross-Priority

Cross-priority refers to the granting of foreign creditors the same priority that is granted to a class of local creditors[193]—for example, the granting of foreign employee claims the same priority, if any, granted to local employee claims. Recall ABC Corporation, Country X, and Country Y.[194] In order to illustrate the problem of cross-priority, assume the following:[195] Country X grants a high priority for tax claims, and no priority for employee claims. Country Y, on the other hand, contains no priority for tax claims, but a high priority for employee claims. Now assume the following financial information about ABC Corp.

ABC Corp.:	Assets	Total Debt	General Unsecured	Tax Debt	Employee Debt
Country X	$4M	$5M	$2M	$2M	$1M
Country Y	$2M	$8M	$3M	$2M	$3M
Total	$6M	$13M	$5M	$4M	$4M

Let's assume now that both countries have adopted the Model Law, and Country X is ABC Corporation's COMI. Country X will attempt to gain access to the court in Country Y through a foreign representative, and, if recognized as a foreign main proceeding, will then pool all $6M in assets. Because it gives tax claims a high priority, it will pay the full $2M to its own government. It will also treat its own employee claims, as well as those of Country Y, as general unsecured creditors, because it doesn't grant a priority to unsecured claims. What, then, will be the treatment of the $2M tax claim of the government of Country Y? Country X can choose whether or not to grant cross-priority. If Country X grants cross-priority, then it will pay the full $2M tax debt to the government of Country Y, and will then have $2M of assets left over to pay the remaining $9M of liabilities, which will result in about $0.22/$1.00. If Country X does not grant the cross-

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EMPLOYEE AND PENSION CLAIMS DURING COMPANY INSOLVENCY – A COMPARATIVE STUDY OF 62 JURISDICTIONS 10 (2008) (noting that "[o]nly two jurisdictions in the [62-country] study, Estonia, and the United Arab Emirates, provide no special protection for employee wage and related claims during insolvency," and that even those two countries provide general employment welfare which covers jobs lost due to company insolvency). Dr. Sarra notes that while not every countries has a "wage priority" per se, those that don't generally have a "wage or compensation guarantee fund or insolvency insurance scheme" to pay wage claims to employees. *Id.* at 9.

[193] Ulrik Rammeskow Bang-Pederson, *Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests*, 73 AM. BANKR. L.J. 385, 387 (1999).

[194] *Supra* Introduction.

[195] For further illustration and expanded analysis of the possibilities of cross-priority across a broad spectrum of bankruptcy schemes, *see* Rammeskow Bang-Pederson, *supra* note 193.

priority, it will pool Country Y's tax debt with the other general unsecured claims (unless it actually subordinates or disallows foreign tax claims), and will have $4M in assets to pay $11M in liabilities, which will result in about $0.36/$1.00. Thus, it would be beneficial to Country X, for the sake of its employees and other unsecured claimants, to not grant the cross-priority.

Let's now assume that Country Y is the COMI of ABC Corporation, and asks for recognition from Country X. Because Country Y grants a high priority to employee claims, it will certainly first pay $3M to its employees. Also, it will certainly not pay the full $2M to either its government or the government of Country X for tax claims, as it does not recognize taxes as a priority. The question then becomes whether it grants cross-priority to the $1M in employee claims of Country X. If it does, then it will have $2M remaining in assets to pay $9M in liabilities, which would result in $0.22/$1.00. If it does not, it will pool the $1M of Country X's employee claims with the other unsecured claims, and will have $3M to pay $10M in liabilities, which would result in $0.30/$1.00.

There are arguments both in favor of and against the granting of cross-priority.[196] Cross-priority obviously favors fairness—after all, if employees in two countries, or if two governments, both file the same type of claim, why should one country's claimant lose out simply due to nationality. Applying cross-priority will "lessen national discrimination while increasing discrimination among classes of creditors, [which is,] [o]f course, precisely the policy point of priority systems."[197] This fairness argument is one of "national treatment," which mandates that discrimination on the basis of nationality or foreignness is "presumptively wrong."[198] In addition, granting cross-priority for foreign claims can enhance predictability by giving creditors the ability to identify, ex ante, exactly which distribution schemes would apply in the event of default, and by assuring that random results would not occur.[199] Indeed, the Model Law promotes this concept, and, although it doesn't per se require the granting of cross-priority, for reasons to be discussed in the next subpart, it promotes the "national treatment" of foreign creditors, which is meant to require the same treatment as similarly situated local creditors.[200] Lastly, if countries do not grant cross-priority, that can jeopardize a universalist regime. In our example above, if Country X does not grant Country Y's tax claim the same

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[196] *See* Westbrook, *supra* note 25, at 31-32 (discussing generally the concept of cross-priority).

[197] *Id.* at 31.

[198] *Id.* at 35. "Beyond treaty obligations, nondiscrimination on the basis of citizenship is a general principle that has evolved in modern international law, especially in international trade . . . ."). *Id.*

[199] Bang-Pederson, *supra* note 193, at 386.

[200] Jay M. Goffman & Evan A. Michael, *Cross Border Insolvencies: A Comparative Examination of Insolvency Laws of Industrialized Countries*, 12 J. BANKR. L. & PRAC. 5 ART. 1 (2003).

priority which it gives to its own tax claim, Country Y may decide to open its own proceeding, grab its local assets, and right the perceived wrong. This will hurt other unsecured creditors of Country X, because they wouldn't have the benefit of pooled assets, and will also threaten the entire fabric of universalism and predictability, because investors will have no idea when a non-COMI country will decide to open its own local proceeding and alter the home-country distribution scheme.[201] In addition to this ex post decline in predictability, there will be an ex ante decline in predictability, as a scheme without cross-priority will cause policymakers to disfavor universalism, as the approach will lead to local assets distributed "disproportionately in favor of creditors favored with priority in a foreign country."[202] The argument against a universal cross-priority, as stated earlier, is that it benefits foreign priority-claimants at the expense of local creditors. In our example, if Country X extends its tax priority to Country Y's tax claim, Country X's other claimants receive only \$0.22/\$1.00, rather than \$0.36/\$1.00. However, as Professor Westbrook stated,[203] such inequality between priority claimants and non-priority claimants is the main purpose of having priorities, and that is preferable to inequality between local and foreign creditors, which can jeopardize the entire structure of universalism.

C. The Reluctance to Enforce Priorities in Transnational Insolvencies

Despite this seemingly overwhelming support, at least in theory, for the universal granting of cross-priorities, it has not been mandated in any legislation, and priorities have been seen as a serious barrier to any harmonizing of bankruptcy law. The ALI Project, despite lofty goals, listed priorities as one of the exclusions not to be discussed by the Project. "Priority problems," states the ALI Project, "are among the greatest obstacles to achievement of a unified approach to the general default of multinational companies."[204] Instead of giving any substantive advice, the ALI Project specifically notes that it intends neither to weaken nor strengthen any existing priority, and only advises that courts, when faced with this issue, should include "international values like comity and

[201] The truth is, even if countries do grant cross-priority, non-recognition can be justified if the non-home country doesn't agree with the priority. *See* Overseas Inns, S.A. v. United States, 911 F.2d 1146 (5th Cir. 1990) (holding that the IRS was justified in not recognizing a bankruptcy proceeding in Luxembourg which would have lowered the IRS's tax judgment on a debtor corporation by treating the tax claim as a general, rather than a priority claim). This case exemplifies the real problem in dealing with priorities in bankruptcy.

[202] Westbrook, *supra* note 25, at 32.

[203] Westbrook, *supra* note 25.

[204] ALI Project, *supra* note 5, at 25. The Project notes tax priorities as one of the problematic priorities. *Id.*

cooperation" in their deliberations.[205] The Project, in its Recommendation regarding priority claims, notes that cross-priority would be desirable, but concludes that laws mandating such cross-priority do not exist, and the system is untested.[206] Similarly, the Model Law, while promoting a spirit of cooperation and comity, does not mandate universal cross-priority.[207] Instead, the Model Law requires only a minimum level of fair treatment,[208] meaning that a foreign creditor must only be treated as well as a general unsecured creditor.[209] This flexibility afforded to home states to either recognize or not recognize foreign priority claims can create tensions between states and hinder cooperation efforts[210] because it gives states discretion to decide whether or not to recognize foreign priorities on a case-by-case basis, which obviously, being an ex post determination, does not provide investors with the type of ex ante predictability supported by a universalist regime.

D. The Special Problem of Tax Priorities

While any type of priority can hinder cooperation and stall efforts at international comity, no priority has created tension and unease like the tax priority.[211] The ALI Project, in avoiding handling the problem of tax priorities, stated that "[t]he granting of priority to domestic tax claims in multinational cases will remain a serious problem."[212] Even though the authors of the ALI Project were hopeful that countries would be able to cooperate on other priorities, cooperation on foreign tax claims was considered to be in serious doubt,[213] as foreign tax claims have traditionally been unenforceable in other countries, whether or not a bankruptcy was involved.[214] The drafters of the Model Law expressed similar reservations.

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[205] *Id.* at 28.

[206] *Id.* at 116-17 ("There is little or no law in any country today concerning the right of a foreign creditor to enjoy the benefit of a domestic priority.").

[207] Westbrook, *supra* note 61, at 16 ("This sweeping requirement of nondiscrimination has an important exception, however, in that it leaves open the question of discrimination in the application of priorities in distribution.").

[208] Model Law, *supra* note 19, at art. 13.

[209] *Id.*

[210] Goffman & Michael, *supra* note 200.

[211] *See* Westbrook, *supra* note 25, at 36 (noting that governmental priorities create unique problems for United States courts, as foreign revenue claims (taxes) have historically been denied enforcement in United States courts).

[212] ALI Project, *supra* note 5, at 117.

[213] This is in stark contrast to the enforcement of foreign "private law" claims. *See generally* Dodge, *supra* note 21; ALI International Jurisdiction and Judgments Project (citing Hague Conference on Private International Law, Preliminary Draft Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters, amended version (Oct. 30, 1999)).

[214] *Id.* *See also* Emilie Beavers, *Bankruptcy Law Harmonization in the NAFTA Countries: The Case of the United States and Mexico*, 2003 COLUM. BUS. L. REV. 965, 1000-01 ("The ALI also notes

In fact, the Model Law proposed an alternative provision from the earlier cited provision (requiring COMI countries to recognize foreign priorities at least to the extent of general unsecured creditors) and amended that language to exclude tax and social security priorities from that requirement—in essence allowing complete discrimination and disallowance of foreign tax claims![215] Thus, a country can adopt the Model Law and be in compliance with its universalist principles, yet continue to discriminate against foreign tax claims.[216] The Legislative Guide to the Model Law further provides:

> Foreign tax claims are currently excluded by many States and it is generally recognized that such exclusion does not violate the objective of equal treatment of foreign and domestic creditors. . . . [The Model Law] . . . provides that the principle of equal treatment of foreign and domestic creditors is not affected by the exclusion of foreign tax and social security claims or by their ranking on the same level as general claims without priority or lower, if equivalent local claims have that lower ranking.[217]

The promulgators of the Model Law and the ALI Project had no choice but to resist mandating universal cross-priority for tax claims, as such a mandate could have rendered the recommendations unimplementable,[218] as countries have historically been reluctant to enforce foreign tax claims.[219]

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that the granting of priority to domestic tax claims in multinational bankruptcy cases is . . . a serious problem. Foreign courts ancillary to the main proceeding will not want to pool assets if they believe a large proportion of these assets will go on a priority basis to a foreign tax authority.").

[215] Model Law, *supra* note 19, at art. 13, Paragraph 2, n.2. The text of the alternative provision is as follows:

> The enacting State may wish to consider the following alternative wording to replace paragraph 2 of article 13(2):
>
> 2. Paragraph 1 of this article does not affect the ranking of claims in a proceeding under [identify laws of the enacting State relating to insolvency] or the exclusion of foreign tax and social security claims from such a proceeding. Nevertheless, the claims of foreign creditors other than those concerning tax and social security obligations shall not be ranked lower than [identify the class of general non-preference claims, while providing that a foreign claim is to be ranked lower than the general non-preference claims if an equivalent local claim (e. g. claim for a penalty or deferred-payment claim) has a rank lower than the general non-preference claims]. *Id.*

[216] Model Law Legislative Guide, *supra* note 32, at 272. The Legislative Guide also states that "[c]onsideration of the priority of tax claims may be of particular concern in transnational cases." *Id.* at 271.

[217] *Id.* at 251.

[218] Bang-Pederson, *supra* note 193, at 428 ("As with all other universalist solutions, universalism with crosspriority for all claims including foreign tax claims provides predictability. Suggesting universalism with crosspriority for foreign tax claims may be considered a solution unlikely of worldwide acceptance.").

[219] Westbrook, *supra* note 25, at 36 ("The rub is that foreign revenue claims have historically

The unclear nature of tax priorities, as presented by the Model Law and the ALI Project, presents serious problems for the universalist model.[220] The lack of recognition of foreign tax claims can threaten universalism both on a case-by-case basis, and in broad legislation. First, it will threaten universalism on a case-by-case basis. Recall the example above with Country X and Country Y.[221] Assume that Country X pays $2M to satisfy in full its own tax claim, and refuses to recognize the tax claim of Country Y. A court in Country Y may then refuse to cooperate with Country X and may either open up a full parallel proceeding according to a territorialist approach,[222] or may simply siphon off the necessary funds from the asset pool to satisfy its own tax claim, and allow the rest of the case to proceed in Country X.[223] Either way, the principles of cooperation will be compromised, and the goals of universalism sacrificed. First, the main advantage of universalism, which is predictability, will vanish, as investors will have no idea, ex ante, how the debtor's assets will be distributed upon default, as the foreign tax claims will give rise to numerous possible methods of distribution in numerous courts.[224] Thus, the natural corollary of unpredictability will be the discouragement of foreign investment, as investors will be uncomfortable investing money without being able to properly assess the risk of the investment, which is based on the possible return in a default. Additionally, fairness will be violated, as similarly situated creditors (here, governments) will not be treated equally.[225] Administrative efficiency will also likely be lost, as the estate will be depleted by unnecessary costs involved in opening up numerous proceedings in multiple countries. In order to salvage the universalist model, a system must be crafted that strikes the perfect balance between the rigidity present in the universalist system with the flexibility needed to

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been denied enforcement in all U.S. courts.").

[220] Jay Lawrence Westbrook, *Priority Conflicts as a Barrier to Cooperation in Multinational Insolvencies*, 27 PENN ST. INT'L L. REV. 869, 870 ("Yet the clash of priority systems presents a serious obstacle to the universalist project.").

[221] *Supra* Part II.B.

[222] Bang-Pederson, *supra* note 193, at 430 ("The question is whether nonhome countries as a consequence should deny deference to the home country proceeding and instead adopt rules for local territorialist proceedings. That would lead to unpredictability.").

[223] This is known as the "enforced priority rule," and mandates that the transfer of assets from the non-COMI state to the COMI state should not take place until all non-COMI priority claims have been paid in accordance with the COMI state priorities. *Id.* at 430.

[224] For the full effect of the unpredictable nature of this hypothetical, consider a case beyond the simple "Country X/Country Y" situation we have been discussing. Consider a case in which 10 countries are involved, each claiming taxes, and the home country refuses to grant priority to any of them. What each country will do to protect its local tax claim is a mystery, at least ex ante, to investors.

[225] Londot, *supra* note 166, at 172 ("Equality of footing would be advanced [through cross-priority] since all creditors would be placed on an equal footing vis-à-vis all others within respective priority classes.").

convince countries, traditionally shy with regard to foreign tax claims, to enforce such claims. Only then will the goals and objectives represented by universalism, which have been so widely accepted over the past two decades, be fully realized. In order to craft this solution, a greater understanding of the hesitation of countries to enforce foreign tax claims is necessary. A proper understanding of this centuries-old doctrine will allow us to propose valid solutions.[226]

III. THE PROBLEM: ENFORCEMENT OF FOREIGN TAX CLAIMS

A. The Revenue Rule – History and Justifications

Enforcement of foreign tax claims[227] has always posed problems distinct from the enforcement of other foreign claims and judgments,[228] which are generally recognized and enforced under the doctrine of international comity, even without an international convention or treaty.[229] Furthermore, in the United States, many states have adopted the Uniform Money Judgments Recognition Act, which renders foreign money judgments "enforceable in the same manner as the judgment of a sister state which is entitled to full faith and credit."[230] Thus, despite recognition problems in priorities other than tax, those problems are more readily fixed, as countries have no established tradition of non-enforcement of such claims; on the contrary, they generally do enforce them.[231] However, when the judgment sought is a tax judgment, the "revenue rule" dictates that courts are under no mandate to enforce such a judgment, and in fact courts do not enforce them.[232] Indeed, the Uniform Money Judgments Recognition Act creates a special exception, allowing non-recognition for "a judgment for taxes, a fine or other penalty."[233]

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[226] *See, e.g.*, Dodge, *supra* note 21 (discussing the revenue rule, which bars enforcement of foreign tax claims).

[227] This article will not be discussing taxes to deter criminal activity. For a discussion of such taxes, see Karen E. Minehan, *The Public Policy Exception to the Enforcement of Foreign Judgments: Necessary or Nemesis?* 18 LOY. L.A. INT'L & COMP. L.J. 795, 807 (1996).

[228] It should be noted that oftentimes foreign penal claims are given the same treatment as foreign tax claims, as they are also considered "public law," as opposed to "private law" claims such as money judgments by private parties. *See generally id*.

[229] William J. Kovatch, *Recognizing Foreign Tax Judgments: An Argument for the Revocation of the Revenue Rule*, 22 HOUS. J. INT'L L. 265, 266 (2000) ("Litigants who have obtained a judgment from a foreign court, for the most part, have little trouble convincing courts in the United States to recognize and enforce that judgment.").

[230] Uniform Foreign Money-Judgments Recognition Act, 13 U.L.A. 265 (1962 & Supp. 1999) [hereinafter Recognition Act] § 3.

[231] Kovatch, *supra* note 229.

[232] *Id.*

[233] Recognition Act, *supra* note 230, at § 1(2).

The origins of the revenue rule are traditionally traced to two English cases decided by Lord Mansfield in the 1700s.[234] Lord Mansfield stated that "[n]o country ever takes notice of the revenue laws of another,"[235] and later reiterated it, stating that "[o]ne nation does not take notice of the revenue laws of another."[236] This English doctrine was adopted into United States law by the Ninth Circuit in *Her Majesty the Queen ex rel. British Columbia v. Gilbertson*,[237] which involved an attempt by the government of British Columbia to enforce a tax on citizens of Oregon who had performed logging work in Canada.[238] The Ninth Circuit upheld the District Court's holding denying enforcement of the tax,[239] and other countries have also refused to enforce foreign tax claims on similar grounds.[240] There are numerous justifications for not enforcing foreign tax claims. First, Judge Learned Hand made famous the theory that requiring (or even allowing) countries to enforce tax claims of their neighbors would require some analysis of the tax claim, and would open up the possibility of the home state declaring the foreign tax laws to be invalid, which would be offensive and embarrassing to the foreign state.[241] Thus, the safer bet, according to Hand, was a blanket rule prohibiting enforcement of foreign tax claims.[242] Another common justification for the revenue rule is judicial competence—proponents of the rule argue that United States (or whichever country is asked to enforce the tax) courts do not have the competence to understand, evaluate, and enforce tax claims of other nations.[243] When one considers the intricacies of our own tax code, it isn't difficult to imagine the

[234] Kovatch, *supra* note 229, at 268.

[235] Holman v. Johnson, 98 Eng. Rep. 1120, 1121 (1775).

[236] Planche v. Fletcher, 99 Eng. Rep. 164, 165 (1779).

[237] 597 F.2d 1161 (9th Cir. 1979).

[238] *Id.* at 1162-63.

[239] *Id.* at 1166. The revenue rule has also been accepted into Restatement (Third) of Foreign Relations Law, which states that "[c]ourts in the United States are not required to recognize or to enforce judgments for the collection of taxes, fines, or penalties rendered by the courts of other states." RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 483 (2005).

[240] Brenda Mallinak, *The Revenue Rule: A Common Law Doctrine for the Twenty-First Century*, 16 DUKE J. COMP. & INT'L L. 79, 88-92 (2006) (bringing examples from Britain, Greece, India, Ireland, and Canada of this idea).

[241] Moore v. Mitchell, 30 F.2d 600, 604 (2d Cir. 1929) ("Thus a scrutiny of the liability is necessarily always in reserve, and the possibility that it will be found not to accord with the policy of the domestic state."). Interestingly, Hand's opinion came in the interstate (within the United States) context, and the rationale, in that context, was later invalidated by *Milwaukee County v. M.E. White Company*, which held that the Full Faith and Credit Clause of the Constitution required each state to enforce taxes of its sister states. Dodge, *supra* note 21, at 173-74; Milwaukee County v. M.E. White Co., 296 U.S. 268 (1935). However, Hand's rationale continued to be followed in the international context. The Ninth Circuit in *Gilbertson* noted this rationale in applying the revenue rule. Gilbertson, 597 F.2d at 1162-63.

[242] Dodge, *supra* note 21, at 173.

[243] Kate Kraus, *Pasquantino: Foreign Tax Evasion as a Domestic Crime*, 32 CORP. TAX'N 03 (2005) ("U.S. judges generally have little experience interpreting foreign law in general, or foreign tax law in particular.").

great challenge that local courts would have in applying a law in which they are not trained.[244] Furthermore, supporters of the revenue rule argue that national sovereignty is threatened when countries satisfy foreign tax claims, as national funds, which could have been used to strengthen the home government or its economy, go directly to strengthen foreign governments.[245] Lastly, in a "Separation of Powers" argument, supporters of the revenue rule argue that even without the aforementioned concerns, if the United States were to enforce foreign taxes, the initiative would have to come from the executive branch, which is the "sole organ of the federal government in the field of international relations," and not from the judiciary.[246] Thus, what complicate the ability of states to grant priorities to foreign tax claims in bankruptcy are not only the insolvency ideas of universalism, territorialism, and comity, but also these tax rationales behind the revenue rule. Our solution to this problem will try to realize the goals of transnational insolvency while not rendering the system unacceptable to countries by implicating the concerns of the revenue rule.

B. Modern International Diplomacy in Tax Enforcement – Unilateral and Bilateral Options

Recently, despite the aforementioned concerns, there have been arguments in favor of discontinuing the revenue rule, or at least in favor of weakening it, and thus allowing countries to enforce foreign tax claims.[247] Enforcing foreign tax claims has been acknowledged to benefit the notion of comity, support the notion of justice, and benefit nations as a whole. It would obviously benefit the notion of international comity, as countries would be able to cooperate and show respect for the laws of one another. It would support the notion of justice, as tax evaders would be forced by their sheltering countries to pay their debt, and wouldn't be allowed to shirk this obligation solely due to geographic location. Finally, it would benefit nations as a whole, as each person would pay their fair share of the national tax burden. For example, if the United States is unable to collect a

[244] Will Rearden, *A "Delicate Inquiry": Foreign Policy Concerns Revive the Revenue Rule in the Second Circuit and Bar Foreign Governments From Suing Big Tobacco*, 51 ST. LOUIS U. L.J. 203, 216 (2006) ("Domestic judges are not trained to interpret foreign tax law. . . . [t]his argument is bolstered when one considers the complexity of our own Internal Revenue Code.").

[245] Dodge, *supra* note 21, at 176 (quoting Her Majesty the Queen ex rel. British Columbia v. Gilbertson, 597 F.2d 1161, 1165 (9th Cir. 1979) (enforcing foreign tax claims would "have the effect of furthering the governmental interests of a foreign country, something which our courts customarily refuse to do.")); *see also* Att'y Gen. of Canada v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103, 111 (2d Cir. 2001) ("[T]he rule prevents sovereigns from asserting their sovereignty within the borders of other nations, thereby helping nations maintain their mutual respect and security.").

[246] Pasquantino v. United States, 544 U.S. 349, 369 (2005).

[247] Kraus, *supra* note 243, at 18 ("The United States has become increasingly willing to collaborate with foreign governments in enforcing their laws.").

hypothetical tax judgment from the Canadian courts, the tax burden which is created by that lack of enforcement will either drain the United States treasury, or, more likely, will be a burden to be shared by other United States taxpayers.[248] Thus, a system in which each country enforces foreign tax claims will not only be fair, but will benefit all (law-abiding) taxpayers in all countries. In fact, Justice Joseph Story noted that cooperation in enforcement of tax claims is "[a]n enlightened policy, founded upon national justice, as well as national interest."[249]

There are two ways of accomplishing this: First, the United States could decide unilaterally to enforce all foreign tax judgments,[250] with or without need for reciprocity, and hope that in leading by example, other nations would adopt similar policies.[251] Of course a limited public policy exception would likely be needed in such a plan to avoid being taken advantage of. Alternatively, the United States could enter into treaties to enforce tax claims.[252] Putting aside for the moment the insolvency implications of either of these approaches, let's examine how they would be impacted by the aforementioned policies supporting the revenue rule. If the United States adopted a unilateral foreign tax judgment recognition rule, Hand's concern about offending or embarrassing foreign nations through a scrutinizing of their tax laws would be alleviated. Because the U.S. court would be accustomed to granting all foreign tax claims, scrutiny of the law would be unnecessary. Of course, for this to hold true, the public policy exception must be truly narrow, and only be implicated in the rarest of cases; if it is used broadly, then Hand's concern would be a legitimate barrier to this method. This policy would also test the national sovereignty concerns; if other nations reciprocated, then, while certainly jeopardizing national sovereignty, the United States would hopefully recoup from other governments in claiming its own taxes what it would lose in enforcing others', and wouldn't ultimately strengthen any other government.[253]

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[248] Dodge, *supra* note 21, at 220. Dodge gives the example of *British Columbia v. Gilbertson*, discussed in the text above, in which the Ninth Circuit refused to enforce a Canadian tax claim, and compares it to *United States v. Harden*, in which the Canadian Supreme Court refused to enforce a United States tax claim, and notes that if only the nations would have cooperated, the net result would have been the same, but principles of cooperation between nations, justice for tax evaders, and national interest (in the alleviation of the burden to make up the loss which would have been placed on all law-abiding taxpayers) would have been supported. *Id.*

[249] Dodge, *supra* note 21, at 220 (quoting JOSEPH STORY, COMMENTARIES ON THE CONFLICT OF LAWS § 620 (1834)).

[250] *See* Kovatch, *supra* note 229, at 285-87 (suggesting that the United States should set a worldwide example by acting unilaterally in tax enforcement, and noting that the United States has, in the past acted unilaterally contrary to overwhelming foreign practice, in the field of discovery procedures).

[251] *Id.*

[252] Kraus, *supra* note 243, at 5.

[253] Dodge, *supra* note 21, at 221 ("[O]n average, each country will have an equal number of evaders of foreign taxes within it as evaders of its own taxes outside it, which means that on average

Requiring reciprocity would ensure that national sovereignty is not diminished. In addressing the judicial competence concern, this scheme would be palatable – since judges would be enforcing virtually all tax claims, there would be no need for United States judges to analyze, or understand, foreign tax laws. The separation of powers issue, however, would present a difficult challenge; however, executive or legislative "consent," which would take place in order to enact legislation recognizing all foreign tax claims,[254] would likely satisfy the separation of powers doctrine, and would allow the judiciary to enforce the tax claims.[255] Likely, judges will be hesitant to grant recognition to a foreign tax claim without some assurance of reciprocity from the foreign country, as, without reciprocity, the national sovereignty concern of the revenue rule will be implicated, and a country will be loathe to benefit its neighbor without the promise of being benefited in return.[256] Thus, the only realistic option for countries who wish to enforce broadly foreign tax judgments is to mandate reciprocity, or to enter into tax-recognition treaties, which will reach the same result.[257]

Before commenting on the success, or lack thereof, of international tax enforcement treaties, let us first analyze whether such treaties alleviate the concerns implicated by the revenue rule. First, and most obviously, separation of powers would not be an issue, as the treaties would be entered into by the executive and legislative branches of government, as prescribed by the Constitution,[258] with the sole role of the judiciary being mere enforcement of executive will. Next, because the countries whose tax claims will be recognized will be set ex ante by treaty, there will be no need for judicial scrutiny of the tax laws of foreign nations, and thus none of the potential for the sort of international embarrassment which gave pause to Judge Hand. In a similar vein, the judicial competence concern will be a non-factor, as the judiciary will not be asked to evaluate any foreign tax laws; they will simply be asked to enforce such laws where mandated by treaty. Lastly, national sovereignty concerns will be alleviated, as such an approach mandates reciprocity, and thus the countries will likely break

cooperation is a break-even strategy.").

[254] After all, legislation recognizing all foreign tax claims is essentially a unilateral "treaty."

[255] Rearden, *supra* note 244, at 213-14 ("[W]ithout evidence of executive or legislative consent, enforcement of a foreign tax judgment would implicate the separation of powers concerns of the revenue rule.").

[256] Dodge, *supra* note 21, at 224-25 ("Because [country] A's judges cannot ensure that [country] B's judges will cooperate (and vice versa), the rational thing for them to do is not to cooperate.").

[257] *Id. But see infra* Part IV, which advocates for a "bankruptcy exception," arguing that unilateral legislation without requiring reciprocity would be the best solution with respect to tax claims in bankruptcy, as the aligned policy goals of bankruptcy and tax would produce highly beneficial results.

[258] U.S. Const. art II, § 2 ("He shall have power, by and with the advice and consent of the Senate, to make treaties, provided two thirds of the Senators present concur.").

even, and won't be unduly benefiting a foreign government.[259] Treaties, it therefore seems, would be the perfect remedy to the revenue rule, and should be used extensively by the United States to ward off potential tax evaders.[260]

There are two potential problems with using tax-enforcement treaties as a solution to the revenue rule. First, tax-enforcement treaties are simply very uncommon.[261] While the United States has entered into double-taxation treaties, which correct the inefficiency of two countries taxing the same income, those treaties do not include provisions mandating enforcement of foreign tax claims outside of the double-taxation context.[262] The United States Model Income Tax Convention of 1996 does not require assistance to foreign countries in enforcing foreign tax claims.[263] Additionally, while the United States ratified the Organization for Economic Cooperation and Development Convention on Mutual Assistance in Tax Matters, it did so with reservation to Article 27, which requires assistance in enforcing foreign tax claims.[264] While the United States did, in the early 20th century, enter into treaties calling for general assistance with Denmark, France, Sweden, and the Netherlands,[265] these treaties simply show that the procedural mechanisms are in place for such agreements; the lack of support in the United States for further, broader, treaties demonstrates the "vitality of the revenue rule" and the "reluctance of the Senate and the State Department to enter into agreements that abrogate the revenue rule . . . ."[266] Thus, despite the potential benefits to a country from entering into tax-enforcement treaties, advancing broad, multilateral agreements (or even many bilateral agreements) is not yet entirely realistic until the United States shows an appetite for such arrangements.

A second pitfall for tax-enforcement treaties as a mechanism to enforce foreign tax judgments and therefore, ostensibly, collect taxes from

[259] *See supra* note 221.

[260] Mallinak, *supra* note 240, at 94 ("The revenue rule can be abrogated in an agreement between the United States and another country through a treaty."); *see also* British Columbia v. Gilbertson, 597 F.2d 1161, 1165 (9th Cir. 1979) ("Even though the political branches of the two countries could have abolished the revenue rule between themselves at the time they entered into the treaties, they did not.").

[261] Hans W. Baade, *The Operation of Foreign Public Law*, 30 TEX. INT'L L.J. 429, 484 (1995) ("Treaty provisions stipulating reciprocal enforcement of tax claims are rare, but not entirely unknown.").

[262] *Id.* ("The inclusion of [tax enforcement] clauses in a few double taxation conventions negotiated by the United States . . . did not set a trend and was soon discontinued . . . .").

[263] Mallinak, *supra* note 240, at 97.

[264] *Id.*

[265] *Id.* at 94-96.

[266] *Id.* at 97.

tax evaders is that tax havens will continue to hamper collection efforts.[267] Even if a large number of countries agree to a multilateral treaty, there will still be a "race to the bottom" between countries vying for international assets, and tax evaders will be sure to relocate to these areas that aren't bound by any such treaty.[268] Tax havens have always been a problem, as individuals would relocate to countries with low, or no, income taxes, and be assured that the revenue rule would shield them from taxes in their old countries.[269] In fact, tax havens aren't simply a problem with small rogue states, but are even a problem with large, industrialized, otherwise-internationally compliant and cooperative states. One need only glance at recent news to understand the United States' frustration in not being able to obtain information from the Swiss regarding foreign bank accounts of United States citizens. Despite United States hopes that the Swiss would lift their veil on secret bank accounts, Swiss courts ruled in January 2010 that such information-sharing by the Swiss would not be allowed, further frustrating United States tax-collection attempts, and possibly forcing a re-negotiation of a deal requiring the Swiss to hand over names of United States customers of UBS, Switzerland's largest bank.[270] Thus, due to the existence of tax havens, even if the United States would succeed in entering into tax-enforcement agreements with some nations, tax evaders would simply relocate to tax havens to shield their assets from collection.

C. Restatement of the Problem and Introduction to Solutions

Having examined the policies underlying both transnational

[267] See Steven A. Dean, *Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation*, 58 HASTINGS L.J. 911, 926-27 (2007) for a discussion of types of tax havens. Dean identifies both tax flight havens, and ordinary tax havens. *Id.* The Organization for Economic Cooperation and Development (OECD) has identified four attributes lacking in tax flight havens: (1) a comprehensive income tax, (2) effective information exchange, (3) transparency, and (4) requirements regarding substantive activities. *Id*. However, even countries which do have these four elements can still be unintentional tax havens by enacting a tax rate substantially lower than that of other countries. *Id.* at n.65.

[268] Baade, *supra* note 261, at 485 ("[T]his trend will continue to be resisted by 'tax haven' countries.").

[269] Tom Redburn, *U.S. Becoming a Tax Haven*, L.A. Times, Dec. 22, 1986 at 1 (noting that in the late 1980s, the United States, with income taxes substantially lower than other industrialized nations, was in danger of becoming a tax haven for foreigners). Redburn's article notes some high-profile individuals, including Bjorn Borg, who used tax havens to shield extensive wealth from taxation in his native Sweden. *Id.*

[270] Court Forces Swiss Rethink in UBS Tax Deal With US, N.Y. Times Online, Jan. 27, 2010, http://www.nytimes.com/aponline/2010/01/27/business/AP-EU-Switzerland-UBS-Tax-Evasion.html ("The Swiss government said Wednesday it may have to renegotiate a carefully wrought deal with the United States to hand over thousands of files on suspected tax cheats in return for an end to U.S. legal proceedings against Switzerland's biggest bank, UBS AG."); Court Says Swiss Order on UBS Data Broke Law, N.Y. Times Online, Jan. 8, 2010, http://dealbook.blogs.nytimes.com/2010/01/08/court-says-swiss-order-on-ubs-data-was-unlawful/.

insolvencies as well as the enforcement of foreign tax claims, we can apply these policies to attempt to craft a solution to our problem. We clearly saw benefits to a universalist scheme with cross-priority. Benefits of that scheme include predictability, encouragement of foreign investment, notions of fairness, and efficiency of administration. Similarly, we saw benefits to an abrogation of the revenue rule. Such benefits included strengthening international cooperation, supporting justice in collecting from tax evaders, and benefiting nations by not placing undue tax burdens on the rest of the nation. Thus, having understood the benefits that can accrue from a system which combines universal cross-priority with an abrogation of the revenue rule,[271] we can also understand the inefficiencies which arise from the current system—one in which the revenue rule applies in bankruptcy, and in which universal cross-priority of tax claims therefore is non-existent. Thus, we must craft a workable solution permitting the universal cross-priority of tax claims in bankruptcy. However, in doing so, the solution must strike the proper balance between rigidity and flexibility in order to maintain the policy goals of bankruptcy, and must also not violate the policy goals of the revenue rule.

IV. SOLUTIONS TO THE ENFORCEMENT OF FOREIGN TAX CLAIMS IN TRANSNATIONAL INSOLVENCIES

A. Preface: Public Policy Exception – A Matter of Construction

Inevitably, in each potential solution, there must be a "public policy exception," allowing the home country to refuse to enforce the foreign tax claim if the foreign claim is "manifestly contrary"[272] to the public policy of the home state.[273] Without such an exception, no country will adopt legislation requiring enforcement of foreign tax claims, as a system without an "escape hatch" would fail to strike the proper balance between rigidity

[271] Only in the bankruptcy context, that is. This article is not discussing a complete and total abrogation of the revenue rule in all contexts, nor would it be so bold. However, it should be noted that any solution which claims to abrogate the revenue rule solely in the bankruptcy context, and not outside of the bankruptcy context, creates a system of perverse incentives. Countries with large tax claims on corporations with substantial assets abroad will have a perverse incentive to force that corporation into insolvency, as the country will then be able to use this new "universal cross-priority of tax claims" to collect on its tax claim, which it would not be able to do outside of bankruptcy due to the revenue rule.

[272] The idea of the public policy exception, as well as the language excepting only cases which are "manifestly" contrary to public policy, is borrowed from Chapter 15. 11 U.S.C. § 1506.

[273] Minehan, *supra* note 227, at 817-818 ("The public policy exception is an essential political tool to encourage [states to enforce foreign law] because it serves as a 'safety valve' for unforeseeable changes in the law."). Another scholar notes that the public policy exception is "indispensable." Volker Behr, *Enforcement of United States Money Judgments in Germany*, 13 J.L. & COM. 211, 224 (1994).

(in requiring enforcement) and flexibility (in allowing non-enforcement in select cases).[274] The question then becomes how to construct the public policy exception. Give it too narrow a construction, and it ceases to function properly as an escape hatch, and the legislation becomes too rigid, resulting in hesitation by countries to enact it.[275] On the other hand, give it too broad a construction, and we run into a § 304 problem all over again – courts will have wide discretion to enforce or not enforce tax claims as they see fit, resulting in too much flexibility.

There is widespread support for giving public policy exceptions a narrow construction. As Justice Benjamin Cardozo famously stated,[276] we do not refuse to enforce judgments "unless help would violate some fundamental principle of justice, some prevalent conception of good morals, [or] some deep-rooted tradition of the common weal."[277] Another court went even further, refusing to enforce a public policy exception when a foreign law was not "repugnant to fundamental notions of what is decent and just."[278] The American Law Institute also has subscribed to this notion of narrow construction.[279] However, despite a narrow interpretation, there are still instances where application of a public policy exception, in the context of enforcing foreign tax claims, would be necessary. The following two subparts examine two distinct types of claim which could possibly be considered contrary to the public policy.

1. *Yukos Oil* and the Problem of Rogue Nations

One possible situation in which a country would use a public policy exception in refusing to enforce its neighbor's tax claim is when the claim is considered illegal. A widely publicized example of such a claim occurred in the *Yukos Oil* case of 2005.[280] The essence of the situation, quite

[274] *See supra* Part I for an extensive analysis of the different approaches toward transnational insolvencies, and the resulting need to strike a balance between these two goals in order to make a bankruptcy scheme realistically implementable.

[275] Much like universalism in its pure form.

[276] Albeit in a state-to-state situation within the United States, rather than in an international context. Still, this quote has been used as a guide to international arrangements as well.

[277] Loucks v. Standard Oil Co. of New York, 120 N.E. 198, 202 (N.Y. 1918). Cardozo further noted that the public policy exception should not be misinterpreted as a "judicial discretion" doctrine, as "[t]he courts are not free to refuse to enforce a foreign right at the pleasure of the judges, to suit the individual notion of expediency or fairness." Rather, the issue must be one of fundamental national interest. *Id.*

[278] Tahan v. Hodgson, 662 F.2d 862, 866 (D.C. Cir. 1981) (enforcing an Israeli default judgment which would not have been enforced under United States law).

[279] AM. LAW INST., *International Jurisdiction and Judgments Project, Report*, at 27 (Apr. 14, 2000) ("We are committed to a narrow interpretation of the public-policy defense to recognition . . . .").

[280] In re Yukos Oil Co., 321 B.R. 396 (Bankr. S.D. Tex. 2005). Yukos Oil was at the time the largest oil producer in Russia, and its bankruptcy petition in the United States was considered the

simplified, was as follows: Yukos Oil was rendered insolvent largely due to Russian tax claims which were in excess of $25 billion dollars.[281] Yukos, however, disputed many of these claims as discriminatory and punitive, and petitioned for bankruptcy in the United States with the hope that the United States court, or another international arbitrator, would declare the tax claims invalid, and Yukos would thus become solvent and be spared from Russian bankruptcy proceedings.[282] In the course of the United States legal proceedings, Yukos declared that:

> The Russian Government . . . began a campaign of creeping expropriation of Yukos' assets under the pretext of retroactively assessed taxes eventually totaling over $32 billion, imposed without due process, in a selective, discriminatory and confiscatory misapplication of Russian tax law. These essential facts have been recognized to be true by: (1) U.S. Bankruptcy Judge Letitia Clark in Houston, Texas; (2) U.S. District Judge Nancy Altas in Houston, Texas; (3) the United States State Department; (4) the Council on Foreign Relations; (5) the Council of the European Union; (6) the English Courts; and (7) the world financial press, including, for example, this week's Wall Street Journal and London Financial Times.[283]

The bankruptcy court indeed found that "[t]he weight of the evidence supports a finding that it is substantially likely that the assessments and manner of enforcement regarding [Yukos'] taxes were not conducted in accordance with Russian law."[284] Ultimately, despite the agreement that the taxes were illegal and should not be upheld, the Texas bankruptcy court dismissed the case, holding that the disputes involving a corporation so substantially tied to Russia should properly be adjudicated there.[285]

Despite the fact that the United States refused to adjudicate Yukos'

"largest bankruptcy case ever filed in the United States." *Id.* at 399.

[281] Dmitry Gololobov & Joseph Tanega, *Yukos Risk: The Double-Edged Sword – A Case Note on International Bankruptcy Litigation and the Transnational Limits of Corporate Governance*, 3 N.Y.U. J. L. & BUS. 557, 582 (2007).

[282] *Id.* (citing Press Release, Yukos Oil Co., Yukos Oil Company Statement in Connection with the Court Decision on Collection of Additional Profit Tax for the Year 2000 (May 27, 2004), available at http://www.yukos.com/vpo/news.asp?year=2004&month=5).

[283] *Id.* (quoting Memorandum of Law of Yukos Oil Company in Opposition to Verified Petition under Chapter 15 for Recognition of Foreign Main Proceeding and Application for Order to Show Cause with Temporary Restraining Order and Preliminary Injunction at 3, In re Petition of Eduard Rebgun, No. 06-B-10775 (Bankr. S.D.N.Y. Apr. 21, 2006)).

[284] In re Yukos Oil, Co., 320 B.R. 130, 136 (Bankr. S.D. Tex. 2004).

[285] In re Yukos Oil, Co., 321 B.R. 396, 399 (Bankr. S.D. Tex. 2005).

insolvency proceeding, and thus did not have the chance to either enforce or refuse to enforce the tax, this case presents a prime example of when the public policy exception should be used to refuse enforcement. Whether or not in the bankruptcy context, there will always be rogue nations which employ obviously crooked tax schemes, or which exert corrupt political pressure. Thus, a public policy exception is needed in any proposed tax-recognition legislation in order to make sure that such claims are not recognized. Both bankruptcy and tax goals are furthered by refusing enforcement of corrupt tax claims. First, on the bankruptcy side, a corrupt tax claim is entirely unpredictable,[286] and thus enforcing it will promote unpredictability and heighten the risk in further foreign investment. In addition, fairness will be compromised, as why should one creditor (here, a government) prosper due to corruption, and thus reduce the asset pool for the other, law-abiding creditors. On the tax side, concerns of national sovereignty are implicated, as using home country resources to satisfy the corrupt whims of a rogue state would be a serious affront to the nationalistic goals of any nation. Thus, this presents an easy application of the public policy exception, which will be in operation in each of the proposed solutions—namely, that any tax claim which is found to be corrupt or illegal is considered contrary to the public policy of the United States (or other home country) and need not be enforced.[287] However, a much tougher situation exists in the realm of tax claims which are not corrupt, but which are considered overly burdensome.

2. The Problem of Burdensome Tax Claims

The problem that would more likely arise is that of burdensome tax claims. Clearly, if a foreign government employs a tax rate similar to that of the United States—say, a top 30% rate, or even 35% rate, that would likely be deemed consistent with the public policy of the United States. Similarly clear is that a foreign tax claim of 110% of income would be deemed to be inconsistent with the public policy of the United States.[288]

[286] Note that this subpart talks only about actual "corrupt" tax claims – such claims are unpredictable, as were the claims in *Yukos Oil*. Claims that may seem corrupt due to their high tax rates, yet are actually within the law of the state (however ludicrous that law may be) are predictable, and thus pose a tougher challenge, as the next subpart will discuss.

[287] An obvious question here is how to define "illegal" or "corrupt" tax claims. In *Yukos Oil*, the claim was found to be illegal by courts in multiple countries, as well as by numerous international organizations. That seems to be valid proof of illegality. However, what if only one organization found illegality, or only one court found corruption? Would that be considered in violation of the public policy? Standards to define "illegality" or "corruption" are beyond the scope of this work, but it should just be noted that this is potentially a litigable topic.

[288] An interesting note, if the United States would enforce such a claim, would be whether it would implicate "Takings Clause" concerns, as the United States would essentially be taking private property, albeit on behalf of a foreign government. That issue will not be discussed in this Comment.

The problem becomes the gray area in middle – what about a tax rate of 50%? Of 60%? 90%? 100%? Nobody would argue that such rates are corrupt, or illegal. In fact, just twenty five years ago, the top marginal income tax rate in the United States was 50%, and twenty five years before that, a whopping 91%![289] Thus, such rates are clearly not illegal, and simply represent the public policy choices of the enacting states.[290] But are those tax rates inconsistent with "fundamental principles of justice?"[291] Are they "repugnant to . . . notions of [decency and justice]?"[292] Likely they are not. At the same time, convincing a country to enact legislation permitting foreign tax enforcement of 95% tax rates would be nearly impossible, due to the national sovereignty concerns of the revenue rule. For example, if the United States and a foreign country, each with substantially similar tax rates, enforce one another's tax claims, the net result will be negligible, and each country will realize intangible gains, as discussed earlier. However, if the United States enforces the 85%, or even 50% tax rate of a foreign nation, and that country reciprocates by enforcing the lower tax rate of the United States, reciprocity doesn't matter, as the United States will be benefiting a foreign country significantly more than it benefits in return. Thus, it is clear that some tax rate would have to be considered against the public policy—a line would have to be drawn somewhere,[293] and that would be a very difficult decision to make.[294]

In sum, it's obvious that any solution must include a public policy exception, and that the public policy exception should certainly exclude illegal, or corrupt, tax claims. Also clear is that some rate of taxation will probably have to be considered contrary to the public policy, and that standards need to be in place to determine the point where a tax rate goes

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[289] For a helpful chart showing the top marginal income tax rates in the United States over the past century, see Top U.S. Marginal Income Tax Rates (1913-2003), http://www.truthandpolitics.org/top-rates.php.

[290] The mere fact that a foreign law is dissimilar to United States law does not, by itself, make the law contrary to the public policy. *See* Minehan, *supra* note 227, at 800-04 (detailing numerous types of claims which have been liberally enforced in the United States despite their either not existing in the United States, or varying substantially from their counterparts in United States law).

[291] *Supra* note 277.

[292] *Supra* note 278.

[293] One possible standard would be to enforce tax rates them up to the top United States marginal level at that time. This would solve the problem on two levels. First, it would allow the claiming nation to receive something instead of nothing. Second, it solves the problem of fluctuating tax rates. Just as tax rates in the United States have declined over time, they can plausibly hike back up. Thus, a standard which is tied to the United States rate would not have to be adjusted for every new tax law promulgated by Congress. Another possibility is to employ a "phasing-out" policy, whereby 100% of the first, say, 35% taxed is paid, 50% of the next, say, 15%, and so on. This would represent a compromise on the part of the enacting country between a sincere desire to cooperate internationally and a need to protect local assets.

[294] The one certainty, though, is that the line must be drawn ex ante. Meaning, the United States needs to have a set rule mandating that "foreign tax claims of xx% or below will be enforced."

from viable to repugnant. However, despite issues which a public policy exception raise, such exceptions have generally not been taken advantage of,[295] the standards for a law being contrary to the public policy are difficult to meet,[296] and the benefits of employing any one of the following recommended solutions greatly outweigh the possible risks of such an exception.

B. Solution A: Mandate Universal Cross-Priority for Foreign Tax Claims With a Narrow Public Policy Exception – The "Ex Ante" Rule

The best possible solution, from both a bankruptcy and a tax perspective, would be to unilaterally mandate universal cross-priority for foreign tax claims with a narrow public policy exception. While not abrogating the revenue rule completely, such a mandate would create a "bankruptcy exception," through which the revenue rule is not recognized in the context of a transnational insolvency, and foreign tax claims are enforced.[297] The public policy exception, which would provide a dose of flexibility, would be understood to have a narrow construction in accordance with Justice Cardozo's intent, and would be restricted to the two situations described earlier—those of illegality, and excessive burden (however that would be defined). Thus, the public policy exception would be a rarely used escape clause, and wouldn't endanger the mandatory nature of the law. There are numerous benefits that the United States would realize through such a rule, both in bankruptcy and in tax. Although at first this seems like an overly ambitious and broad suggestion—since foreign tax claims have never been recognized—it is this author's contention that when dealing solely within the bankruptcy context, this solution ameliorates the policy concerns that the revenue rule had addressed, and achieves tax policy goals, which, when combined with bankruptcy policy goals, make this a clear choice as the best possible approach. Because the goals of international bankruptcy law and international tax law are aligned, the benefits of a more rigid approach are multiplied by treating tax claims in a rigid fashion, while the potential downsides of a flexible, discretionary approach are exacerbated by treating tax claims flexibly.

First, in terms of bankruptcy goals, this approach is the ultimate "ex

[295] Minehan, *supra* note 227, at 799 ("Theoretically, this exception may be easily abused. . . . [r]ecognizing this potential for abuse, U.S. courts have narrowly construed the public policy exception and exercised it on rare occasions."). See *id.* at 804-07 for the rare occasions on which the exception was used.

[296] Ackerman v. Levine, 788 F.2d 830, 841-42 (2d Cir. 1986) ("[T]he standard is high, and infrequently met.").

[297] This has the potential to cause perverse incentives on the part of foreign countries, who will attempt to force certain corporations into bankruptcy in order to collect taxes which it would otherwise not be able to collect under the revenue rule.

ante" solution. The United States would be unilaterally telling corporations, investors, and foreign governments, before any relationships or obligations are entered into, that foreign tax claims will be paid upon insolvency. This would further the goals of universalism, as non-COMI countries would be much more likely to completely defer to the home court, instead of opening up their own proceedings to satisfy their tax claims. Obviously, this promotes the goal of predictability, as investors will know for sure that taxes will be paid. This is in stark contrast to the alternative, in which investors have no idea, ex ante, if the tax claim will be paid, if it will be given a priority or not, or, if it isn't paid, if the claiming country will open up its own proceeding to "grab" assets to satisfy the claim. This predictability therefore encourages investment in multinational companies, as investors are accurately able to calculate their risk, and predict the distributions in event of default. Additionally, this solution promotes administrative efficiency, as all claims will be able to be dealt with by the home-country court, and foreign courts will have no need to waste the debtor's resources by opening up ancillary or parallel proceedings to satisfy their tax claims. Furthermore, this is the ultimate achievement in terms of fairness, as competing governments, which are similarly situated creditors, are given the same treatment in bankruptcy, and are not discriminated against based on nationality. Lastly, debtor corporations will be less likely to "forum shop" by moving assets out of countries with large tax claims, as those tax claims will be paid regardless of where the assets actually are located.

On the tax side, such an approach produces similarly beneficial results. First, such a policy promotes cooperation and notions of comity, which are beneficial in any area of law,[298] as cooperation leads to increased sharing of burdens and information, which reduce costs for individual nations.[299] Second, such a policy promotes justice, as it cracks down on would-be tax evaders, and forces them to pay lawful taxes regardless of where the assets may be located.[300] Lastly, such a policy will protect the national interest, as non-enforcement of taxes would have created a tax burden in the claiming country, which would have to be filled by the rest of

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[298] Richard W. Hulbert, *Some Thoughts on Judgments, Reciprocity, and the Seeming Paradox of International Commercial Arbitration*, 29 U. PA. J. INT'L L. 641, 641 (2008). ("The international enforceability of judgments is, quite reasonably, thought to be relevant to the efficiency of international business.").

[299] See Westbrook, *supra* note 83, for a discussion of the transactional gain which results from such cooperation. Thus, even if the United States may come out behind in one case, Westbrook argues that the overall gain which results from international comity makes cooperation worthwhile. While Westbrook's contention isn't specifically in the tax arena, the idea holds true.

[300] While an insolvent corporation isn't a "tax evader" in the pure sense like an actual individual who crosses national boundaries to reach foreign territory, the idea is the same, that people who owe taxes should pay them regardless of geographic considerations.

the lawful taxpayer base. Thus, this approach will promote these three policy goals of international taxation.[301] Additionally, let's address the concerns of the revenue rule, and show how such an approach ameliorates all of those concerns. First, Judge Hand's concern about judicial embarrassment of other nations is no longer an issue; judges will not be analyzing foreign tax laws, and will simply be enforcing them. Second, and closely related, judicial competence to assess foreign tax law is a non-issue, as they will obviously not have to analyze the foreign tax code. Third, separation of powers won't be an issue, as the enforcement won't be a direct result of judicial action, but will be as a result of legislation imposed by the other branches of government, which are permitted to deal in foreign matters. Lastly, national sovereignty concerns will hopefully be ameliorated through the inducement (not the mandate—that will be discussed in another approach) of reciprocity.[302]

The obvious potential risk with this approach is that, if adopted unilaterally by the United States, other countries won't adopt the legislation, and will take advantage of the United States. This approach simply cannot work over the long run if no other country adopts it, and if that proves to be the case, then the approach will need to be amended. However, it is likely, due to the acceptance of this issue as a complex and disruptive problem, and due to the recent spirit of cooperation, that many other countries will adopt similar statutes.[303] The United States, as the undisputed leader of the world, should take the first leap and implement this legislation which would provide tremendous advantages to all countries.[304] Professor Westbrook has noted that "acts of helpful cooperation, without an initial requirement of reciprocity, breed reciprocity in friendly countries,"[305] and Westbrook tests

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[301] Obviously these goals would be promoted also by an across-the-board (not just in bankruptcy) repeal of the revenue rule. However, as stated at *supra* Part III.B, that's not a realistic suggestion at this point, and restricting it to the bankruptcy context is a logical first step.

[302] Dodge, *supra* note 21, at 219 (arguing that the "sovereignty argument for the public law taboo lead[s] ultimately to reciprocity. If reciprocal enforcement of a nation's . . . tax . . . laws could be assured, then such cooperation would be more advantageous to both governments and their citizens than protectionism."). Reciprocity can be assured in two ways – it can either be induced, which it what this solution intends to do, or it can be mandated, which will be discussed in the third possible solution.

[303] Westbrook, *supra* note 61, at 29 ("The experience in the United States . . . is that helpful and cooperative actions . . . produce reciprocal assistance from courts in other countries.").

[304] For a judicial view on the hesitation to require reciprocity, *see* Cunard Steamship Co. Ltd. v. Salen Reefer Servs. AB, 773 F.2d 452, 460 (2d Cir. 1985) ("Cunard also argues that, since there is no indication that a Swedish court would grant comity to a United States bankruptcy court under analogous circumstances, the district court's granting of comity here was improper. We find this contention without merit. . . . while reciprocity may be a factor to be considered, it is not required as a condition precedent to the granting of comity.").

[305] Westbrook, *supra* note 61, at 29. *See also* Westbrook, *supra* note 62 ("This unilateral initiative did not require reciprocity and did not attract much reciprocity at first . . . . More recently other countries have began to move in the direction of cooperation . . . .").

and proves this assertion using examples from § 304, which was a unilateral statute which was reciprocated by certain foreign governments, despite no reciprocity requirement.[306] Despite the risk caused by unilateral action, because the goals of bankruptcy and of tax are aligned, the benefits realized by this approach are vast, and it should ideally be implemented.

C. Solution B: Mandate Universal Cross-Priority for Foreign Tax Claims With a Broad Public Policy Exception – The "Ex Post" Rule

A similar approach would be to impose a mandate requiring the universal cross-priority of tax claims, but allow for wide judicial discretion to disallow any claim which is even remotely in contrast to United States policy. In other words, judges would decide, ex post, whether to enforce a given tax claim. While unlikely to be implemented in light of the accepted interpretation of public policy exceptions in this country and abroad,[307] this policy ameliorates the concern of those who believe the first approach is a reckless endangerment of our national sovereignty. However, this is actually a very weak approach, as it compounds the problems of flexible bankruptcy rules with those of flexible tax rules.

First, this approach is nothing short of disastrous in the bankruptcy arena. Judges would insert their own opinions and interpretations, and the inconsistent approach which led to the downfall of § 304 would cause the same problems with this rule. Similar cases would lead to dissimilar results solely based on judicial prejudice.[308] Obviously, this is far from a rigid approach, and fails to accomplish the goals which transnational insolvency scholars and organizations have been striving to meet. This approach is wildly unpredictable, as investors have no idea, ex ante, whether a potential foreign tax claim will be paid, and therefore will stifle foreign investment as these investors will not be able to properly calculate their risk. Of course efficiency isn't accomplished, as a spurned country would have a great incentive to "grab" its local assets for distribution to the local government, which would create an unnecessary secondary proceeding and would waste dwindling resources. Lastly, this is hardly a fair approach, as similarly situated creditors will be discriminated against based on nationality.[309]

Furthermore, such an approach will implicate the precise concerns

[306] Westbrook, *supra* note 61, at 29 (citing Roberts v. Picture Butte Mun. Hosp., [1999] 4 W.W.R. 443 (Canadian court recognizes a U.S. court as the best court for the case in the interest of international comity); Barclays Bank plc v. Homan (In re Maxwell Communication Corp.), [1992] B.C.C. 757 (Ch.) (Homan), *aff'd*, [1992] B.C.C. 767 (C.A.) (noting a British court's recognition of U.S. action even when most parties were British)).

[307] *See generally* Minehan, *supra* note 227.

[308] *See supra* Part I.C.2.

[309] *Id.*

that the revenue rule aims to correct! Judges will have wide discretion to analyze foreign tax claims, and will often reject some, which (1) will cause embarrassment to foreign nations, and (2) United States judges are ill-equipped to do, due to competence issues.[310] Also, separation of powers will be an issue, as the enforcement of the claims will come directly from the judiciary, instead of from the other branches of government. Thus, this approach would be a step backward in both the bankruptcy and tax contexts, as it would be a reversion to § 304 policies, and should not be considered a viable solution.

D. Solution C: Mandate Universal Cross-Priority for Foreign Tax Claims With Reciprocity

An alternative approach would be to mandate universal cross-priority of foreign tax claims, with a narrow public policy exception, but to require reciprocity—meaning, to only extend the cross-priority privilege to those nations which have adopted a similar provision. The benefit of a reciprocity requirement is that it would ostensibly solve the major problem of the first approach, in that it would give the United States some leverage in having its own tax claims recognized abroad.[311] However, there are several problems with including a reciprocity requirement,[312] aside from the United States generally disfavoring such a requirement.[313] In fact, "[a] reciprocity requirement was debated several times in the UNCITRAL discussions because a small number of countries favored it, but it was defeated by a large consensus each time."[314]

There are two ways in which a reciprocity requirement could be enforced.[315] Under the first version, it would be done on an ex post, case-by-case basis, whereby in each insolvency case in the United States in which a foreign country has filed a tax claim, the United States court would have to analyze the foreign law to determine if it meets the reciprocity

[310] *Supra* Part III.A.

[311] Hulbert, *supra* note 298, at 653 (discussing whether such a requirement would give the United States this leverage).

[312] *Reciprocity and the Recognition of Foreign Judgments*, 36 YALE L.J. 542, 547 (1927) ("Reciprocity has been bitterly criticized. The criticism generally takes the form of comparing it disadvantageously with a theory of universal recognition of foreign judgments.").

[313] Dodge, *supra* note 21, at 227-28 (stating that most U.S. states which have adopted the Uniform Money Judgments Recognition Act have not included a reciprocity requirement, and that the Restatement of Conflicts, the Restatement (Second) of Conflicts, and the Restatement (Third) of Foreign Relations Law all do not require reciprocity).

[314] Westbrook, *supra* note 61, at 29.

[315] Susan L. Stevens, Note, *Commanding International Judicial Respect: Reciprocity and the Recognition and Enforcement of Foreign Judgments*, 26 HASTINGS INT'L & COMP. L. REV. 115, 131 (2002) (citing International Jurisdiction and Judgments Project, ALI Council Draft No. 1, at Summary (Nov. 20, 2001)).

requirement.[316] The burden could either be on the claimant to prove a reciprocal foreign law, or on the party resisting the claim to prove its non-reciprocal nature. Regardless of the burden, the court would need to analyze the foreign laws on this ex post basis. This arrangement would bring about the same "judicial discretion" concerns that the other ex post approaches do.[317] While the court wouldn't be directly deciding whether to enforce the tax claims, requiring judges to analyze whether a law is, in fact, reciprocal, would simply be moving the ball forward and would "spawn satellite litigation over whether the requirement is satisfied by the foreign country."[318] Thus, because the enforcement of the foreign tax claims would essentially be made discretionary and much flexibility will be given to the courts, the concerns over flexibility in both the bankruptcy and tax realms will be present. The second method for enforcing a reciprocity requirement analyzes foreign law on an ex ante basis.[319] Under this approach, the United States government would maintain a list of countries with reciprocal statutes, whose tax claims would be enforced. This method would remove judicial discretion from the equation, and would essentially force the judiciary to enforce or not enforce a given tax claim. Thus, the aforementioned bankruptcy and tax concerns which flow from judicial discretion would not be present. Due to the lack of judicial discretion, and the ex ante publishing of a list of reciprocal nations, this second approach to reciprocity would foster greater predictability than would the first approach.

However, reciprocity requirements, in either of their two forms, have generally not been used in the United States, are not as beneficial to the goals of transnational insolvency, international taxation, or to the promotion of international cooperation,[320] and are ultimately an unnecessary requirement on the road to universal enforcement.[321] Nevertheless, if a unilateral mandate is not implementable, then a mandate combined with a reciprocity requirement (preferably the second version) would be a compromise worth enacting, as it would (1) be a step toward universal enforcement, and (2) would at least provide benefits between reciprocal

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[316] *Id.*

[317] See *supra* Part I.A for a discussion of the ex-post approach of territorialism, and *supra* Part IV.C for the ex-post approach of a broad public policy exception.

[318] Hulbert, *supra* note 298, at 651. This could, of course, be fixed by having an international organization promulgate a Model Law in the area, and having countries adopt the Model Law. However, unless each country adopted it verbatim, there would invariably be nuances and variation in each country's law which would need to be analyzed by the courts to determine reciprocity. *See* Westbrook, *supra* note 61, at 24-29 (describing the changes that countries adopting the UNCITRAL Model Law have made).

[319] Hulbert, *supra* note 298, at 651.

[320] As these goals will only be realized be reciprocal nations. For example, even if Country Y doesn't reciprocate Country X's cross-priority of tax claims, it does not promote fairness to refuse to enforce Country Y's tax claim. Similarly, refusal does not promote justice for tax evaders.

[321] Westbrook, *supra* note 61.

nations.

E. Solution D: Encourage Multilateral Tax Treaties Dealing Specifically With Insolvency

This solution, which would encourage the United States and its counterparts to enter into either many bilateral treaties, or, better yet, a large, multilateral treaty mandating the enforcement of foreign tax claims in bankruptcy,[322] would reach the same result as would an approach mandating the second version of reciprocity. After all, if the United States would publish a list of reciprocal nations, and mandate cross-priority to those nations, that would essentially constitute a "treaty" with those nations. The benefits and detriments of such an approach would therefore be nearly analogous to the previous approach, in that while it is a valid solution and would foster a great deal of cooperation, predictability, and rigidity, and would minimize judicial discretion, the benefits would not be as great as if countries unilaterally decided to grant a universal cross-priority, without regard to reciprocity or treaty. Thus, in comparison to Solution A, this is clearly a weaker option, yet may be more realistic for those with strong national sovereignty concerns. When compared to Solution C, as stated, the results are the same; however, this approach would be substantially more difficult to implement,[323] as it would require significantly more effort, in the form of international cooperation—as opposed to a solution simply requiring each nation to act unilaterally and to qualify the law with a reciprocity requirement.

> Experience has shown that despite the potential for international treaties to bring widespread harmonization, the effort to negotiate such agreements is generally substantial and . . . "the greater the degree of practical utility that is pursued by means of a treaty, the greater the difficulty in bringing it to fruition, and hence the greater the risk of ultimate failure."[324]

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[322] While we saw *supra* in Part III.B that the United States has been reluctant to enter into treaties abrogating the revenue rule, the hope here is that limiting the treaty to the transnational insolvency setting will make this more amenable than a broad treaty, similar to the hope of Solution A, that unilateral enforcement of foreign claims solely in the insolvency context is a much more workable solution than attempting a broader abrogation.

[323] Clift, *supra* note 126, at 312 ("There has also been a lack of multilateral treaty arrangements.").

[324] *Id.* Clift also provides examples of the difficulty of negotiating such a broad agreement, and notes the contrast between actual, enforceable treaties, which are difficult to negotiate, and non-governmental recommendations, such as those promulgated by the United Nations, the ALI, and the International Bar Association. *Id.* at 313-14.

Thus, this Solution, while similar in result to Solution C, would take significantly more effort, and is therefore less realistic. Thus, in the event that the United States is not able to implement Solution A, and to grant a universal cross-priority of tax claims irrespective of a reciprocity requirement, the United States should preferably enact similar legislation with such a requirement, instead of relying on treaty negotiations.

CONCLUSION

This Comment began by discussing the goals of transnational insolvency, proceeded by following the evolution of the cooperative, universalist spirit in transnational insolvency, and finally assessed the substantial problem that priorities, and specifically those of taxes, presented. In response to this problem, and taking into account the aforementioned goals of insolvency, the current cooperative spirit, and the underlying policy reasons behind the problem caused by tax priorities, this Comment suggested four possible solutions to resolve this problem. In analyzing the possible solutions, a number of principles are clear: (1) a universal cross-priority system for tax claims, without the need for reciprocity or judicial discretion, accomplishes the goals of transnational insolvency, promotes and furthers the spirit of international cooperation, and minimizes the concerns of the revenue rule while promoting tax goals; (2) in enacting such a system, the public policy exception must obviously be given its customary narrow interpretation, or else risk rendering the entire law impotent; (3) the issue of national sovereignty—meaning, concerns that a unilateral granting of cross-priority won't be reciprocated by other nations—is the prime concern of the universal granting of cross-priority; (4) there are those who would enact unilateral legislation regardless of this concern, in the hope of fostering a spirit of cooperation and inducing reciprocal legislation, as the benefits obtained from this system far outweigh the benefits of other approaches; and (5) for those who cannot tolerate a unilateral enactment, the two possibilities to lessen national sovereignty concerns are either to (a) include a reciprocity requirement, or (b) engage in insolvency/tax treaties mandating the enforcement of cross-priorities between the agreeing nations. Taking into account these ideas, the best possible solution is for the United States, acting unilaterally, to mandate the universal cross-priority of tax claims, with a narrow public policy exception, and hope to foster a cooperative spirit to induce similar legislation in other nations. Such a result will have a profound benefit on all of the parties involved in a transnational insolvency case,[325] on

[325] Corporations and investors will know ex ante that tax claims, domestic and foreign, will be

governments,[326] and on our increasingly global society at large.[327]

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paid in accordance with the home country's priority. Of course, as mentioned throughout the Comment, determining which country is the home country could be difficult.

[326] Governments won't lose their rightful tax revenue simply due to a corporation's insolvency in a foreign country.

[327] This benefit is twofold—first, there won't be a tax burden resulting from non-enforcement which would have to be borne by the rest of the lawful taxpayers; and second, this spirit of cooperation and certainty will promote predictability and thus will encourage economic growth in all countries. Westbrook, *supra* note 83 (discussing the "transactional gain" which accrues to countries that mandate a rigid approach to transnational insolvency).