I. Introduction

Today even the leaders of the People’s Republic of China [FN1] agree with the Founders of the American Republic [FN2] that a bankruptcy system is central to fundamental economic reform. Yet only recently has this understanding risen to an international...
level, focusing attention on the problem of multinational (cross-border) insolvency. Just as automotive enthusiasts rarely rave about radiators, bankruptcy is not often a major topic in the discussion of economic development and globalization—until the engine boils over. Recent developments, in particular the adoption of a Model Law on Cross-Border Insolvency by the United Nations Commission on International Trade Law (UNCITRAL), [FN3] demonstrate a dramatically increased awareness of this problem and provide a stimulus to look ahead to the next evolution. Traditionally, scholars have identified two fundamental views about the administration of a multinational insolvency. One is universalism, which means that a single bankruptcy proceeding affects the debtor’s assets wherever located in the world such that the orders entered and dispositions made in the main proceeding are given effect by courts everywhere. [FN4] The second view, territorialism, has meant seizure of local assets by each local court to be distributed under local law for the benefit of locally filing creditors. In recent years, adherents to both systems have urged cooperation among courts, especially in reorganizations. We in the United States face some difficult decisions related to this distinction. Universalism, in a modified form, is the fundamental concept underlying U.S. approaches to cross-border insolvency, while a modified territorialism dominates thinking in most other countries. U.S. courts are conditioned to think of seeking deference to a court in a debtor’s home country, or, if the United States is the home country, of seeking deference from other courts. In many other countries, courts think in terms of local or secondary bankruptcies in cases where a local jurisdiction has a significant interest in a particular debtor. In these countries, deference to a main proceeding is limited for the most part to instances where the local jurisdiction has some assets but not enough to justify a local proceeding. Section 304 of the U.S. Bankruptcy Code [FN5] and the leading case law thereunder exemplify “modified universalism,” [FN6] while “modified territorialism” has its most advanced example in the European Union Bankruptcy Convention. [FN7] This distinction is not to suggest for a moment that U.S. courts have always been internationally minded and other courts have always been parochial. That is certainly not true; but it is true that the underlying idea behind section 304 is centralization and deference while the fundamental concept behind the EU Convention [FN8] is cooperation among decentralized proceedings. [FN9] *29 The question that faces U.S. policymakers is whether and to what extent to adapt U.S. doctrine to the realities of a world of modified territorialism despite the U.S. conviction that modified universalism is a superior long-term solution. This paper addresses a central point in the structure of cross-border insolvency, the problem of priorities, in the context of that question.

II. Summary

In a previous paper, [FN10] I addressed the potentialities of universal cross-filing (UCF), which is a system that permits a liquidator in Country A to file claims in an insolvency proceeding in Country B on behalf of all the creditors who have filed claims in the insolvency proceeding in Country A. In that paper my concern was to show how UCF might produce distributions in a system of modified territorialism similar to that produced by a universalist system. [FN11] In the process it was necessary to discuss the interesting question of “cross-priority,” by which I mean nondiscriminatory, national treatment for foreign [FN12] claims that fall within a category of claims given priority in a local insolvency system. In a UCF system, for example, a Mexican liquidator could file in a U.S.
proceeding on behalf of all the Mexican creditors of the U.S. debtor. To determine the effect of UCF, it would be important to know whether the Mexican employees would receive the same priority distribution as the U.S. employees. My conclusion in the previous paper was that the answer is undetermined in the legal systems I know something about, but that plausible arguments exist for granting national treatment—\textit{that is, equivalent priority}—to the Mexican employees and other foreign priority claimants. That conclusion held despite the fact that the conventional assumption is that foreign creditors would not be given the benefit of priorities under local law. \[FN13\] The argument suggested that the best rule may depend on the international system, universalist or territorialist. In this paper, I want to carry the analysis of my earlier paper farther. After summarizing the earlier analysis in Part I, my focus changes from the effects of UCF to the merits of national treatment for foreign creditors: Should foreign creditors enjoy cross-priority? After making the general argument in favor of cross-priority in Part II, I want to turn in Part III to a largely unexplored question, the proper choice of law for priority claims. The earlier paper assumed a (distributing) forum choice of law in every case, but there is no a priori reason that that should be true. Indeed, as to the most important form of priority—secured claims—it is generally assumed that the law of the situs of the collateral is most often chosen for all purposes. \[FN14\] It is helpful to introduce secured claims into the discussion of choice of law for priority claims because they have been assumed to enjoy national treatment—\textit{that is, secured claims held by foreigners get the same treatment as secured claims held locally.} \[*30\] The discussion of secured priorities together with other priority claims has a more than theoretical interest, because the priority of secured claims is trumped by other priority claims in many legal systems, unlike our own. Thus, it is practically important to understand the relationship between choice of law for secured priority and choice of law for other sorts of priority. The timeliness of the discussion is highlighted by current proposals to change fairly radically the choice-of-law provisions for Article 9 of the Uniform Commercial Code. \[FN15\] There is no room here to analyze these questions fully, but I hope it will be helpful to expose the issues and some of the relevant considerations. It is important to emphasize at the start that universalism does not necessarily imply cross-priority or national treatment, while territorialism does not necessarily imply denial of cross-priority. Universalism—territorialism and cross-priority vel non are independent variables. We will examine each alternative.

\textbf{III. Cross-Border Priority}

\textbf{A. Universal Cross-Filing}

Although the new European Union Convention is based on a system of "secondary bankruptcies" or "modified territorialism," it also contains a provision for cross-filing of claims. \[FN16\] Each liquidator in an insolvency proceeding in an EU country may file claims on behalf of all the creditors in that proceeding in each other EU-member proceeding involving the same debtor. Thus every claim made in any proceeding may be asserted in all proceedings through the liquidators, and therefore every claim may share in the distribution from every proceeding. That is the system I want to call universal cross-filing, or "UCF." If there were no national priority systems, the result of UCF would approach the same equality of distribution as in a system of modified universalism, in which all distributions take place under the direction of a single national court. \[FN17\]
B. Effects of Priorities

The reality is that each national insolvency regime has a system of priorities. These national systems differ, although they also have some important commonalities. For example, our country is alone, as far as I know, in granting special protection to consumers who have made deposits with retail stores and landlords. [FN18] On the other hand, we have in common with many other countries priority systems favoring employees, the domestic fisc, and secured creditors. [FN19] The primary discussion of priorities in connection with cross-border insolvencies has been to note the difficulties that variations in priority present for harmonization or cooperation. While that point is important, it cannot be fully appreciated without first considering whether local priorities are available to foreign creditors. Most national legal systems I have explored seem not to have developed a rule about the availability of local *31 priorities to foreign creditors whose claims would qualify for priority treatment if they were local creditors. The granting of such nondiscriminatory treatment can be called "cross-priority." The grant of cross-priority would be a specific instance of the important modern concept of "national treatment," which promises the same treatment for foreigners as similarly situated citizens would receive. The primary example in my earlier paper was the priority often given to employees. In the United States, the relevant priority provision, section 507(a)(3), is silent about national treatment. [FN20] Indeed, the entire Bankruptcy Code is silent about giving nondiscriminatory treatment to foreign creditors. Nonetheless, such treatment is usually assumed. [FN21] On that basis, it would seem that foreign priority creditors, such as foreign employees of the debtor, ought to be given the same priority available to U.S. employees. Apparently, the same argument would be plausible in other legal systems. The argument is made much more powerful because the national treatment standard has achieved such a central place in international trade law. [FN22]

1. With Cross-Priority

In a system of universalism or a system of modified territorialism permitting UCF, distributions will be greatly dependent upon whether each jurisdiction also applies a system of cross-priority, even if the bankruptcy laws of the relevant jurisdictions have similar priorities for the priority claims against that debtor. In an example elaborated in Appendix A, if the main priority claims against North American Amalgamated, Inc. (NAAI) are employee claims, NAAI has most of its assets in the United States, and all of those claims will fit within the employee priorities of pending insolvency proceedings in Canada, Mexico, and the United States, then cross-priority will greatly benefit any Canadian and Mexican employees who make such priority claims. At the same time, cross-priority will greatly disadvantage general creditors. The result of applying cross-priority will be to lessen national discrimination while increasing discrimination among classes of creditors. Of course, discrimination among classes of creditors--for example, in favor of secured creditors versus unsecured creditors--is precisely the policy point of priority systems. Therefore, cross-priority serves national policies, unless those policies are rooted solely in the local polity and economy, a point discussed below. If we change our example to a system with UCF and cross-priority, but the priority systems in the two countries are very different, cross-priority will still make the distribution more like a universalist distribution, but to a much reduced extent. [FN23]
*32 2. Without Cross-Priority

(a) Universalist System

Without cross-priority, a universalist system may produce results quite different from a UCF system. Without cross-priority, a universalist system will greatly serve home-country priorities and general creditors, while all creditors with priority rights outside the home country will suffer. Such a result may make universalism less palatable to policymakers, who risk seeing local assets distributed disproportionately in favor of creditors favored with priority in a foreign country. In our pending example, as detailed in Appendix A, a universalist system without cross-priority will benefit the U.S. employees and all general creditors of the company, while the employees in Canada and Mexico will do much worse.

(b) Territorialist System

On the other hand, in a territorialist system without cross-priority it is very hard to predict who would win and lose. Such a system, which is what most people assume exists today, would give some effect to each country’s priority choices. This equal treatment may recommend territorialism, but it would also produce very unpredictable results. A territorialist system without cross-priority is so unpredictable because results vary directly with the location of assets at the time insolvency proceedings begin in various jurisdictions. [FN24] Each country will be either a "surplus" or a "deficit" jurisdiction. A surplus jurisdiction is one in which the ratio of assets to claims filed in the local proceeding [FN25] is greater than it is for the debtor company as a whole. [FN26] A deficit jurisdiction is one in which the ratio is less than the worldwide ratio for the debtor. [FN27] A change in the country of surplus does not change the result in a universalist system, even in the absence of cross-priority. In a territorialist system without cross-priority, a change in the surplus-deficiency allocation substantially changes results, even with UCF, because the nationality (or other indicia of local status) of the winners in a territorialist system changes depending on which jurisdiction is the surplus jurisdiction. In a universalist system, the primary jurisdiction’s favored classes of local creditors always receive priority and no one else does. [FN28] If one assumes that an international system will be one without cross-priority, the absence of cross-priority might make a universalist system *33 less attractive from a local policy perspective, but a universalist system would have the virtue of being much more predictable. In summary, in an international system with UCF, a universalist system is much more predictable, with or without cross-priority. It is most predictable without cross-priority, but may be more politically acceptable with cross-priority. With or without cross-priority, UCF makes a territorial system produce distributions more like universalist distributions. Cross-priority increases that effect. The importance of UCF is heightened by the fact that it is relatively easy to adopt. It may well be that a modified territorial system with UCF is more achievable in the medium term than a universalist system.

IV. Arguments for Cross-Border Priority

Because the conventional wisdom would seem to be that most national priority schemes will not be interpreted to grant cross-priority, it is first appropriate to address arguments that might be made in favor of cross-priority. These arguments can be divided into
domestic or "merits" arguments and international arguments. The only system I can discuss with some confidence is our own, so the United States will be my example.

A. Domestic Arguments

Domestic arguments must begin with an understanding of the policies underlying each priority because the granting of cross-priority must be evaluated by the applicability to foreign creditors of the policies underlying domestic priority rules. For this purpose, the U.S. priorities can be divided into procedural and substantive priorities. The procedural priorities, the first two in section 507(a), serve the insolvency system itself. The first, giving top priority to administrative expenses, protects the personnel who administer the system. [FN29] Such expenses are given first rank in every system I know about, for the obvious reason that an insolvency system cannot operate without some assurance of payment for its personnel, either from the taxpayer or from the estate. [FN30] The second procedural priority protects "gap" creditors who extend credit while an involuntary petition is pending. [FN31] This is an obvious necessity if the system is to have time to consider the decision to grant or deny the petition. It seems patent that foreign creditors may have claims entitled to priority under either section 507(a)(1) or (2) and that it would be inconsistent with the purposes of the provisions to deny that priority. For example, if a foreign professional were employed to conduct or assist in a foreign litigation or foreign insolvency proceeding on behalf of the estate, the professional should obviously be compensated. [FN32] If a foreign creditor can pass the difficult test of making a substantial contribution in a case, who would seriously argue that compensation should be denied on account of the creditor's foreignness? [FN33] Similarly, if a foreign party supplies goods or services on credit in a "gap" period, surely the second priority should be available to encourage the widest availability of such credit. These cases *34 seem the easiest ones and appear to demonstrate that cross-priority can be justified on domestic policy grounds for at least some priorities. The same thing is true of the most important substantive priority, that given to secured creditors. [FN34] There is, of course, a vast literature devoted to the policy arguments that support the secured-credit priority. [FN35] Happily, the merits of those arguments are not the present subject. For present purposes, it seems fair to say that the policies supporting the secured-credit priority apply equally to domestic and foreign creditors, so if the secured-credit priority is justified for one, it is justified for the other. In both cases, the asserted policy justifications require the creation of an expectation of priority in a creditor who proceeds as the law requires, and the asserted benefits can follow from credit advanced by a foreign party as surely as from one obtained domestically. The domestic policies underlying the remaining U.S. priorities are hard to establish. There is little literature defending, or even explaining, the basis for most of our priorities. On the whole, one could say there are two arguments for the substantive priorities in section 507(a)(3)-(9) of the Code: fairness and protection of the fisc. Employees, [FN36] grain farmers and fishermen, [FN37] and ex-spouses and children [FN38] are all weak parties whose special protection seems fair as against creditors generally, and whose support might fall on the taxpayer if they were not favored. [FN39] Presumably, fairness alone justifies favoring those who make deposits for consumer purposes [FN40] because it can be assumed their relegation to general unsecured status would not usually threaten a resort to the welfare rolls and a consequent burden on the taxpayer. [FN41] In the case of priorities eight and nine protecting certain federal
government claims, [FN42] the protection of the fisc is the obvious justification, but there may also be a claim that the losses suffered by these public agencies are entitled to preferential treatment because such agencies do not choose to deal with a particular debtor and cannot check a credit rating before risking loss. [FN43] It is obvious that these arguments have different impacts on the question of cross-priority. Fairness arguments presumably apply equally to foreigners--one would hope. Public burden arguments presumably do not apply to nonresident foreigners; we may not be concerned about children or employees on welfare rolls other than our own, and we certainly are not concerned with other countries' tax collections, except where treaties have produced fairly specific reciprocal obligations. Thus, the domestic arguments cut both ways as to cross-priority: On the basis of domestic arguments alone, whether to apply *35 cross-priority might depend on each observer's opinion about the strength of fairness versus fiscal justifications as to each domestic priority. Other domestic arguments could be made for each of these provisions. For example, one could no doubt construct an economic model for or against a priority in terms of incentives and disincentives to being an employee of a start-up or a distressed business or to giving consumer deposits to such businesses. I assume such arguments are interesting, but so attenuated in reality as to deserve little consideration. The same thing is true of arguments about incentives to pay taxes because there seems little likelihood that insolvency priority rules will have a real impact in an environment full of much more powerful incentives to pay taxes. I propose to ignore these other arguments.

B. International Arguments Generally
Although the domestic arguments are a mixed bag, the international arguments seem to me to cut strongly in favor of cross-priority in most cases. The first international argument is the general principle of national treatment. Our FCN (Friendship, Commerce, and Navigation) treaties with many countries provide for national treatment in commercial matters, [FN44] so an argument exists that we are required to give cross-priority to citizens of those countries. Beyond treaty obligations, nondiscrimination on the basis of citizenship is a general principle that has evolved in modern international law, especially in international trade under GATT (now the WTO). [FN45] Thus, at a minimum, one would think that discrimination on the basis of foreignness would be presumptively wrong. Even if one wanted to discriminate, it is difficult to determine a standard for foreignness for that purpose. This difficulty provides a second argument against discrimination, revealing the anomaly of such discrimination in a globalizing environment. Shall we refuse priority if the claimant is a noncitizen although a resident, so that the green-card employee gets no priority? [FN46] Shall we base refusal on residence or nonresidence instead, so that the U.S. citizen who works for a U.S. company in France gets no priority when it goes bust? Shall we permit priority to both citizens and residents, but deny it to a French employee who came to Toledo to work for six months or two years alongside Toledoans? Should it matter if he or she worked for the same company in Lyons instead, alongside the U.S. employees assigned there? Should the answers vary if the debtor is a company incorporated in one country but doing business primarily in another? Or one doing business in ten countries, including the United States? If we switch to ex-spouses or children, the distinctions become even more difficult and painful. 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. As discussed earlier, cross-priority offers further advantages in that it makes a universalist system, or a system of modified territorialism with UCF, more palatable. Cross-priority also makes the latter system produce results closer to universalism.

*36 C. Governmental Priorities

The governmental priorities of section 507(a)(8)-(9) of the Code remain. Subsection (a)(8) on its face applies as fully to foreign governmental tax claims of the sort given priority in that section as it does to U.S. tax claims of the same sort. [FN47] The rub is that foreign revenue claims have historically been denied enforcement in all U.S. courts. Thus, the question of foreign revenue claims is more a question of disallowance than priority as such, but with some of the effect of a "reverse priority." [FN48] If such claims are allowed at all, as discussed below, we would then have to determine if they are entitled to the eighth priority like domestic revenue claims. Of course, the ninth priority is specifically limited to certain agencies of the U.S. government, [FN49] so cross-priority is unavailable. This priority does, however, serve as a place marker for another issue, the priority, if any, given to foreign government claims other than tax claims. Because we do not usually give priority to nontax claims for U.S. governmental units in bankruptcy, we may avoid having to confront this issue in the United States. [FN50]

D. Other Priorities

So far, we have not discussed nonconsensual lien priorities, which often have purposes and effects similar to other priorities. [FN51] Most jurisdictions create various priorities by way of liens. U.S. law is replete with them. Common examples are mechanics, materialmen, and landlords liens. If a specific property is subject to a priority claim under U.S. law, it is hard to imagine that anyone would claim that the foreignness of the claimant would affect the priority of the lien. Would a French supplier who provided rivets for a Manhattan building be less entitled to "lien" it and gain priority than a supplier from Brooklyn? Surely not. On the other hand, if the building is in Martinique but owned by a U.S. debtor in a U.S. insolvency proceeding, the problem is in the first instance a choice-of-law question, which we put to one side. [FN52] A final category in the priority puzzle is "reverse priorities." Reverse priorities are subordinations or disallowances that operate to reduce or eliminate recovery by specific classes of creditors or members of such classes. [FN53] Because they have the effect of lowering priority, reverse priorities really must be considered in a discussion of cross-priorities. Should a Canadian stockholder of a Salt Lake City business be subject to subordination of a loan just as a U.S. insider would be? [FN54] Should a Mexican landlord suffer the same cap on its rent recovery (after any landlord's lien) from that company as would a landlord in Salt Lake City? [FN55] It seems clear to me that the answers to these questions should be "yes" where the debtor is a U.S. entity. For reasons reciprocal to those given for positive cross-priority, the policies underlying these rules apply to foreigners just the same. National treatment should cut both ways; a foreigner who invests in or rents to a U.S. company must realize the likelihood that U.S. rules will apply to any claim against the general assets of that company. [FN56] Furthermore, any attempt to immunize foreigners against these rules would encounter the same difficulty of defining "foreignness" as with positive cross-priority. In general, therefore, it would seem that cross-priority should include national treatment in
the application of reverse priorities as well. [FN57] Some might want to argue that these questions should be governed by the "proper law of the contract," even as to a U.S. company. For a U.S. lawyer, these rules of reverse priority are easily seen as insolvency rules meant to trump contract rules. It is easy for us because we have a federal system. The rights of a lender-shareholder or a landlord are governed in our country by state law. It is precisely those laws, the proper laws of those contracts, that the insider rules and the landlord-cap rules are meant to trump. Thus, it is obvious for us that they should trump applicable foreign contract law as well. [FN58] The rule refusing to enforce foreign revenue claims is a common law doctrine imported into U.S. law. [FN59] It is more than a "reverse priority" rule. It is a rule of complete disallowance, but it seems appropriate to discuss it here. It is closely related to a major cross-priority issue, cross-priority for tax claims. Furthermore, subordination rules often operate as de facto disallowance rules, even though they are technically lowering priority in distribution. [FN60] So, priority-lowering by class of claims and disallowance by class of claims are not terribly different. On the other hand, denial of revenue claims is not limited to insolvency cases. One cannot speak of the applicability of domestic policies here because this rule is based squarely on nationality: only non-American governments are denied enforcement. There is no general question of national treatment because governments are not usually granted such treatment. They get "MFN" treatment at best, ensuring that they are no worse treated than other governments. [FN61] There is also little problem of definition because the notion of sovereignty almost always provides a bright-line distinction. The general policy question transcends insolvency law. *38 Having said that, revenue priorities, and governmental priorities in general, have long been recognized as major barriers to cross-border cooperation. [FN62] They have been the subject of considerable criticism domestically in many countries. Recent reforms reducing such priorities have been regarded as progressive, both domestically and internationally. [FN63] Furthermore, continued exclusion of allowance and cross-priority for tax claims presents a considerable obstacle to universalism and, to a lesser extent, to modified territorialism. If revenue authorities, who are politically potent in most countries, believe that they will receive recoveries only locally, they will be an important force against expatriation of assets and other forms of international cooperation in insolvency matters. This problem is so large and has so many noninsolvency dimensions that I will not attempt to address it in this paper. It must suffice to say that it requires serious attention. To this point, the argument is that a home-country court—a U.S. court in the case of a company based primarily in our country—should grant national treatment, or cross-priority, to all claims falling within a defined priority category under applicable U.S. priority law without regard to nationality, residence, or other indicia of "foreignness," with a possible exception for governmental priorities. So far in this paper, as in my earlier paper, it has been assumed that U.S. priority law applies to any distribution by a U.S. court. That assumption is examined next.

V. Choice of Law for Priorities

To introduce the question of choice of law for priority rules, let us begin with the example of a U.S. company with one Mexican employee, one Mexican supplier-creditor, and one Mexican asset. [FN64] The employee is owed US $4,000, the creditor is owed US$6,000, and the asset is worth US$10,000 net of expenses. The debtor has dozens of U.S.
employees owed US$45,000 and many other unsecured creditors in the United States as well, along with US$15,000 in U.S. assets net of administration costs. [FN65]

A. Universalist Analysis
Suppose, contrary to fact, that the Mexican court would adopt a universalist position and defer to the U.S. proceedings. The court would transfer the asset here, leaving the Mexican claimants to make their claims in the United States. In that case, assuming cross-priority under the U.S. priority rule for wages, [FN66] the Mexican employee would receive about US$2,000, fifty cents on the dollar, and the Mexican supplier would receive nothing. [FN67] Absent cross-priority, both Mexican creditors would receive nothing. [FN68] *39 Although cross-priority is preferable, either of those results would be appropriate for a universalist system, because in such a system it does not make sense to segregate assets into pools determined by their location (or by the sheer power to capture them) on the date an insolvency proceeding is commenced. The great benefits of universalism are predictability and the consequent vindication of expectations, which can be achieved only by applying home-country rules. Even if administration is conducted by several courts, a universalist system achieves predictability by distributions under a predictable set of rules applied by one or more courts. Only the home-country rules have a hope of being predictable. [FN69] Thus, a purely universalist court will always choose home-country law for priorities.

B. Territorialist Analysis
On the other hand, a home-country court committed to modified territorialism is faced with a different set of choice-of-law questions. To understand those questions, we must first consider why a jurisdiction would commit to territorialism despite its disadvantages from an international perspective. Although modified territorialism represents the farthest most countries are willing to go at the present time, there is relatively little articulation in the literature or even in discussions at international conferences of the reasons for favoring that system over some form of universalism. Perhaps the explanation for this silence is that some of the reasons for territorialism are unfashionable and unflattering. A territorialist policymaker could be completely noninternationalist or somewhat internationalist. There are probably two reasons for a policymaker to be noninternationalist in insolvency matters, and therefore, a territorialist. One is a simple desire to prefer local creditors. The other is a conviction that the local jurisdiction will be a surplus far more often than a deficit jurisdiction, and, therefore, the national interest cuts against an internationalist policy. [FN70] Although either view might lead to overt discrimination in favor of local creditors, internationalist pressures might produce a compromise: equal treatment of anyone, local or foreign, who manages to file a claim in the local proceeding. [FN71] For such a policymaker, there is no reason to consider applying foreign priority rules. I hope and trust the United States does not fall into this category.

C. Reasons for Choosing a Foreign Priority Rule
A somewhat internationalist policymaker would be willing to consider applying foreign rules to foreign claims. On the other hand, it is not clear that the somewhat internationalist policymaker would have much reason to apply foreign rules if a system of modified
territorialism has been adopted. I suggest that the very structure of the system of modified territorialism cuts against applying foreign rules. As we have seen, the traditional assumption is that each forum will distribute according to its own priority rules. [FN72] Just the granting of cross-priority--equal treatment for foreigners under the local priority rules--is an advanced idea at the present time. So we can be confident that even a somewhat internationalist policymaker would not apply foreign priority rules without a fairly compelling reason to do so. Assuming all the assets to be distributed were associated with [FN73] the local jurisdiction at the time of bankruptcy, there is no obvious reason the policymaker would apply foreign priority law. As we have seen, there seem to be two grounds for priority rules other than secured priority: fairness and protection of the fisc. Neither of these grounds are likely to persuade the policymaker in the local jurisdiction to apply foreign priority rules. The policymaker, by hypothesis, thinks the local rules are more fair than alternative rules and is likely to have little interest in protecting a foreign fisc. On the other hand, in the choice-of-law context there is another argument, one based upon expectations. Employees, for example, could argue that they expected to be protected by their laws. They would argue those expectations should be honored. Those expectations could be honored, at least in part, as an example will show. Suppose a U.S. company has US$10,000 in U.S. assets, no Mexican assets, a Mexican employee with a US$6,000 claim, two U.S. employees with claims of US$5,000 each, and many general unsecured creditors. [FN74] The Mexican claim could be treated as a full priority claim, as it would be in Mexico, and the U.S. claims could be allowed as priority claims under U.S. law to the extent of US$4,000 each. [FN75] The assets would then be divided pro rata, 71.43 cents on the dollar: US$4,286 for the Mexican employee and US$2,857 each for the U.S. employees. [FN76] I find it hard to imagine the Mexican claimant would receive such favorable treatment. With purely U.S. assets involved, there is no obvious reason to change the default position of applying U.S. law. The claimant's argument of an expectation that Mexican law would govern the insolvency of a U.S. employer seems tenuous at best, especially in a territorial world when there were no Mexican assets of any value and no Mexican proceeding. Cross- priority--equal treatment under U.S. law--is the best a foreign priority claimant can expect to get. If there are Mexican assets, the situation becomes somewhat different. Ordinarily, in a territorialist world one would expect Mexican proceedings to be opened to distribute the Mexican assets. A basic assumption of the territorialist system is that assets from another jurisdiction will rarely be available for distribution in a local court, because the presence of substantial assets in a jurisdiction will generally lead to the opening of a local proceeding and distribution in that proceeding. [FN77] On that basis, modified territorialism ordinarily produces only one asset pool in each relevant jurisdiction consisting of assets captured by the local court. The possibility of applying foreign priority law in a territorialist system arises in the less usual situation where substantial assets have been captured by the local court, even though the assets were associated with another jurisdiction at the time insolvency proceedings began. We will call that court the "enriched" jurisdiction. It may be that procedural problems or costs prevented opening local proceedings in the other jurisdiction before the enriched court ordered the debtor to transfer the assets to it. The captured assets might include, for example, an inventory of goods, a bank account, or receivables. In this context, it is plausible to create two asset pools, domestic and foreign. The claimants who would have been entitled to claim priority had a local proceeding been opened in the other jurisdiction...
will seek application of its priority rules to the proceeds of the foreign assets. Amending
our example, we will add US$5,000 worth of assets that were associated with Mexico at
the time of bankruptcy. No Mexican proceedings were opened, for whatever reason, and
the assets are now under the control of the U.S. bankruptcy court. The U.S. court may
now, if it chooses, treat the Mexican-derived assets as a separate pool. If so, it could
apply Mexican priority law to those assets. How might it do so? One note prefatory to an
answer: Separate distributions from two asset pools create an issue as to how each
distribution should take account of the other. The traditional answer in common law
countries has been the hotchpot rule embodied in section 508(a) of the U.S. Bankruptcy
Code. [FN78] That rule is applied by a) establishing a claim’s classification under local
law; b) determining if that claim has received payment from another insolvency
proceeding; and c) if so, paying that claim only the amount which will make the total
distribution on that claim equal proportionately to the distribution received by other
members of that class in the local proceeding. [FN79] The hotchpot rule is at best a first
step toward an appropriate "adjustment" rule. It is unsophisticated
and unsatisfactory. However, I do not intend in this article to explore the adjustment-rule
issue any farther. Understanding this rule, we can answer the question posed above.
The Mexican employee’s claim would get full and first priority, but what about the U.S.
employees? In a world of UCF and cross-priority, [FN80] if a local proceeding had been
opened in Mexico—as a territorialist would expect—the U.S. employees would also have
gotten full priority. Thus, applying Mexican priority law to the Mexican assets has the very
considerable benefit of replicating the results that would have followed from the usual
situation, the opening of a Mexican proceeding. The result is to make modified
territorialism substantially more *42 predictable and, perhaps more important, to lower the
incentives for multiple local proceedings. If Mexican creditors, especially priority creditors,
know that their claims will be given Mexican-law treatment in the U.S. courts to the extent
of the Mexican assets, they have much less motive to institute Mexican proceedings. In
that case, there is the prospect of much lower costs and greater speed than where each
relevant jurisdiction opens a proceeding. On that basis, the Mexican and U.S. employees
would share the US$5,000 of Mexican-derived assets pro rata, 31.25 cents on the dollar.
[FN81] When the employees claim in the U.S. proceeding, they will assert their full
claims, subject to adjustment as discussed above. [FN82] Because the U.S. priority caps
recovery at US$4,000 per employee, there will be US$12,000 of priority claims against the
US$10,000 of U.S. assets, permitting 83% of those claims to be paid under the usual
rules. All of these claims would receive a pro rata distribution in Mexico, and therefore
they have no need for adjustment inter se, but they remain subject to the U.S. cap on
employee priority. The result might be US$2,125 for the Mexican employee and
US$2,437 for each U.S. employee, giving each of them a worldwide total of US$4,000.
That would leave US$3,001 of U.S. assets to be shared among the general creditors'
claims, which would include the remaining US$2,000 nonpriority claim of the Mexican
employee. Note that there are many interesting alternatives to this calculation, but I leave
them to the insomniacs. [FN83] This exemplary result will do for present purposes.
However those details are sorted out, we have found a substantial justification for a rule of
priority based on the situs of the property at the time of bankruptcy. In many ways this
type of rule is not a happy result because situs rules are notoriously difficult and arbitrary
in application. There are powerful arguments for situs rules, however, in a world of
territorialism, even modified territorialism. A case can be made on such a basis that the most urgent item on the international reform agenda should be the adoption of UCF and cross-priority along with a uniform choice-of-law rule along the foregoing lines. Until universalism can be established, such reforms may be the best option. Note that the application of UCF and cross-priority in such a territorialist scheme eliminates the problem of defining foreign creditors. All creditors get equal priority under each relevant national system within whatever classes each system defines. To complete the picture, we must examine the effect of security interests. In our example, we make both the Mexican and U.S. assets subject to perfected security interests in amounts exceeding their value.

[FN84] Following the situs-of-collateral rule for assets is consistent with the traditional situs rule for security interests, with the result that the employees do much worse because of the presence of secured claims. Assuming UCF and cross-priority, the employees take first in Mexico, ahead of the secured party, getting 31 cents on the dollar as before, [FN85] but they get nothing in the United States. [FN86] The secured party gets the full US $10,000 of U.S. assets. None of the unsecured creditors gets anything in either jurisdiction. Once again, these are the results one would expect through local proceedings in each country under a territorial scheme. *43 What happens if the encumbered assets become subject to the control of the U.S. court in this example? That could happen if the Mexican court permitted the assets to be expatriated--for example, as part of a cooperative effort in a reorganization attempt that failed--or if the U.S. court, debtor-in-possession (DIP), or trustee-in-bankruptcy (TIB) removed them to the United States after the U.S. proceeding was filed but before a proceeding had been opened in Mexico. If the United States applies a situs-of-collateral rule, we see the same results as in the two-proceeding situation. If, however, the U.S. court applies its own priority law to the entire distribution, then the secured creditors, U.S. and Mexican, take all and the employees, U.S. and Mexican, get nothing. [FN87] This result confounds the expectations of the Mexican employees in a world of modified territorialism and gives the Mexican secured party a windfall it had no good reason to count on. It would likely make the Mexican court completely unwilling to expatriate assets, reorganization or no reorganization, and would undoubtedly spark races to the courthouse. Here the employees' Mexican union would be sprinting to open a Mexican bankruptcy, and only some bond or other guarantee would justify its forbearance from doing so. The situs-of-collateral rule for security interests is old-fashioned and often pernicious. It creates adventitious and unpredictable results as to tangibles in an increasingly mobile world and creates often arbitrary results as to intangibles. But the situs-of-collateral rule has two powerful practical advantages: it is the well-established rule in most countries, and it fits a world of modified territorialism. Here, as elsewhere, the notice and priority rules of secured claims and the insolvency rules must fit together reasonably well. If parochialism is to continue its reign in insolvency systems, situs rules may have to remain in place for secured credit.

VI. Conclusion
I am deeply committed to the idea of universalism in insolvency matters. It has long seemed to me the best practical answer in a world of globalizing finance and enterprise, as well as the ideal approach to a future in which a host of institutions might combine to produce peace, prosperity, and democracy around the world. But I have been enormously
struck in various international venues by the resilient power of sovereignty and territorialism, in this field as in many others. It may be that we must shape our reforms in international insolvency to a version of modified territorialism for the present if they are to work efficiently and fairly in the world as it is. Thus, for example, there is everything to be said for abandoning the situs-of-collateral rule for the priority of secured claims, but it may be imprudent to do so too soon. As discussed just above, cooperation in a system of modified territorialism may require the application of collateral-situs rules to encourage asset protection or expatriation and to discourage races to the courthouse. Second best is better than bad. Accommodation with territorialism, in this and other respects, may have the additional virtue of increasing the commercial pressures for universalist approaches. Secured creditors faced with the realities of multiple-jurisdiction rules and inconsistent results may throw their considerable weight on the side of universalism when they realize that jiggering secured-credit rules alone will not overcome the effects of territorialism on their interests. Large unsecured creditors, especially lenders and underwriters, may begin *44 to press for universalist structures when they see that territorialism is hopelessly unpredictable. If the shouts of self-interest can be joined to the sweet strains of comity and universality, thus putting words to the music, perhaps we may hope for progress toward a universalist future.

*45 APPENDIX A

The following examples illustrate the key points mentioned in a summary fashion. They are taken from a previous paper, Universal Participation in Transnational Bankruptcies, published as part of a tribute to a central figure in international commercial law, Professor Roy Goode. [FN88] The debtor in a U.S. Chapter 7 liquidation is an American company with operations in Canada, Mexico, and its home city of Raleigh, North Carolina. It has 1,000 employees in each jurisdiction and owes the equivalent of US $3,000 in wages to each of them at the time of filing, a total of $3 million in each jurisdiction. It also owes $1 million in other general unsecured claims in each jurisdiction. It has enough assets in the USA to pay $4 million to creditors after costs of administration. It will have $1 million after administration costs in each of the other two jurisdictions. [FN89] If all the countries involved give full priority to the employee claims, then both a universalist court and a group of UCF local courts taken together would pay the employees 66 2/3%. [FN90] The general creditors would do much worse here than in a world with no priorities in any country, getting nothing because of the employee priorities. By contrast with the foregoing, consider the effect of denying cross-priority in a universalist or in a UCF system. In a universalist system without cross priority, the U.S. employees would be paid in full (US$3 million). The Canadian and Mexican employees would get no priority in the U.S. proceeding, so US$3 million of the US$6 million in worldwide assets would be available for payment of U.S. general creditors and all other creditors on a pro rata basis. Each of those creditors, non-U.S. employees and others, would get 33 1/3% of its claim (US$3 million in remaining assets divided by US$9 million in remaining claims). These results in a universalist system without cross-priority are very different from universalism with cross-priority. The U.S. employees do much better, going from 66 2/3% to 100% recovery, as do the general creditors in all three countries, going from no recovery to 33 1/3%. The Mexican and Canadian employees do much worse, dropping from 66 2/3% to 33 1/3%. Note that the combination of a unitary distribution and the discrimination in favor

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of the local priority creditors in the primary jurisdiction (here the U.S. employees) means
the winners and losers are not defined simply by nationality or class, but by a combination
of the two. On the other hand, gains and losses work a bit differently in a UCF system.
The U.S. employees would be paid in full. The Canadian and Mexican employees would
get 33% in their local proceedings, leaving nothing in those proceedings for the general
creditors. Those employees and the general creditors in all three proceedings would then
claim against the US$1 million in assets remaining in the U.S. case. The general creditors
would get 11.1% (as against nothing in a UCF system with cross-priority and 33 1/3% in
an universalist system without cross-priority) and the non-U.S. employees would get a
total of about 45% worldwide (as against 66 2/3% in a UCF system with cross-priority and
33 1/3% in an universalist system without cross-priority).

[FNd1]. Benno C. Schmidt Chair of Business Law, The University of Texas School of Law.
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organizing the best international law symposium in which he has ever participated.

[FN1]. See, e.g., Seth Faison, China's Leader Announces Sell-Off of State Enterprises,
N.Y. Times, Sept. 13, 1997, at A7 (reporting China's President's proposed bankruptcy law
reform as part of a massive privatization program and a "fundamental economic shift").
The PRC has gone through one major reform of its bankruptcy laws since economic
liberalization began and has done a number of studies of further reform since then. See
(unpublished paper presented at the Texas International Law Journal Symposium on
International Bankruptcy Law: Comparative and Transnational Approaches, on file with the
Texas International Law Journal).

[FN2]. See U.S. Const. art. I, s 8, cl. 4.

[hereinafter UNCITRAL Report]. A draft of the Model Law was pending at the time of this
symposium, but the final version was adopted just two months later.

[FN4]. See Donald T. Trautman, Jay Lawrence Westbrook, & Emmanuel Gaillard, Four
Four Models]. There is also the notion of "unity," which means that one court administers
all assets, but that notion is so far from contemporary reality that it is not really part of the
working hypothesis of present scholars.


[FN9]. See Four Models, supra note 4, at 607.


[FN11]. See id. at 424.

[FN12]. By "foreign" I mean a claim seen as foreign in the local jurisdiction. Defining "foreign" in a globalizing world is not as easy as it looks. See text infra second paragraph of Part II.B.

[FN13]. Admittedly, to talk about the "conventional assumption" in this whole area is a bit attenuated given the nascent stage of its development. My characterization reflects many conversations with experts around the world rather than any published commentary.

[FN14]. Only recently have discussions of choice of law for secured claims really focused on the possibility of different choices of law for different issues relating to secured claims. Currently, U.C.C. s 9-103 provides for a single choice of law for all issues. See discussion infra Part III.


[FN17]. See Universal Participation, supra note 10, at 424.


[FN19]. See generally 1-2 International Loan Workouts and Bankruptcies (Richard A. Gitlin & Rona R. Mears eds., 1989) (describing aspects of bankruptcy law in Argentina, Brazil, Canada, Egypt, England, France, Germany, Israel, Italy, Japan, Mexico, the Netherlands, Switzerland, the United States, and Venezuela).

[FN21]. See American Law Institute, Transnational Insolvency Project: International Statement of United States Bankruptcy Law, Tentative Draft 112- 14 (Apr. 15, 1997). This "Tentative Draft" has not been published in final because it awaits translation into Spanish; but it has, in fact, been finally approved by the ALI at its May 1997 annual meeting.


[FN24]. This discussion assumes that the location of the assets of a multinational enterprise may be unpredictable. Obviously, that assumption is subject to empirical testing, and the facts are likely to vary greatly from industry to industry and with reference to many other variables as well.

[FN25]. Because most countries allowing claims do not discriminate against foreigners, the phrase "locally filed claims" is not the same as "local claims." The latter, traditional idea refers to claims of local citizens or residents, while the former refers to any claim that is allowed or recognized in the local proceeding, which nowadays often includes the claims of foreign-based creditors.


[FN27]. See id.

[FN28]. Another potentially important consequence is that countries that expect to be in surplus much more often than in deficit, but do not expect to be the primary jurisdiction in most cases, may prefer UCF (or even more extreme localism) to universalism. See id. See also Sir Peter Millet, Cross-Border Insolvency: The Judicial Approach, 6 Int'l Insolv. Rev. 99, 101 (1997) (arguing that smaller countries with more assets than local debt are not likely to embrace international agreement).


[FN30]. See J. H. Dalhuisen, Dalhuisen on International Insolvency and Bankruptcy s 1.06[1] (1986). In some systems, including the Mexican, these claims share the first position with other claims. See American Law Institute, Transnational Insolvency Project:


[FN32]. See id. s 503(b)(2) (1994).


[FN34]. By the term "security interests," I mean to include consensual security in real estate or personal property and to exclude liens given by operation of law--like a landlord's lien--or involuntarily--like a mechanic's lien or a tax lien.


[FN41]. This is not the occasion for wondering why grain farmers are entitled to more solicitude than other farmers or why tenants who make deposits with landlords should step ahead of tort victims.


[FN43]. See Teresa A. Sullivan, Elizabeth Warren, & Jay Lawrence Westbrook, As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America 297 (1989). Even accepting the argument, it is not clear why this justifies a preference vis-a-vis tort creditors and other involuntary creditors, but we must resist these tempting diversions.

[FN45]. See GATT, supra note 22, art. III.

[FN46]. Note that a resident foreigner raises some of the same "burden on the taxpayer" arguments as does a resident citizen, assuming we continue to provide at least some benefits to such persons.


[FN48]. See infra notes 53-59 and accompanying text.


[FN51]. Indeed, many of our English-speaking foreign friends call them both "preferences," distinguishing between "special" preferences (security) and "general" preferences (priorities).

[FN52]. See discussion infra Part III.

[FN53]. I do not mean to include any disallowance of a claim on its merits under the law applicable to that claim. I do mean to include any situation where the disallowance depends in part on the class to which the creditor belongs. If a stockholder of a U.S. company is subject to equitable subordination for wrongdoing, the relevant class may not be "wrongdoer," but "insider."

[FN54]. See 11 U.S.C. s 508 (1994); see, e.g., In re Carolee's Combine, 3 B.R. 324, 327-28 (1980) (subordinating rights of loan-holder investors who had engaged in inequitable conduct that resulted in injury to other creditors of the bankrupt or unfair advantage to the investors).

[FN55]. See 11 U.S.C. s 502(b)(6) (1994). This question is separate from recovery on a landlord's lien under Mexican or Utah law.


[FN57]. These conclusions may not apply, on the other hand, where the debtor has substantial contacts--like place of incorporation, principal place of business, or principal operations or assets--in another country.

[FN58]. See generally Four Models, supra note 4, at 585.

[FN59]. See Her Majesty the Queen in Right of B.C. v. Gilbertson, 597 F.2d 1161, 1163-65 (9th Cir. 1979); Restatement (Third) of the Foreign Relations Law of the United States
It is not clear whether the United States would refuse to enforce other sorts of governmental claims (as opposed to commercial claims by governmental agencies), for example, a right of reimbursement for payments of wages to the debtor's employees after the debtor failed to pay them. See generally Hans W. Baade, The Operation of Foreign Public Law, 30 Tex. Int'l L.J. 429, 478-81 (1995) (discussing the integration, or lack thereof, of claims based on foreign public law into conventional choice-of-law categories).

[FN60]. For example, it seems clear that subordination likely meant no recovery for the investors in In re Carolee's Combine, 3 B.R. at 327-28.


[FN62]. See generally Susan J. Cantile, Preferred Priority in Bankruptcy, in Current Developments in International and Comparative Corporate Insolvency Law 419 (Jacob S. Ziegel ed., 1994) (arguing that the preferred priorities accorded by Member States in the European Convention on Certain International Aspects of Bankruptcy belie the popular wisdom according to which governmental priorities are impediments to international harmonization of bankruptcy law).

[FN63]. See, e.g., id. at 416 (discussing Canada's new Bankruptcy and Insolvency Act under which all Crown claims are presumed to rank as unsecured claims).

[FN64]. This discussion applies to nonconsensual liens as well as consensually secured assets.

[FN65]. This analysis ignores currency conversion issues. See, e.g., Mexican Statement, supra note 30, app. J, reporter's note 144, 156-57.

[FN66]. See 11 U.S.C. s 507(a)(3)(A) (1994). We assume that the wages were earned within the 90 days before bankruptcy.

[FN67]. The employees would take all of the assets. Assuming all wages were earned within 90 days of bankruptcy and that each U.S. employee claim was less than US$4,000, the total employee priority claims would be US$49,000. Dividing US$25,000 in assets by US$49,000 in total employee priority claims yields about a 50% distribution with cross-priority. Nothing is left for nonpriority creditors. If the Mexican employee were treated as a nonpriority creditor--that is, if cross-priority were denied--then the U.S. employees would get slightly more (25,000/45,000 = 56%) and the Mexican employee as a general creditor would get nothing.

[FN68]. This example illustrates why cross-priority makes universalism more palatable, because it gives some creditors at least a hope of priority in the home-country court.
[FN69]. There may be problems predicting which country will be determined to be the
home country, but no other rule offers even a strong likelihood of predictability. See
Westbrook, supra note 6, at 529.

[FN70]. See discussion supra Part I.B.2.

[FN71]. In the modern world, this finesse will be increasingly unsuccessful as more and
more sophisticated creditors crowd into local proceedings everywhere.

[FN72]. See Westbrook, supra note 26, at 462.

[FN73]. I say "associated" because "located" is a factual description only for tangible
assets, while intangibles have to be assigned a fictional "location."

[FN74]. An example is meaningful only if there is not enough to go around.

[FN75]. There are several other formulas one could use to apply the Mexican priority, but
this example makes the point.

[FN76]. The U.S. rule where there is too little to pay all claims in full within a given priority
class is pro rata distribution within that class. See 11 U.S.C. s 726(b) (1994). This
analysis ignores rules accounting for distribution in another jurisdiction. See infra note 79
and accompanying text.


[FN78]. See 11 U.S.C. s 508(a) (1994). Section 508(a) states as follows: If a creditor
receives, in a foreign proceeding, payment of, or a transfer of property on account of, a
claim that is allowed under this title, such creditor may not receive any payment under this
title on account of such claim until each of the other holders of claims on account of which
such holders are entitled to share equally with such creditor under this title has received
payment under this title equal in value to the consideration received by such creditor in
such foreign proceeding.Id. A similar rule has been included in article 32 of the
UNCITRAL Model Law. See UNCITRAL Report, supra note 3, art. 32.

[FN79]. For example, if I have a claim for US$100 and receive the equivalent of US$20 in
a Mexican proceeding, a U.S. court will first determine the classification of my claim under
the U.S. priority system. Assuming that I have a general unsecured claim and that 30% is
to be the approximate distribution to such claims in the U.S. proceeding, the court will first
distribute 20% to all completely unpaid claimants, putting them even with me. It will then
allocate the remaining money pro rata among all claims, including my claim. If the final
U.S. distribution to general claims is US$31, then the other general claimants will get
US$31 from the U.S. court and I will get US $11. All such claimants, including me, will
end up with US$31 from the distributions made from the two asset pools.
[FN80]. If there were no UCF and cross-priority, the U.S. employees would likely get nothing in the Mexican proceeding, but the Mexican court might transfer the surplus to the U.S. court for distribution after paying the sole Mexican creditor. (Of course, it is more likely a sophisticated general creditor would file in Mexico and enjoy the surplus, a result that would be avoided by a UCF system even without cross-priority.) The Mexican court would likely do so if the UNCITRAL Model Law on Cross-Border Insolvency were adopted. See UNCITRAL Report, supra note 3, arts. 21(1)(e), 25, 27. In that case, the U.S. employees would get priority in the transferred funds under section 507(a)(3) of the Code.

[FN81]. The Mexican employee gets US$1,875 and the U.S. employees get US$1,563 each.

[FN82]. This statement assumes the hotchpot rule, as explained above.

[FN83]. A very able and knowledgeable insomniac, Professor Ulrik Rammeskov Bang-Pederson, after reading this article in draft demonstrated to me that a "hypothetically simultaneous" distribution, accounting for overage distributions to certain classes, is theoretically possible but fraught with practical difficulties. Beyond this acknowledgment, this interesting and important elaboration will have to await another discussion.

[FN84]. We therefore ignore the problem of choice of law for perfection purposes, interesting as it is.

[FN85]. See Mexican Statement, supra note 30, at 47-48. We are ignoring for clarity's sake the possibility of administration and other claims that share first priority. See id. at 51-52.


[FN89]. Id. at 425.