No Two Snowflakes the Same: The Distributional Question in International Bankruptcies

JOSÉ M. GARRIDO*

Abstract

This article provides a short comment to the House of Lords' decision in McGrath v. Riddell, and takes that decision as an example for a summary analysis of the diverse situations that differences in priorities may create in international bankruptcies. It is well known that differences in priority regimes correspond to diverse distributional decisions taken by states, and represent one of the most important roadblocks in the way of international cooperation in insolvency. The theoretical and legal models of international bankruptcy have not tackled all of the issues connected with the treatment of priorities, so court decisions have to devise pragmatic approaches in order to deal with the problems that differences in priorities present. A typology of the differences in priorities could be a starting point to understand the balance of interests that needs to be achieved for effective international bankruptcy cooperation.

SUMMARY

I. INTRODUCTION .......................................................................................................... 460

II. McGrath v. Riddell: An Example of the Treatment of Priorities in International Bankruptcy ........................................................................................................... 461

III. A Summary Consideration of Theories of International

* This article presents the personal views and opinions of the author, and does not purport to represent the World Bank’s position on these issues. Professor of Commercial and Corporate Law, Universidad de Castilla-La Mancha (Spain), and Senior Counsel, Insolvency and Creditor Rights Initiative, The World Bank. The views expressed in this article are exclusively those of the author, and do not necessarily reflect the views of the World Bank, its Executive Directors, or the Governments they represent. I wish to thank Jay Westbrook and all the distinguished participants in the University of Texas Law School 2010 International Insolvency Symposium for their views.

1. In this article, “bankruptcy” and “insolvency” are used as synonyms throughout the text.
I. INTRODUCTION

In the case of McGrath v. Riddell, an Australian insurance company (HIH) was declared insolvent in Australia, but had substantial assets in the United Kingdom. The U.K. Courts debated on whether to apply the Australian distributional scheme or to apply the U.K. distributional scheme to the assets located in the United Kingdom. In the final judgment, the House of Lords agreed to transfer the assets to the Australian insolvency proceedings, in spite of the differences in distribution schemes, and the corresponding differences in outcomes for creditors. This result conforms to a universalist view of international insolvency: given the fact that the Australian courts had jurisdiction over the insolvency of the insurance company, it was appropriate that the Australian ranking of claims was applied to all assets of the company, universally. It is widely recognized that one of the salient features of the universalist approach to international bankruptcy is that a single ranking of claims should be applied to all creditors and proceeds, wherever they may be located. However, there are several specific circumstances that explain the ability of the British courts to defer to the Australian hierarchy of creditors.

After a consideration in Section II of the most important facts in the case, Section III deals with the basic propositions of the different theories of international bankruptcy law, especially territorialism, universalism, and modified universalism. It is suggested that practical experience has shown the advantages of modified universalism. The different implications of the theories are explored in connection with the existence of different preferential creditors in their respective insolvency law systems. It is submitted that, frequently, the discussion of the different positions is highly theoretical and, to a certain extent, even “byzantine.” Theories have to be tested against real and specific situations in order to assess the different outcomes that they can provide to the problems of international insolvency. The weak spot of the modified universalist approach is found on the different interpretations that may be given to the concept of the “center of main interests” (COMI) of the debtor, and to the important concept of “establishment.”

Section IV covers the problems that differences in priorities cause in international bankruptcies. It is submitted that there are no two priority systems that are identical, and that harmonization or unification of the law in this area is extremely unlikely to happen. In fact, priority systems are but the expression of the hierarchy of values that permeate a given legal system. This means that graduation of creditors is primarily political, and that the influence of powerful groups of

---

3. Id.
4. Id. at [2], [43].
creditors, the inertia of legal tradition, or the conscious and deliberate choice to promote certain values, are the factors that explain the fundamental differences encountered in various jurisdictions around the world. However, once that diversity is accepted as a fact in international bankruptcies, it is helpful to formulate a “taxonomy” of the various situations that may arise where there are differences in priorities between the legal systems connected to an international bankruptcy. This classification of situations illustrates the potential for different outcomes in the treatment of priorities. Section V concludes.

II. **McGrath v. Riddell: An Example of the Treatment of Priorities in International Bankruptcy**

The facts that gave rise to the different judgments in *McGrath v. Riddell* are relatively straightforward and easy to summarize: companies belonging to an Australian insurance group of companies (HIH Casualty & General Insurance) were declared insolvent in Australia, but had substantial assets in the United Kingdom.\(^5\) The assets situated in the United Kingdom were mainly reinsurance claims corresponding to reinsurance policies taken out in the London market.\(^6\) A request was sent to England, asking that the provisional liquidators be directed, after payment of their expenses, to remit the assets to the Australian liquidators for distribution.\(^7\)

The existence of a priority in Australian legislation in favor of insurance creditors, and the lack of a similar provision in English law at the time, meant that the differences in outcome for unsecured creditors would be substantial, depending on the decision to recognize or to disregard the Australian priority:

> It is agreed that if the English assets are sent to Australia, the outcome for creditors will be different from what it would have been if they had been distributed under the 1986 Act. Some creditors will do better and others worse. Approximate figures are given in para 17 of the judgment of the Chancellor in the Court of Appeal. Generally speaking, insurance creditors will be winners and other creditors will be losers.\(^8\)

Therefore, the English courts debated whether to apply the Australian distributional scheme or to apply the English distributional scheme to the assets located in England. In the first instance, the English court considered that English creditors would have been disadvantaged if the assets of HIH were remitted to Australia for distribution in accordance with Australian law.\(^9\) Some Australian statutory provisions (specifically, § 562A of the Corporations Act 2001)\(^10\) create a priority for insurance creditors,\(^11\) and this would result in a prejudice to English unsecured creditors. Richards J. rejected the Australian request, on the basis that

---

5. *Id.* at [1].
6. *Id.* at [35].
7. *Id.* at [1].
8. *McGrath,* [2008] UKHL 21, [2], 1 W.L.R. at 855 (Lord Scott). The differences resulting from applying the English and the Australian distributional schemes are stated in a table. *Id.* at [53].
9. *Id.* at [59].
the court had no power to order a transfer if the pari passu rule of the principal jurisdiction were not substantially the same as that under English law.\footnote{McMahon v. McGrath (In re HIH Cas. & Gen. Ins. Ltd.), [2005] EWHC (Ch) 2125, [50] (Eng.).}

In the Court of Appeal, the same result was reached, but Sir Andrew Morritt CVO decided that there was jurisdiction.\footnote{McGrath, [2008] UKHL [11] 1 W.L.R. at 857.} The test for the exercise of the court’s discretion was balancing the advantages and disadvantages to the creditors in the ancillary jurisdiction resulting from a transfer to the principal place of bankruptcy.\footnote{Id. at [33]–[35].} The advantage for some insurance and reinsurance creditors resulting from the transfer did not outweigh the prejudice suffered by the other creditors.\footnote{Id. at [11].} So, no countervailing advantage could justify the interference with the statutory scheme of distribution imposed under the Insolvency Act 1986.

After differing judgments in previous instances, the House of Lords agreed to transfer the assets to the Australian insolvency proceedings, in spite of the differences in distribution schemes.\footnote{Id. at [36].} This result corresponds, prima facie, with a universalist view of international insolvency: given the fact that the Australian courts had jurisdiction over the insolvency of the insurance company, it was appropriate that the Australian ranking of claims was applied to all assets of the company, universally.\footnote{Id. at [6] (“There should be a unitary bankruptcy proceeding in the court of the bankrupt’s domicile which receives world-wide recognition and it should apply universally to all the bankrupt’s assets.”).} That included the assets located in England, despite the fact that the English distributional scheme did not include any priority for the claims of insurance creditors.\footnote{Id. at [21], [24], [41].} Universalism has been historically connected to the predictability of the insolvency regime and the protection of creditors’ expectations. Some of the reasoning by Lord Hoffmann appears influenced by that orientation:

Furthermore, it seems to me that the application of Australian law to the distribution of all the assets is more likely to give effect to the expectations of creditors as a whole than the distribution of some of the assets according to English law. Policy holders and other creditors dealing with an Australian insurance company are likely, so far as they think about the matter at all to expect that in the event of insolvency their rights will be determined by Australian law. Indeed, the preference given to insurance creditors may have been seen as an advantage of a policy with an Australian company.\footnote{McGrath, [2008] UKHL 21, [33], 1 W.L.R. at 862.}

In fact, Lord Hoffmann’s concluding remarks stress that in this case the principle of universalism must be given “full rein.”\footnote{Id. at [36].} However, it would be more correct to state that in the particular set of circumstances of the case, the court agreed to a solution consistent with the basic tenets of universalism. Moreover, it would be too far-reaching to declare that the court decided to embrace universalism as the approach to be taken in all issues pertaining to international insolvency problems.

14. Id. at [33]–[35].
15. Id. at [11].
16. Id. at [36].
17. Id. at [6] (“There should be a unitary bankruptcy proceeding in the court of the bankrupt’s domicile which receives world-wide recognition and it should apply universally to all the bankrupt’s assets.”).
18. Id. at [21], [24], [41].
19. McGrath, [2008] UKHL 21, [33], 1 W.L.R. at 862.
20. Id. at [36].
There are numerous specific factors that explain the ability of the English courts to defer to the Australian hierarchy of creditors. Perhaps the single most important factor is that Australia is one of the jurisdictions listed by the Secretary of State as being qualified to receive special assistance under the Insolvency Act (§ 426 of the English Insolvency Act 1986). The fact that a country is included in the list attached to § 426 means that the possibilities for assistance by English courts are greatly increased. Actually, in the judgment in McGrath v. Riddell, several of his Lordships remarked that they did not consider that the case would have been resolved in the same way if the jurisdiction that sought assistance was not included in the list. It is the existence of this selected list of jurisdictions that grants a special character to English international insolvency law, as this provision allows English courts to cooperate closely with courts from those jurisdictions, and apply foreign law in situations like the one that is the subject of this commentary. By including a country in the list of relevant jurisdictions, the Secretary of State is satisfied that the law and the courts of that jurisdiction are reasonably similar and compatible with those of England. Under present English law, the possibilities of cooperation in international bankruptcies have been increased: thus, not only § 426 may assist in international cooperation, but also the E.U. Insolvency Regulation and the provisions that have incorporated the UNCITRAL Model Law in England (Cross-Border Insolvency Regulations 2006). However, the fact that the case involved an Australian company and that English courts are prepared to defer to Australian law in ways that would be inapplicable to other countries, is not the only explanation for the outcome in this particular case.

Another important factor that helps explain the deference to a different priority scheme lies with the very elimination of those differences: English law was set to recognize the priority granted to insurance creditors over reinsurance claims, due to the necessary implementation of European rules on the matter. If the case were to

21. Id. at [4].
22. See Kate Dawson, Assistance under Section 426 of the Insolvency Act 1986, 8 INT’L INSOLVENCY REV. 109, 117 (explaining that a court requesting assistance must be on the list of countries or territories designated by the Secretary of State).
23. See McGrath, [2008] UKHL 21 [4], [11], [55], [76], [77], 1 W.L.R. at 856, 868, 875–76. (including three Lords reference that a country be on a list of relevant countries designated by the Secretary of State, in order to receive assistance under § 426(4) of the 1986 Insolvency Act).
24. For some time, lawyers have referred informally to this list as the “cricket-playing” countries. Sandy Shandro, International Judicial Co-operation: Can the Common Law Make a Comeback?, 7 INT’L INSOLVENCY REV. 63, 84 (2008). According to Lord Hoffmann, England traditionally has recognized closer cooperation with countries sharing a similar legal tradition, specifically countries that were or are British colonies. Leonard Hoffmann, Cross-Border Insolvency: A British Perspective, 64 FORDHAM L. REV. 2507, 2511 (1996).
27. Council Regulation 1346/2000, 2000 O.J. (L 160) 1 (EC). As it is well known, regulations are directly applicable in all E.U. Member States, and do not require implementation by national legislation or regulations.
be heard today, there would not be any difference in the ranking of claims and, consequently, no differences in outcome for the creditors involved.

A supplementary specific circumstance that needs to be remembered in the context of the analysis of this case is that, as Lord Hoffmann recognizes, the deference to the Australian priority for insurance creditors actually benefits the position of London as an important reinsurance market:

The fact that there are assets in England is principally the result of the companies having placed their reinsurance business in the London market. For the purposes of deciding how the assets should be distributed, that seems to me an entirely adventitious circumstance. Indeed, it may not be to the advantage of London as a reinsurance market if the distribution of the assets of insolvent foreign reinsurance companies is affected by whether they have placed their reinsurance business in London rather than somewhere else.30

Notwithstanding all the circumstances and specific factors listed above, I would argue that there is a major feature of this case that is crucial for the better understanding of its implications. The issue in McGrath v. Riddell is mainly a conflict between a foreign priority and the local principle of equality of creditors (pari passu rule or par condicio creditorum). According to the taxonomy of conflicts between priorities in international settings that is developed later in this article, this type of conflict is not as intense as others and allows for some flexibility in its resolution, precisely because in it there is no confrontation with a major interest protected by local law, but, rather, with the diffuse interest of unsecured creditors as a class. This logical underpinning is implied in the reasoning of Lord Neuberger:

It is not as if the Australian regime would distribute assets between groups of unsecured creditors (whether preferential or not) other than on a pari passu basis, or has significantly different set-off rules from those which apply in this jurisdiction.32

It is clear, therefore, that a host of different factors contributed to a solution in which the courts defer to the Australian hierarchy of distribution among creditors, but it is submitted that the one of the decisive factors—and the most interesting one, from a comparative law perspective—is the nature of the conflict between unsecured creditors and a foreign priority.

There were, of course, some arguments in favor of a solution based on territoriality. Basically, it could be argued that the English courts should protect the ranking of claims according to English law, whereas cooperation with the Australian courts amounted to disregarding the scheme of distribution of English law, and it

31. See infra part 4 (explaining the various approaches to differences in priorities in cooperative systems of international bankruptcy).
worsened the position of unsecured creditors under English law. In fact, the Court
considered a common law test, whether “distribution in the country of the principal
liquidation produced advantages for the non-preferred creditors which counteracted
the prejudice they suffered.” However, this test was not satisfied as the unsecured
creditors in England would not derive any particular benefit from the remission of
the assets to Australia, where the operation of a different ranking of claims would
result in a net prejudice to the unsecured creditors in England.

It is possible to conclude that the judgment “provides an illustration of the
pragmatism which is brought to bear on matters relating to distribution in international
insolvency.” In fact the word “pragmatism” captures the approach taken by English
courts on numerous occasions, and it aptly describes a solution that some specialists
may find at odds with the theoretical analysis of international insolvencies. The
different theoretical approaches to international cooperation have been analyzed in
an enormous body of legal literature. A quick review of the main orientations will
serve as the basis for a more fruitful discussion of the different problems caused by
diverging priorities in international insolvencies.

III. A SUMMARY CONSIDERATION OF THEORIES OF INTERNATIONAL
BANKRUPTCY

The question of the treatment of priorities in international bankruptcy cases
cannot be complete without a summary analysis of the different theoretical
approaches that have been followed in international bankruptcies, a favorite subject
for international private lawyers since the 19th century. The analysis of the theories
that have been developed would cover far more space than is available for this
discussion. The aim of this section, therefore, is solely to summarize some of the
tenets of the different orientations, as a theoretical background, in order to proceed
to the analysis of the specific problem of the conflict between diverse priority
schemes in international bankruptcy.

The discussion on international bankruptcy models is often abstract and highly
theoretical. In order to keep the discussion focused, it would be helpful to remember
that bankruptcy regulation should promote certain goals, especially the need for
predictability in asset distribution, and, above all, the need for efficiency. It is in

33. Id. at [11] (Lord Hoffmann).
34. Id. at [31], [34] (Lord Hoffmann).
35. Mamutse, supra note 26, at 15 (emphasis added).
36. Specific cases of English and U.S. courts have taught us many lessons in international bankruptcy.
See Richard A. Gitlin & Ronald J. Silverman, International Insolvency and the Maxwell Communication
Corporation Case, in INTERNATIONAL BANKRUPTCIES: DEVELOPING PRACTICAL STRATEGIES 7, 21
(Practising Law Institute, 1992) (discussing the process the courts used to facilitate cooperation); Jay L.
“unprecedented cooperation” between American and English bankruptcy courts); Hoffmann, supra note
24, at 2507 (outlining the history of Anglo-American relations in the bankruptcy context); see generally
John K. Londot, Handling Priority Conflict Rules in International Bankruptcy: Assessing the International
37. Ulrik Rammeskow Bang-Pedersen, Asset Distribution in Transnational Insolvencies: Combining
Predictability and Protection of Local Interests, 73 AM. BANKR. L.J. 385, 386–87 (1999); Jay L. Westbrook,
457, 466 (1991); F. J. Brewerton & Jane LeMaster, Toward Universalism in International Bankruptcy Law:
the interests of the creditors that liquidation occurs in “an equitable, orderly, and systemic manner, rather than in a haphazard, erratic or piecemeal fashion.” International cooperation is needed to achieve these goals; therefore, the discussion should revolve around the appropriate ways to advance the interests of all parties involved in the debtor’s bankruptcy.

The theoretical discussion on international bankruptcy is polarized in two opposing positions: territorialism and universalism, with a number of intermediate theories in the middle of the spectrum.

Territorialism simply postulates that the courts in a jurisdiction will have the competence to open insolvency proceedings in their own territory, and that insolvency proceeding will be limited to the assets and creditors located in the jurisdiction. Foreign creditors are left unprotected, unless there are assets in their own jurisdiction, in which case they will be able to open a local bankruptcy proceeding.

Territorialism is directly linked to the definitions of competence and forum non conveniens in insolvency proceedings. In some legal systems, it suffices that assets exist in the jurisdiction in order to assert the existence of bankruptcy competence. Courts may even open insolvency proceedings where there are no assets in the jurisdiction, as normally the presence of assets in the jurisdiction is not a requirement for the opening of insolvency proceedings, and even though an insolvency process with no assets is generally useless. In other cases, a sufficient connection with the jurisdiction is required, and the reasonable possibility that, if a winding-up order is made, there is benefit to those applying for the winding-up order and the court is able to exercise jurisdiction over one or more persons in the distribution of assets.

In fact, territorialism is the most ancient approach to insolvency: in the first systematic work on insolvency law, Salgado de Somoza’s *Labyrinthus Creditorum*, there is already a sense that those creditors who have relationships with a debtor that has an establishment (*negotiatio*) in the territory, should satisfy their claims with the proceeds of the liquidation of that establishment. Salgado makes this claim...
irrespective of the fact that the establishment as such has no legal personality. In the time Salgado’s work was published, the questions connected with legal personality had not developed as we understand them today. In any case, it is interesting to note that, in the first stages of development of modern bankruptcy law, the theorists defended two ideas. First, that the liability of the merchant was connected to the assets and organization displayed in a territory. Second, that creditors should enforce their claims over the assets of the debtor that are located in the territory, as the natural reach of the creditors’ powers is limited by the territorial organization of the debtor. It is also implicitly understood that merchants extend credit to debtors based on the assets that those debtors have, and which are immediately accessible to creditors.

Territorialism, in its original form, suggests a total lack of coordination between courts in different jurisdictions. The courts of each country would be free to initiate insolvency proceedings against a debtor, even if other insolvency procedures have been opened in other countries. The territorialist approach is easy to implement in practice, as it requires no coordination efforts, but its operation denies the attainment of the objectives of insolvency law: in a pure territorialist approach, it is virtually impossible to attain the proper objectives of an insolvency regime, like the maximization of the value of the assets of the estate, the minimization of the creditors’ losses, and the reorganization of the debtor’s business. Moreover, the outcome of insolvency is fundamentally unpredictable, as it is extremely difficult to determine where the debtor’s assets are located, and the location of assets determines the applicability of the insolvency law, including priorities and rules for distribution. Territoriality is shown to generate a distortion in investment patterns that might lead to an inefficient allocation of capital across countries. The fact that creditors are able to “grab” the assets of the debtor wherever those are located means that local creditors and multinationals tend to be benefited by territorialism.

Notwithstanding these disadvantages, there are countries that have been traditionally inclined towards territorialism. Territorialism is also strong in some business places.


45. See, e.g., id. at 260.

46. In today’s world, the location of assets for a given debtor is a real spinning wheel. For some important assets, location is purely conventional (like intellectual property). The location of creditors is a different matter, but it is not entirely exempt from complications. Frederick Tung, Skepticism About Universalism: International Bankruptcy and International Relations 57 (Berkeley Law & Econ., Working Paper No. 2001-7, 2002), available at http://www.escholarship.org/uc/item/0kn6d3dw.

47. Lucian A. Bebchuk & Andrew T. Guzman, An Economic Analysis of Transnational Bankruptcies, 42 J. L. & ECON. 775, 778 (1999) (“More specifically, territoriality leads to a distortion of the capital allocation decision while universality avoids the distortion and leads to a more efficient allocation of capital.”). However, it is recognized that some countries may benefit from territoriality, at the expense of foreign firms. Id. at 780.

48. Westbrook, supra note 36, at 2532 (“[G]rab rule proceedings yield inequitable results. Creditors appearing before the courts that have grabbed the most assets fare better than creditors generally”); Todd Kraft & Allison Aranson, Transnational Bankruptcies: Section 304 and Beyond, 1993 COLUM. BUS. L. REV. 329, 337 (1993).

specialized sectors, such as international bank insolvency, and has also received some academic support.\footnote{50}

Universalism occupies the opposite end of the spectrum. In universalism, “one court administers the insolvency of a debtor on a worldwide basis with the help of the courts in each affected country.”\footnote{52}

Thus, universalism defends the existence of a single bankruptcy proceeding for any given debtor, irrespective of the fact that a debtor may have assets located in different jurisdictions, or that creditors have their domicile in other countries. In universalism, ideally, there should be one forum and one law, applicable to the single bankruptcy procedure. The obvious appeal of universalism lies in its simplicity and its coherence with the basic features of insolvency. From a general point of view, bankruptcy arises, as a procedural and substantive institution, as a response to the problem of plurality of creditors and insufficiency of the debtor’s assets to meet those claims. In order to fulfill its objectives, bankruptcy law requires that all of the debtor’s assets and creditors are brought together in a single proceeding, in order to minimize the damage to creditors and achieve the most efficient economic solution to the indebtedness problem.

The English courts have defended universalism vigorously:

The English common law has traditionally taken the view that fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets of fewer or the creditors are situated.\footnote{54}

In addition, universalism brings several important advantages: the fact that the debtor is subject to a single insolvency procedure and to a single insolvency law means that the creditors can predict more accurately the impact of insolvency, and that fact, in turn, influences the pricing and availability of credit for debtors. Increased predictability, as derived from universalism, is one of the clear benefits of the doctrine. And predictability would, in turn, have positive economic effects.\footnote{55}

\footnote{50. \textit{See} Thomas C. Baxter, Joyce M. Hansen, & Joseph H. Sommer, \textit{Two Cheers on Territoriality: An Essay on International Bank Insolvency Law}, 78 AM. BANKR. L.J. 57, 80–81 (2004) (discussing the possible superiority of territoriality for banks, even if universality is superior for general business firms). The international financial crisis has prompted efforts for coordination in crises of multinational financial institutions. However, those efforts have not yet crystallised into specific international instruments.}


\footnote{52. Jay L. Westbrook, \textit{Multinational Enterprises in General Default: Chapter 15, the ALI Principles and the EU Insolvency Regulation}, 76 AM. BANKR. L.J. 1, 5–6 (2002).}


\footnote{54. Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26, [16] (appeal taken from Isle of Man). The judgment goes on to affirm that univeriality of bankruptcy has long been an aspiration of United Kingdom law, even if it has not always been fully achieved. \textit{Id.} at [17].}

\footnote{55. “[T]he increased predictability of the results of default would significantly reduce the costs of borrowing.” Westbrook, \textit{supra} note 37, at 466. However, there is some criticism as to the validity of these
The fact that there is a single competent forum and a single applicable law for the insolvency of any debtor means that, depending on the criteria selected for the determination of the insolvency regime, a different law would be applicable to the insolvency of one debtor. This means that, under universalism, authorities and creditors must be prepared to accept differences in outcome. Under universalism, local creditors can receive a worse treatment than they would receive under territorialism. But it can also happen that, in other cases, those local creditors benefit from universalism, as they would be able to recover from assets located in other jurisdictions. Hopefully, the cases in which local creditors would be prejudiced and the cases in which they would be benefited would compensate each other (“rough wash” is the expression coined by Jay Westbrook), so that a universalist rule will roughly even out the benefits and the losses to local creditors. Therefore, it is possible to hypothesize the existence of a net gain for all creditors, materialized in increased predictability, and reductions in costs for all parties. Therefore, the treatment of local creditors as the main objection against universalism would be unfounded.

Universalism is the theory that has received the most academic attention: it is by no means the oldest theory for international insolvency—as we have seen, territorialism was developed before—but it is certainly the most influential theory among bankruptcy scholars. Indeed, it can be said that universalism is the preferred paradigm among bankruptcy theorists, but its validity is more theoretical than the positive effects of universalism.

Sefa Franken, Three Principles of Transnational Corporate Bankruptcy Law: A Review, 11 EUR. L.J. 232, 233 (2005) (“Universalism claims its superiority over territorialism in that it would offer investors an enhanced ex ante predictability of the outcomes of their debtors’ bankruptcies as well as foster ex post value maximisation of transnational businesses. Yet, despite the claimed advantages of universalism, territorialism still is the dominant approach to cross-border insolvency, not in the least because states resist universalist régimes by pointing to the differences in local redistributive policies.”). Franken continues arguing that the predictability argument has been not proved by universalists: “although universalism may have advantages with respect to the ex post value maximisation of cross-border businesses, proponents of universalist rule have not been able to argue convincingly that universalism would offer a higher degree of ex ante predictability to investors. Proponents of territorialism, on the other hand, have not been able to demonstrate that local creditors and local policies would be systematically harmed if a universalist approach were adopted.” Id. at 233.

56. See Westbrook, supra note 37, at 458 (noting universalism reform must have certain characteristics, including an acceptance of outcome differences).

57. See id. at 464 (noting that a principle argument in favor of universalism is that it creates an even wash for local creditors).

58. See Andrew T. Guzman, International Bankruptcy: In Defense of Universalism, 98 MICH. L. REV. 2177, 2208 (1999–2000) (arguing that universalism offers more certainty regarding which rules are applicable); see also Rasmussen, supra note 40, at 27 (noting that universalism is known for decreasing lending and administration costs).

59. See Bebchuk & Guzman, supra note 47, at 780 (noting that favoritism among creditors in the United States is unlikely).

60. See id. at 778 (“The alternative rule, universalism, favors the settlement of bankruptcy within a single ‘main’ jurisdiction. Other jurisdictions turn the assets of the bankrupt corporation over to this ‘primary’ jurisdiction and the case is dealt with under the latter’s laws.”).

practical, because it is generally challenged by the insurmountable obstacles faced in practice.

Universalism is simpler conceptually, but the practical problems of applying a universalist rule are considerable. Pure universalism would require that all countries would share the same private international law rules.\(^\text{62}\) If the rules for assigning competence over matters, or the rules to determine the applicable law to all substantive and procedural aspects of the insolvency, are different, it would be impossible to establish, for a specific debtor, one competent court and one applicable law. Therefore, universalism would require, in order to operate seamlessly, that private international law rules relating to bankruptcy be unified, possibly by means of an international treaty.\(^\text{63}\) It would also require that all countries would adhere to this universalist view: if a number of significant countries deviate from universalism, most of its benefits are simply lost. Transformations of world economy make the application of pure universalism more unlikely, because universalism hides a power struggle between jurisdictions. For these reasons, pure universalism remains largely a utopia, an unrealistic proposition in today's world.\(^\text{64}\) It is hardly surprising that the judgment in *McGrath v. Liddell* states emphatically that universality is an aspiration, rather than a reality.\(^\text{65}\)

One of the most important obstacles to universalism is the existence of different priority regimes. Universalism “creates incentives for ‘priority inflation’”: if the priorities created by a legal system are recognized to have a worldwide effect, the chances of priorities being effective actually increase, and the legislator may feel prone to expand the categories of protected creditors as much as possible.

As it was stated before, universalism and territorialism should be regarded as the opposite and extreme ends of a spectrum. Pure universalism is practically unworkable, and extreme territorialism has serious detrimental effects for the interests of international business. Ultimately, the distinctions between the different theoretical solutions to the problems of international bankruptcy are blurred. It is submitted that the discussion of the different positions is highly theoretical and, to a certain extent even “byzantine,” as Professor Giuliano, one of the pioneer scholars in the field of international bankruptcy law, wrote.\(^\text{67}\)

---


63. According to Lord Hoffmann, “Full universalism can be attained only by international treaty.” *McGrath*, [2008] UKHL 21, [7], 1 W.L.R. at 856 (Lord Hoffmann). Another possibility for attaining real universalism would be through a model law, but experiences with model laws suggest that the degrees of separation from the model would cause different systems to operate, thereby destroying the benefits of a unified approach.

64. See Tung, *supra* note 46, at 11 (arguing that regularized universalist cooperation is improbable).

65. *McGrath*, [2008] UKHL 21, [7], 1 W.L.R. at 856 (Lord Hoffmann) (referring to Lord Hoffmann’s previous assertion in *Cambridge Gas* that universality is an aspiration).


67. MARIO GIULIANO, IL FALLIMENTO NEL DIRITTO PROCESSUALE CIVILE INTERNAZIONALE 80 n.48 (1943) [Bankruptcy in International Civil Procedural Law] [Italy].
The common point of all modern solutions to the problem of international bankruptcy is the focus on cooperation. International cooperation is essential to achieve the ends of bankruptcy, in spite of the numerous obstacles.

Most of the solutions with practical relevance in international bankruptcy law lie within the space situated between pure territorialism and pure universalism. In this intermediate space, the solutions that appear more successful are cooperative territorialism and, especially, modified universalism.

In cooperative territorialism, courts are free to open insolvency proceedings where there are assets located in the jurisdiction, and there are no restrictions for the opening of insolvency procedures in other jurisdictions, but the courts of different countries coordinate in order to attain efficiencies in the treatment of the debtor's insolvency, and foreign creditors are allowed to participate in national proceedings. Cooperative territorialism may be defended as a realistic solution to the problems of international insolvency.

"Modified universalism" is an accepted term in legal terminology that refers to a universalist approach in which some concessions are made to territorial interests for the sake of ensuring the effective functioning of the international bankruptcy system. Modified universalism accepts the central premise of universalism, that is, "that assets should be collected and distributed on a worldwide basis, but reserving to local courts discretion to evaluate the fairness of the home-country procedures and to protect the interests of local creditors." In modified universalism, it is possible to open non-main insolvency proceedings where there is an establishment of the debtor situated in the relevant jurisdiction. However, the plurality of proceedings does not imply lack of coordination between them: in fact, modified universalism assumes that there will be coordination between main and non-main proceedings, and that courts of other jurisdictions where assets are located will also cooperate with bankruptcy proceedings.


69. Cf. Douglass G. Beshkoff, Some Gloomy Thoughts Concerning Cross-Border Insolvencies, 72 Wash. U. L.Q. 931 (1994) (arguing that the lack of interest in the reciprocity requirement and the lack of trust in foreign legal regimes are barriers to international cooperation).

70. See Frederick Tung, Is International Bankruptcy Possible?, supra note 61, at 101–02 (arguing that international bankruptcy should focus on territorially-based cooperation); see also Lynn M. LoPucki, The Case for Cooperative Territoriality in International Bankruptcy, 98 Mich. L. Rev. 2216, 2240 (1999–2000) ("The level of error and deception would be higher in a universalist system than in the current territorial one.").


73. Modified universalism has been aptly described by Westbrook, supra note 36, at 517–18 (explaining that countries accept that assets should be collected and distributed by a single forum on a worldwide basis, while reserving to their local courts discretion to evaluate the fairness of the home-country procedures and to protect the interests of local creditors).

It is submitted that practical experience shows that modified universalism is the preferred position, both in theoretical and practical terms. Certainly, modified universalism has been criticized on the grounds that, the advantages of universalism are lost, but modified universalism offers a pragmatic compromise between the theoretical foundations of universalism and the realities of international practice.

“Modified universalism” is the theoretical foundation of international bankruptcy systems such as those of the European Insolvency Regulation and the UNCITRAL model law for cross-border insolvency. According to both systems, there is one jurisdiction in which the debtor should file for bankruptcy, and that bankruptcy should have a universal effect. In both instances, there is a uniform conflict-of-laws rule according to which the State in which it is possible to open bankruptcy proceedings with universal reach is the country where the center of main interests (COMI) of the debtor is located. The concept of COMI, therefore, assumes a pivotal role in the determination of the competent court for the opening of insolvency proceedings. Naturally, the problem is the lack of definition of some of the elements of COMI and the divergent interpretations of that concept in different countries and different courts. It is extremely difficult to find a completely predictable rule, uniformly interpreted, that would provide a totally certain solution to the problem of determining the forum for the opening of bankruptcy proceedings in the case of debtors with multiple international connections. The complexity of the connecting factors that are taken into account for the determination of the center of main interests, and the high likelihood that there are international elements in the connecting factors, increase the difficulties in the determination of the appropriate insolvency regime. Certainly, the weak spot of the modified universalist approach is found on the different interpretations that may be given to the concept of “centre of main interests” of the debtor. Although some of the international legal materials cited before express a preference for a concept which would be easier to determine, such as the legal seat of the corporate debtor, this is used only as a rebuttable presumption for establishing the center of main interests of the debtor.

It is important to note that in modified universalism, the approach taken is not entirely universal: certainly, it is assumed that the bankruptcy will be opened before the courts of the debtor’s COMI, and that proceeding will initially have universal reach. However, the adjective “modified” suggests that there are limits to this universalist proposition. Modified universalism allows for the opening of

75. See Lynn LoPucki, *Cooperation in International Bankruptcy*, supra note 51, at 728–32 (describing the problems of modified universalism including that its departures from pure universalism undercut its benefits).
76. See Edward S. Adams, & Jason K. Fincke, *Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism*, 15 COLUM. EUR. L. 43 (2008–2009) (describing that UNCITRAL and Model Law have a modified universalism foundation); see also Christoph G. Paulus, *Global Insolvency Law and the Role of Multinational Institutions*, 32 BROOK. J. INT’L L. 755 (2007) (discussing the momentum toward a common theoretical framework for international insolvency). Naturally, there are many technical differences between the European and the UNCITRAL approaches to the regulation of international insolvency, but it can be said that both texts share numerous features.
77. See Model Law, supra note 74, art. 2(b) (defining “foreign main proceeding” as a “foreign proceeding taking place in the State where the debtor has the centre of its main interests”).
78. For this reason, UNCITRAL has decided to start a project on refining the definition and interpretations of the elements of COMI. See the proposal by the U.S. delegation at http://daccess-dds-ny.un.org/doc/UNDOC/LTD/V10/511/16/PDF/V1051116.pdf.
79. See *Stanford International Bank: UK Court of Appeals Clarifies Appropriate Test for COMI*, 29 AM. BANKR. INST. J., no. 4, May 1, 2010, at 38 (surveying approaches to defining COMI).
simultaneous insolvency proceedings, thus denying one of the nuclear principles of pure universalism. However, proceedings that are not opened at the forum of the debtor’s COMI are subordinated to the principal bankruptcy (these proceedings are defined by terms such as “secondary” or “ancillary”) and their reach tends to be territorial. Secondary proceedings cannot be opened in all cases—otherwise, there would be no distinction between modified universalism and territorialism—but only if certain conditions are met. Only where there is a special connection between the debtor and the jurisdiction is it possible to open a secondary insolvency proceeding. In the model of the Council Regulation and UNCITRAL Model Law, the special connection is defined by the concept of “establishment.” An “establishment” identifies a permanent place of operations, but this concept is just as elusive as the concept of center of main interests, in spite of a long tradition in its usage by courts and legislators in numerous countries.

In both the European and the UNCITRAL models, a pragmatic compromise is at work. However, in both models a criticism can be made because the lack of specific duties by courts does not allow attaining the much needed predictability in international bankruptcies. Among the countries that have incorporated the UNCITRAL Model Law, there are significant differences. In the United States, Chapter 15 of the Bankruptcy Code has incorporated the UNCITRAL Model Law, and some specialists suggest that the United States is still undecided between universalism and territorialism. It is submitted that this is only a reflection of the hybrid nature of modified universalism.

Finally, it must be noted that there are new theoretical orientations in international bankruptcy. A theoretical trend defends a contractual solution to the

80. See Council Regulation 1346/2000, art. 3 (discussing that secondary proceedings cover only assets which are situated in the state in which the proceedings are opened are allowed alongside the main proceedings).
84. See Paul Stephan, The Futility of Unification and Harmonization in International Commercial Law, 39 VA. J. INT’L L. 743, 785 (1999) (stating that the UNCITRAL Model Law on Cross-Border Insolvency expands the range of action of bankruptcy courts without imposing substantial obligations that those bodies must honor, which is likely to result in a régime that would decrease the predictability of outcomes in international bankruptcies without achieving any clear improvements in the legal rules).
85. See John J. Chung, The Retrogressive Flaw of Chapter 15 of the Bankruptcy Code: A Lesson from Maritime Law, 17 DUKE J. COMP. & INT’L L. 253, 269 (2007) (“Thus, there are two messages concerning Chapter 15, and the content of each message depended on the audience. For Congress, the message: Chapter 15 is about cooperation; there is no universalism in the legislation. For internationalists, on the other hand, the message was: Chapter 15 is a significant step toward eventual and inevitable universalism.”).
problems of international bankruptcy, even though the practical problems of such an arrangement are likely to be insurmountable. The most interesting new theoretical orientation is possibly virtual universalism. Virtual universalism defends the existence of an ancillary proceeding with no substantive effects, no distribution of proceeds or ranking of claims. This model would be closer to the ideal of universalism. These theoretical models have not gained widespread support among policymakers and rulemaking bodies with responsibilities in international bankruptcy.

IV. APPROACHES TO DIFFERENCES IN PRIORITIES IN COOPERATIVE SYSTEMS OF INTERNATIONAL BANKRUPTCY (WITH A TAXONOMY)

An important point to address is that of the different implications of the theories are explored, in connection with the existence of different preferential creditors in their respective insolvency law systems. In fact, theories of international bankruptcy meet their test in the treatment of creditors, where advantages and disadvantages of each theory become apparent.

Under pure universalism, only the priorities of the lex fori concursus are enforced. This means that the priorities of the applicable law would gain universal recognition, while the priorities of jurisdictions in which there are assets and/or creditors would be entirely disregarded.

By contrast, under a purely territorial system, the priorities of local creditors are enforced over the assets located in the jurisdiction. Thus, every set of priorities would find satisfaction limited to the proceeds of the assets that are situated in a particular country.

Both the pure universalist and territorialist positions are thoroughly unsatisfactory from the point of view of the treatment of priorities. The universalist system is unrealistic, as it requests that local courts cooperate with a universal proceeding disregarding entirely the protection of interests explicitly adopted by their national laws. As priorities are the expression of a hierarchy of interests in a legal system, it is unreasonable that this hierarchy of interests, which in many cases is a reflection of local political interests, is imposed universally.

86. See Robert K. Rasmussen, Resolving Transnational Insolvencies Through Private Ordering, 98 Mich. L. Rev. 2252, 2254 (2000) (proposing “contractualism” as an option that allows firms to elect a universalist, territorial, or hybrid approach in the event of insolvency).
87. See Menendez, supra note 43, at 112–13 (proposing a new model for approaching insolvency proceedings that focuses on procedural aspects).
88. See Franken, supra note 55, at 236 (pointing out that ex ante predictability is one of the major emphases of universalism proponents). Franken criticizes universalism proponents’ arguments about universalism’s efficiency as “based on the assumptions that in a territorialist regime local and foreign creditors are paid on a pro-rata basis,” because these assumptions do not correspond to the way in which bankruptcy regimes deal with foreign creditors in practice. Id. n.16.
90. See, e.g., In re Bank of Credit and Commerce Int’l[, 1997] EWHC (Ch.) 213 (Eng.) [1997] 2 W.L.R. 172 (discussing the example of how set-off is treated differently in England and Luxembourg and is considered a matter of public policy, at least in the latter).
Moreover, the universalist position has the effect of increasing the efficacy of the priorities contained in the applicable law, and eliminating the protection for creditors whose priorities are based on other laws. This has been one of the biggest obstacles for the expansion of universalism. In a territorialist model, the satisfaction of priority creditors depends on the presence of sufficient assets in the jurisdiction, and the synergies of a going concern liquidation or reorganization, which would benefit all creditors, are lost.

Thus, the problem of priorities re-emerges in the creation of cooperative international bankruptcy regimes, in which different bankruptcy procedures coexist and cooperation demands a solution to the problem of the treatment of creditor priorities. In this way, complexities appear in all models in which there is a degree of international cooperation, and most notably, in modified universalism.

The first question to be addressed is the participation of foreign creditors in bankruptcy proceedings. It is assumed that in a system of cooperative international bankruptcy, creditors should be allowed to participate in all the different proceedings. In models of cooperation, therefore, foreign creditors are allowed to file their claims in all bankruptcy proceedings opened vis-à-vis the same debtor, irrespective of the jurisdiction (universal cross-filing, or UCF). Indeed, “universal cross-filing” is one of the basic manifestations of cooperation, and implies the ability of foreign creditors to prove their claims in a bankruptcy in the same manner as local creditors. In this way, cross-filing allows a universality of claims, as opposed to the universality of bankruptcy assets. This principle tends to be universally accepted, overcoming a long history of discrimination against foreign creditors.

92. Id. at 1934. Ideally, universalism would work best in systems where there are no priorities (klassenlose Konkurs, as in Austria or Germany), but there is a characterization problem. There are priorities in those systems, but those priorities receive a different name (like legal pledges, gesetzliche Pfandrecht for instance).

93. This is the case in the European Regulation: each liquidator is required to lodge claims in a secondary proceeding, when he is appointed in other proceedings, provided that the interests of creditors in the former proceedings are served thereby. Thus, a global list of creditors and claims is created. See Council Regulation 1346/2000 art. 32(1)–(2) (stating that “any creditor may lodge his claim in the main proceedings and in any secondary proceedings” and that “liquidators in the main and any secondary proceedings shall lodge in other proceedings claims which have already been lodged in the proceedings for which they were appointed, provided that the interests of creditors in the latter proceedings are served thereby, subject to the right of creditors to oppose that or to withdraw the lodgement of their claims where the law applicable so provides”).


95. See id. at 30–31 (describing how a universal cross-filing system may lead to equal distributions and how the addition of cross-priority would “lessen national discrimination”).

96. See 11 U.S.C. § 1513 (2006) (“foreign creditors have the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors. But afterwards this provision states that this does not change or codify present law as to the priority of claims under sections 507 or 726, except that the claim of a foreign creditor under those sections shall not be given a lower priority than that of general unsecured claims without priority solely because the holder of such claim is a foreign creditor.”)

97. See Westbrook, supra note 94, at 31 (arguing that the prevalence of national treatment standard in international trade law, when viewed together with the principle of nondiscrimination, results in equivalent treatment of national and foreign creditors, similar to UCF).

98. See Kurt H. Nadelmann, Discrimination in Foreign Bankruptcy Law Against Non-domic. Claims, 47 Am. Bankr. L.J. 147 (1973) (profiling different bilateral, regional, and international
important exception to this principle affects the claims of tax and other public authorities. In fact, tax claims and other public law claims can be understood to be unenforceable outside their national jurisdiction. This means that the claim, and not only the priority, is disregarded in international insolvencies. Therefore, tax and public law claims remain subject to express discrimination in numerous jurisdictions, including the United States. In the European Union system, however, tax and public law claims of Member States are recognized in the insolvency proceedings of other Member States, although it seems that only unsecured creditor status is given to those claims.

In short, the models of cooperation in international bankruptcy assume that creditors are allowed to file their claims in all bankruptcy proceedings. However, there is insufficient theoretical analysis as to the treatment of priorities in those models. In fact, the only reference to the position of foreign creditors indicates that those creditors cannot be subordinated to the status of local unsecured creditors, but it leaves open the question of whether priority status can be accorded to foreign creditors.

The position more consistent with the cooperative methodological approaches should posit not only universal cross-filing, but also universal priorities: creditors with priorities under a national legal system should be allowed to exercise their approaches to preferences for individual creditors). It has been recognized, long ago, that equality of creditors plays a very important role for cooperation, although equality can be understood as lack of discrimination more than equality in distribution. See Kurt H. Nadelmann, Creditor Equality in Inter-State Bankruptcies: A Requisite of Uniformity in the Regulation of Bankruptcy, 98 U. PA. L. REV. 41, 51–53 (1949–1950) (demonstrating discrimination against foreign creditors in different countries’ statutes); Kurt H. Nadelmann, Concurrent Bankruptcies and Creditor Equality in the Americas, 96 U. PA. L. REV. 171, 172 (1947) (explaining the principle of equalization as expressed in the Hotchpot Rule move case cite to after the second sentence).


100. See also Pottow, supra note 91, at 1912 (“While many well developed legal systems now accord national treatment, it remains the case that at least certain matters, such as tax claims, remain subject to express discrimination, by being either disallowed wholesale or precluded from enjoying the special priority distribution that may attend domestic tax claims.”).

101. See Westbrook, supra note 94, at 37 (“denial of revenue claims is not limited to insolvency cases”); see also 11 U.S.C. § 1513(b)(2) (2006) (stating that the previous sections of the code do not “change or codify present law as to the allowability of foreign revenue claims or other foreign public law claims in a proceeding under this title”). This is a general policy question that transcends insolvency law.

102. See Council Regulation 1346/2000, art. 39 (“Any creditor who has his habitual residence, domicile or registered office in a Member State other than the State of the opening proceedings, including the tax authorities and social security authorities of Member States, shall have the right to lodge claims in the insolvency proceedings in writing.”).

103. Id. art. 32(1). For instance, The European Regulation contains the explicit rule that creditors are allowed to claim in the main proceedings and in any secondary proceedings. Id.

104. See Model Law, supra note 74, para. 104 (referring to the possibility of granting a special ranking to claims of foreign creditors). This rule is interpreted in the sense that a claim of a foreign creditor cannot be subordinated below the claims of general unsecured creditors simply because the holder of such a claim is a foreign creditor. See 11 U.S.C. § 1513 (2006) (describing the access of foreign creditors to a case).
priorities in foreign insolvency proceedings, at least in some cases. However, this theoretical approach faces numerous obstacles, in practice there is a trend to not recognize foreign priorities. The traditional assumption is that each forum will distribute assets according to its own priority rules. Thus, there would be an asymmetry: foreign creditors are allowed to participate in all bankruptcy proceedings, but the priorities would be subject to a territorial rule. The alternative would be to recognize the priorities awarded to foreign creditors: a general recognition of all priorities would be unfeasible, as it would directly and dramatically impact the prospects of recovery for local creditors. A more limited recognition could be accepted where the foreign creditors meet the same requirements for a priority that local creditors enjoy. In the words of Jay Westbrook:

Most national legal systems I have explored seem not to have developed a rule about the availability of local priorities to foreign creditors whose claims would qualify for priority treatment if they were local creditors. The granting of such non-discriminatory treatment can be called “cross-priority.” This is one of the most important questions that is omitted in

105. See Franken, supra note 55, at 239

Equating foreign security interests to similar, albeit somewhat different, security rights of the home country therefore attenuates to some extent the costs imposed on trade creditors by a foreign bankruptcy regime. . . . With respect to foreign statutory priority rights the situation is somewhat different. Because in a universalist system the home country’s forum applies its own priority scheme, it disregards foreign priority rights, thereby relegating creditors with such rights to the status of generally unsecured creditors. In this way, universalism interferes with local distributive policies, which are typically translated into statutory priority rights. However, under the real-world forms of territorialism or modified universalism, bankruptcy courts generally do not recognise foreign statutory priority rights either. On the one hand, in a territorial system, local bankruptcy courts only recognise local statutory priority rights. The extent to which local creditors could benefit from their statutory priority rights then depends on the amount of assets available in the local estate. On the other hand, a universalist system replaces all local statutory priority rights by those of the home country. Foreign local rights are then negated insofar as the home country’s laws do not grant the same statutory priority status to the creditors involved. The issue of statutory priority rights is perceived as highly sensitive, as it affects differing national policies and political beliefs on desired forms of redistribution.

106. See Westbrook, supra note 94, at 40 (discussing the traditional application of foreign and domestic priority rules).

107. Id. at 32 (“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.”).

108. See, e.g., 11 U.S.C. § 507(a)(6)(B) (2006) (regulating unsecured claims of persons engaged as United States fishermen). It should be possible to apply priorities to foreign claimants that conform to the requisites for the recognition of priority treatment. If the U.S. Bankruptcy Code contains a provision that refers specifically to U.S. fishermen, maybe it is legitimate to suppose that the references to workers, or consumers, are made irrespective of the nationality of the creditor. Of course, the question is more complicated than determining the nationality of the creditor, because the territoriality element is not normally attached to nationality (i.e., a priority for workers’ claims covers all labor contracts subject to the law of the jurisdiction).

109. Westbrook, supra note 94, at 30–31; see also Pippa Rogerson, International Insolvency—Law Applied to Distribution, 67 CAMBRIDGE L.J. 476, 476–79 (2008) (discussing the challenges in private international law caused by international insolvency proceedings where both creditors and assets have
the models of regulation of international bankruptcy. In spite of all the work on modified universalism, the treatment of priorities has not been sufficiently developed. It is unclear if foreign priorities can be recognized in a main proceeding, or to what extent national courts can apply foreign law in granting relief to petitioners. It is unclear if the priorities in the main proceeding have to be recognized in the secondary proceeding. The failure to address the issue of the treatment of priorities in international bankruptcy brings back the question of diversity in priority regimes as an obstacle to cooperation.

It is not an exaggeration to assert that the difference in priority regimes constitutes one of the most important barriers to the treatment of international insolvencies. In fact, one commentator has argued that priority conflicts represent an intractable problem.

In international cooperative regimes, the bankruptcy organs in the main proceeding will seek assistance from jurisdictions where assets are located and cooperation with jurisdictions where secondary or ancillary proceedings are opened. This is the essence of modified universalism. However, the necessary cooperation of foreign courts may be subject to considerations of the differences in priorities, which remain formidable obstacles to cooperation.

Under the influential UNCITRAL Model Law, the courts whose assistance is requested are allowed to subject relief to the conditions that they deem appropriate, but the courts must pay special attention to the adequate protection of national creditors. Public order considerations could also interfere with the assistance to foreign insolvency proceedings.

 overlapping connections with multiple countries).

110. It is debated to which extent it is possible to apply foreign law. See generally Look Chan Ho, Applying Foreign Law Under the UNCITRAL Model Law on Cross-Border Insolvency, 24 BUTTERWORTHS J. INT’L BANKING & FIN. L. 655 (2009) (noting objections to the application of foreign law and giving reasons why the application of foreign law is appropriate).

111. See Jay L. Westbrook, Priority Conflicts as a Barrier to Cooperation in Multinational Insolvencies, 27 PENN ST. INT’L L. REV. 869, 869–70 (2008–2009) (“In recent years we have seen the general acceptance of ‘modified universalism’—a pragmatic, accommodating form of the universalist approach to insolvency that seeks to promote cooperation between courts and to produce results as near as possible to the ideal of a single, global proceeding. This approach also permits a meaningful chance for a global reorganization of a business, thus avoiding the serious loss of value almost always associated with piecemeal liquidation. Yet the clash of priority systems presents a serious obstacle to the universalist project.”).


113. Id. at 173.

114. UNCITRAL Model Law, supra note 74, art. 22(2).

115. See id. art. 21(2) (positing the protection of local creditors as a precondition for cooperation: “Upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor’s assets located in this State to the foreign representative or another person designated by the court, provided that the court is satisfied that the interests of creditors in this State are adequately protected.”). See also Cross-Border Insolvency Regulations, 2006, S.I. 2006/1030, Reg. 2 (U.K.) (incorporating the UNCITRAL Model Law, requiring that “the interests of creditors in Great Britain are adequately protected”); 11 U.S.C. § 1521(b) (2010) (requiring that interests are sufficiently protected). The model of the European Union does not contain a similar provision, as it implies a restriction in cooperation.
The UNCITRAL Model Law does not condition cooperation upon the relevant insolvency systems containing same priorities. As a matter of fact, it is extremely unlikely that two priority systems would be completely identical. In some systems, the courts have discussed the requirement of a “rough similarity” between priority systems in order to cooperate with foreign bankruptcy proceedings, but that requirement did not find widespread acceptance in the international community. Instead, the Model Law makes an explicit point of the protection of local creditors, and that point is directly connected with the question of priorities.

The issue of the adequate protection of local creditors is directly related to the question of the differences in priorities. In order to cooperate, the courts will make sure that local creditors are not disadvantaged by that cooperation. Because the prevailing doctrine is that priorities have a territorial effect, the courts tend to make sure that local priority creditors are satisfied with the proceeds of local assets before remitting the rest of the assets to the foreign court. This is an implicit solution in the modified universalist system implemented by the European Union. In modified universalist regimes, if creditors receive a partial payment in a foreign proceeding, independent of their status as preferential or unsecured creditors, they will not be able to receive a payment under the national proceedings until creditors in the same class receive a proportionate equivalent payment (hotchpot rule).

---

116. See Westbrook, supra note 94, at 28 (discussing how “modified territorialism” dominates thinking in most of the other countries in the world).
117. Model Law, supra note 74, part 2, para. 20(d).
118. See Franken, supra note 55, at 235 (discussing how protection of local creditors denies universalism).
119. See Pottow, supra note 91 (discussing the effect of different types of local bankruptcy laws that focus on different priorities and how these provisions affect local creditors).
120. McGrath, [2008] UKHL 21, [62], 1 W.L.R. at 872 (Lord Scott) (“I agree, as I think is common ground, that the English liquidators should first discharge the debts of those creditors who, under the English insolvency scheme, are entitled to preferential payment.”). See also id. [21] (quoting Lord Hoffmann discussing the usual English practice, when remittal to a foreign liquidator is ordered, to make provision for the retention of funds to pay English preferential creditors). This is also the position of the Istanbul Convention of the Council of Europe, which only envisaged the transfer of assets to the home country net of secured and preferential claims that are distributed in the recognizing country according to the lex situs. See European Convention on Certain International Aspects of Insolvency (Istanbul Convention) arts. 21, 22, 28, June 5, 1990, E.T.S. No. 136. Similar principles exist in numerous jurisdictions, like Singapore. Tohru Motobayashi v. Official Receiver [2000] 4 SLR 529 (CA); see also Hans Tjio & Wee Meng Seng, Cross-Border Insolvency and Transfers of Liquidation Estates from Ancillary Proceedings to the Principal Place of Bankruptcy, 20 SINGAPORE ACAD. L.J. 35, 40 (2008) (discussing Tohru Motobayashi v. Official Receiver as an example of Singapore’s cross-border bankruptcy policies).
121. See Council Regulation 1346/2000, art. 35 (showing claims accepted in secondary proceedings, particularly those entitled to preferential treatment, can be satisfied before anything is remitted to the main proceedings); see also id., art. 20 (according to the “hotchpot” rule, creditors who receive full or partial satisfaction of their debts in proceedings in one state are entitled to keep them, except that a partially paid creditor would not receive anything from proceedings in another state where it has made claims until creditors in those proceedings have received the same percentage of payment as it has).
122. 11 U.S.C.A. § 1532 (2005) (stating hotchpot rule: “a creditor who has received payment with respect to its claim in a foreign proceeding pursuant to a law relating to insolvency may not receive a payment for the same claim in a case under any other chapter of this title regarding the debtor, so long as the payment to other creditors of the same class is proportionately less than the payment the creditor has already received”).
rule is aimed at preserving the equality among creditors, but its specific application to priority creditors is particularly unclear.\textsuperscript{123}

However, the question of the adequate protection of local creditors can be more complex: local creditors can be not only priority creditors, but also general unsecured creditors, and those creditors would be impaired by the remission of the assets to a foreign court, which applies a law in which other priorities exist. Although local creditors are not discriminated against and can take part in the foreign insolvency proceedings, the existence of a different set of priorities may imply that, as unsecured creditors, they will not receive any significant payment, whereas the situation would have been different under a territorial system. Thus, the problem intensifies where the foreign proceeding may treat creditors in a different way, denying\textsuperscript{124} or granting priorities to creditors that do not exist under the law of the ancillary proceeding.\textsuperscript{125}

In any case, adequate protection cannot mean that the priorities are exactly the same. In the Privy Council case of \textit{Cambridge Gas}, one of the tests used for determining the possibilities of cooperation with a U.S. court was whether there was any prejudice to a creditor in the Isle of Man by cooperating with the Chapter 11 proceedings.\textsuperscript{126} The assets should not be transferred to the United States if the prejudice suffered by creditors was not overcome by countervailing advantages. It is submitted that pragmatic approaches to the issue of adequate protection should substitute a mere comparison of the priority regimes between jurisdictions.

The definition of “local” or “national” creditors is extremely difficult, as there are no elements to suggest that the criteria should be based on nationality, residence, or place of business.\textsuperscript{127} In the case of financial creditors, the distinction between local and foreign creditors does not seem logical.

Naturally, the underlying problem is that the key concepts of “adequate protection” and “local creditors” are not sufficiently defined in the international texts. Therefore, there is a high degree of court discretion involved in international bankruptcy cooperation.\textsuperscript{128} If these concepts are interpreted in an extensive way, the possibilities for international cooperation are restricted.

Another built-in safeguard is the fact that an outcome cannot be manifestly contrary to public policy.\textsuperscript{129} “This signals that there is no natural conflict between

\begin{flushleft}
\textsuperscript{123} In fact, the hotchpot rule refers to creditors of the same ranking, but it is not clear which ranking to apply. \textit{See id.} (for instance, if a foreign creditor had a priority abroad, it is understood that that creditor will not be able to share as an unsecured creditor until the general unsecured creditors in the U.S. bankruptcy have received the same amount for their claims). Therefore, the notion of “equality” introduced by the rule is questionable.

\textsuperscript{124} \textit{See In re} Bank of Credit and Commerce Int'l, [1997] Ch. at 246 (concerning the winding up of a major international bank in the U.K.).


\textsuperscript{127} \textit{See} Pottow, \textit{supra} note 91, at 1913 (discussing the interests of “local creditors” due to the ambiguity in the subset of individuals that this term includes).

\textsuperscript{128} \textit{See} Adams & Fincke, \textit{supra} note 76, at 50 (discussing how modified universalism maintains the court discretion with respect to protection of local creditors’ interests).

\textsuperscript{129} Model Law, \textit{supra} note 74, art. 6 (“Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of this
The purpose of the expression “manifestly” used in the international legal texts as a qualifier of the expression “public policy” is to emphasize that public policy exceptions should be interpreted restrictively, and that the public order exception is only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting state.

It is interesting to discuss the extent to which differences in priorities affect cooperation in numerous situations. In the case of *McGrath v. Riddell*, a difference in priorities was the main source of controversy in granting the cooperation request from the foreign court. The fact that this difference in priorities could be overcome is what makes this case a good starting point for an analysis of the differences in priorities in international bankruptcy.

Priorities are ubiquitous, and differences in priorities are ubiquitous too. It is next to impossible to find countries that share exactly the same priorities. If science has shown that the saying “no two snowflakes the same” probably holds true, it is hardly surprising that priority schemes are all dissimilar. As a matter of fact, there is some parallel in the reasons for these physical and legal phenomena: in both examples, the existence of differences is explained by the presence of different circumstances. These differences can be minimal—but they still exist—in countries with similar legal systems and social conditions, but they can be substantial where the countries present deep divergences in society, economy, or legal tradition. “The reality is that each national insolvency regime has a system of priorities.”

Indeed, every insolvency system, or in a broader sense, every credit protection system, needs to address the distributional question as the nucleus of credit regulation. It is not surprising that the decisions taken by local legislatures are often idiosyncratic, as they respond to the pressure exerted by powerful local social groups, and it is easy to see why this creates an additional problem in the international coordination demanded by transnational bankruptcy.

There is no identity between credit protection systems: in fact, if identity were the requirement for cooperation, there would be hardly any international cooperation in international bankruptcy. Moreover, harmonization or unification

---

130. Mamutse, supra note 26, at 38–39 (discussing *McGrath v. Riddell* and noting “there is no natural conflict between public policy concerns and a departure from the established distribution structure”).

131. UNCITRAL Model Law, supra note 74, Guide to Enactment para. 89.

132. *McGrath*, [2008] UKHL 21, [2], 1 W.L.R. at 855 (Lord Hoffmann) (“It is agreed that if the English assets are sent to Australia, the outcome for creditors will be different from what it would have been if they had been distributed under the 1986 Act. Some creditors will do better and others worse. […] Generally speaking, insurance creditors will be winners and other creditors will be losers.”).


134. See Westbrook, supra note 94, at 30 (explaining that national priority systems often have both commonalities and unique features).


136. See Bank of N.Y. v. Treco (*In re Treco*), 240 F.3d 148, 158 (2d Cir. 2001) (holding “the priority rules of a foreign jurisdiction need not be identical to those of the United States,” but “directs the court to consider whether the priority rules are ‘substantially in accordance’ with United States law”) (emphasis in original). The case shows that no abstract comparison should be drawn, but an analysis of the effects of
of the law in this area is extremely unlikely, precisely because of the political nature of numerous priorities.

It is frequently asserted that cooperation takes place where there are no substantial differences in the graduation of credits, but there are very different national experiences in this regard, and it is not possible to establish the degree of similarity that makes cooperation possible. What is possible, however, is to include an analysis of the various differences and how they affect international cooperation.

In this respect, a taxonomy of differences is suggested: in it, a matrix of different situations is provided to illustrate the possible interactions of priorities in international insolvency cases. The matrix is built on the comparison of priorities, priority-related rules, and the possible results of that comparison. The possible situations are the following:

- Case A: a priority exists in the foreign law that does not exist in national law.
- Case B: a priority exists in national law that does not exist in the foreign law.
- Case C: a priority exists both in national law and in foreign law, but:
  - Case C1: Some elements of the priority are different.
  - Case C2: The position of the priority in the general graduation of credits is different.
- Case D: the same priority (or absence of priority) exists in both the foreign law and the national law.

These four different cases, or groups of cases, illustrate the complexities that differences in priority regimes bring to international cooperation in insolvency. Naturally, international insolvency law is not algebra: these cases correspond to specific situations, with specific sets of circumstances. The sole justification for this

---


138. See Daniel M. Glosband & Christopher T. Katucki, Claims and Priorities in Ancillary Proceedings under Section 304, 17 BROOK. J. INT’L L. 477, 486 (1991) (“Courts have taken both territorial and universal approaches in the treatment of secured and unsecured claims, leading to the conclusion that no firm conclusions can yet be drawn about how claims will be treated in any particular instance.”); Knecht, supra note 137, at 288 (observing that no two countries’ insolvency laws are precisely the same).

139. It is not useful to oversimplify and disregard the differences. Instead, Franken argues that the national policies behind priorities do not differ in fundamental ways, and underestimates the importance of the differences in the priority of workers’ claims. Franken, supra note 55, at 239 (“Notably, most bankruptcy régimes afford employee wage claims priority over unsecured creditors, albeit the scope of the priority right and the exact priority ranking may differ from jurisdiction to jurisdiction. However, such differences may not constitute serious problems if one considers that at the moment of filing for bankruptcy wage liabilities are generally low, since most corporate debtors will have an interest in paying their employees as long as possible if they want to continue their operations. Consequently, corporate debtors’ incentives to forum shop ex post may not be strong as the de facto treatment of wage claims may not differ that much among jurisdictions.”). It is submitted that this is an overoptimistic assessment of the situation.
classification is its usefulness of the allowing the study of common elements across those situations. In order to understand the possibilities for international judicial cooperation, it is helpful to analyze the different implications of each of these cases. Thus, this taxonomy is merely an analytical tool for understanding the issues involved in the treatment of priorities in international bankruptcy.

A quick analysis reveals that only in Case D is there no problem for cooperation between the courts of different countries, irrespective of the model for international cooperation that is adopted, and leaving aside the existence of other issues that may affect the relation of the courts. Case D assumes that there are no differences between the priority systems of two jurisdictions: the priorities recognized in the respective systems would be the same, with identical elements and requirements, and in the same ranking positions. The probability that this situation will arise in reality is extremely low: in practice, the existence of significant differences is the rule, and the existence of identical systems can be almost discarded. If identity is used as a condition for cooperation, the possibilities for effective international bankruptcy cooperation will be severely limited.

Some insolvency systems demand that there be substantial similarity between priority systems. This has led to the observation that similarity between bankruptcy laws is an important factor for international cooperation. However, the consideration of “substantial similarity” introduces the question of what a “substantial difference” is. Substantial similarities may be easier to establish between legal systems that belong to the same family—like quasi-secured creditors in common law systems—but may be considerably more difficult when comparing legal systems with different traditions and conceptual frameworks.

Thus, in virtually all of the cases that arise in practice, there are some differences between priorities in the jurisdictions involved. In those cases, there are problems associated with the differences in priorities, but it would be wrong to assume that all of those problems are similar. The distinction between cases A, B, C1, and C2 is therefore pertinent.

In Case A situations, a priority exists in the foreign law that is unknown in the national law. The judgment in McGrath v. Riddell deals with a Case A situation, and Case A situations are those which are more likely to be solved in favor of the foreign law. The main reason for this tolerance of the difference is to be found in the nature of the conflict with the foreign priority. In fact, in Case A situations, conflict

140. Absolute coincidence is next to impossible. McGrath, [2008] UKHL 21, [21], 1 W.L.R. at 859 (Lord Hoffman) (“[I]n practice such a condition would never be satisfied. Almost all countries have their own list of preferential creditors.”).

141. See, e.g., 11 U.S.C. § 304 (repealed 2005) (stating that a factor for the court to consider is whether “distribution of proceeds of such estate [are] substantially in accordance with the order prescribed by this title”).

142. Therefore, there is a need for some similarity in bankruptcy laws. See Westbrook, supra note 37, at 468–69 (“The second prerequisite to obtaining the benefits of universalism is general similarity of law. Similar laws about distributions, avoidance, and the like are not in principle necessary to the acceptance of universalism, but in practice similarity is very important.”).

143. See, for examples of claimants under a constructive trust, In re Koreag 130 B.R. 705, 716 (Bankr. S.D.N.Y. 1991) (pointing out that a New York Court allowed assets to be turned over to Swiss courts for liquidation); Remington Rand Corp. v. Bus. Sys., 830 F.2d 1260, 1273 (3d Cir. 1987) (“The district court should bade fealty to the doctrine of comity and recognize the Dutch bankruptcy proceeding, but only if and to the extent that the Dutch court is willing to recognize the American judgment in its proceedings.”).
materializes between a foreign priority and the domestic *pari passu* principle. In Case A the two principles that clash are the priority in the foreign jurisdiction and the *pari passu* principle in the domestic jurisdiction.

Technically, the *pari passu* principle is not a priority (in fact, it is quite the opposite, as it is an *absence* of priority), but it constitutes a distributional option. The distributional questions admit different solutions. However, general creditors are not a protected category, and it is difficult to argue that general creditors are “local” creditors. They can be foreign creditors for all purposes (e.g., international financial institutions).

Given that *pari passu* is a default principle, and legislators do not place emphasis on it, there is less tension in recognizing a foreign priority, even if it means that the principle of equal distribution is further restricted in its allegedly already limited role. The discussion of the real importance of the principle of equality of creditors has been a constant theme in bankruptcy literature, but it should be concluded that, in spite of pompous formulations, the principle is residual and expresses only that, absent a specific policy choice by the legislature, all creditors should be treated equally. Naturally, there is a conflict between asserting equality of creditors and recognizing the specific choice made by a foreign legislature in favor of a specific creditor group. However, the courts will have to decide between recognizing a preference that has not been admitted in the local law and inflicting some damage to the *pari passu* rule. As a default rule, the *pari passu* principle does not protect any specific group of creditors, so it is not easy to identify the rationale and objective of the rule with local creditors who would suffer prejudice by virtue of the recognition of the foreign priority. The policy in favor of equality is never as strong as the explicit option in favor of a group of creditors, expressed in a priority. This means that in Case A situations, the courts will be more inclined to recognize the foreign priority than in other cases, because the recognition of a foreign priority does not automatically mean that local creditors are prejudiced. This is, of course, subject to an important qualification: in a Case A situation, the foreign priority has no equivalent in the local law—and that is precisely the source of the problem—but in order to be recognized, the foreign priority should not clash with some fundamental conception in the national law. This conflict with the local law mainly arises because of two different factors:

1) Substantial differences in legal traditions and legal conceptions; and

2) *Ordre public* considerations, as in the case of the recognition of a priority of foreign tax authorities.

---

144. See Riz Mokal & Look Chan Ho, *The Pari Passu Principle in English Ancillary Proceedings*, 21 INSOLVENCY L. & PRACTICE 207, 210 (2005) (explaining that “insofar as English proceedings are ancillary to foreign insolvency proceedings, none of the versions of what is described as the *pari passu* principle, nor the HIH decision, necessarily constitute hurdles to English assets being handed over to a foreign insolvency official for distribution according to the foreign insolvency regime”).

145. Cf. McGrath, [2008] UKHL 21, [21], 1 W.L.R. at 859 (Lord Hoffmann) (“But the existence of foreign preferential creditors who would have no preference in an English distribution has never inhibited the courts from ordering remittal.”).

146. It is possible to enunciate a basic principle: the more intense the public policy element, the more difficult it is to deal with a priority internationally (that is the case with the priority of workers’ claims and of taxes, as opposed to security interests, for instance).
The analysis of the McGrath v. Riddell case suggests that all of the conditions for the recognition of a foreign priority were met: the conflict involved the Australian priority and the English pari passu rule; and the priority recognized in the foreign law did not clash with any fundamental legal principle or public order considerations in England.

Therefore, the conflict in Case A is less intense than in Case B and Case C situations, where the recognition of priorities may be more problematic.

In Case B situations, there is a national priority that is not recognized under the foreign bankruptcy law. A Case B situation is the reverse of a Case A situation. Because the tables are reversed in Case B, it means that cooperation with the foreign courts will in fact be much more difficult, if at all possible, unless the court is assured that the local creditor will in fact receive payment of its preferential claim. Otherwise the national courts would have to ignore a fundamental choice made by the national legislature in advancing the interests of a specific group of creditors, in order to benefit unsecured creditors in a foreign bankruptcy proceeding of universal reach. If courts enjoy discretion, it is unlikely that they would cooperate in that setting, as experience shows.

An example of Case B is the situation analyzed in In re Bank of Credit and Commerce International. The bank was incorporated in Luxembourg, but had operations worldwide. There were ancillary proceedings in England, the problem: the application of set-off before the assets were transferred to Luxembourg. Scott VC stated several important points regarding the nature of ancillary proceedings, including its territorial character and the usefulness of a single distribution of dividends (“Since in order to achieve a pari passu distribution between all the company’s creditors it will be necessary for there to be a pooling of the company’s assets worldwide and for a dividend to be declared out of the assets comprised in that pool, the winding up in England will be ancillary in the sense that it will be the liquidators in the principal liquidation who will be best placed to declare the dividend and to distribute the assets in the pool accordingly”). But all of these points were subject to the conditions that substantive rules of distribution under the English statutory scheme are mandatory and the court has no power to make an order, that will have the effect of misapplying them.

An interesting example of a Case B situation with a different solution can be found in the U.S. case In re Griffin Trading Co. In this case, an unsecured creditor of a Chapter 7 debtor commodities broker argued that English law, instead of U.S. law, should apply to transactions executed in the debtor’s London office. English law placed the claims of the debtor’s general unsecured creditors on par with the debtor’s

148. Id.
149. Id. at 4–5.
150. Id. at 18, 21.
151. McMahon, [2005] EWHC (Ch) 2125, [175] (quoting an authority for not cooperating with the Australian liquidators in the McGrath case). See McGrath, [2008] UKHL 21, [17], 1 W.L.R. at 859–60 (Lord Hoffmann) (“I think that justice required that a remittal of the assets should have been qualified by a provision which ensured that the English set off was given effect. Luxembourg has not been designated a ‘relevant country’ under section 426 and there was accordingly no jurisdiction to apply Luxembourg law, but, as at present advised, I think that even if there had been, I would not have thought it appropriate to do so. The mutual debts were too closely connected with England.”).
customers. In contrast, U.S. law gave customers’ claims a super-priority. \footnote{153} The court did apply U.S. law, although it eventually struck down the regulation that gave priority to customers. \footnote{154}

In Case A and in Case B it is possible to see the two extreme contrasts between jurisdictions: a priority exists in one legal system and does not exist in another. However, the most frequent situations are those grouped under the Case C heading. Case C reflects the fact that similar priorities exist in numerous legal systems, but there are substantial differences in those priorities, and those differences act as obstacles for cooperation. For instance, many jurisdictions share the existence of the “Big Three” priorities—tax, employees, and secured credit—but there are substantial differences as to the elements of those priorities. \footnote{155}

I have distinguished between Case C1 and Case C2 because I believe that differences in graduation (Case C2) deserve some special consideration. In Case C1, the priority exists in both the national and the foreign jurisdiction, but there are divergent elements in the priorities. \footnote{156} Certainly, there are priorities that appear in most legal systems that can be considered as “meta-norms,” like employee protection, \footnote{157} but the elements of the priority can be different. The divergences can affect any of the elements of the priority: persons benefited by the priority (e.g., a priority in favor of workers, generally, versus a priority that favors only workers in the manufacturing sector); extent of the priority (e.g., an unlimited priority in favor of workers, and a priority capped at $5,000 per worker) \footnote{158}; and structure of the priority (there is a fundamental difference between general priorities, i.e., those that grant the creditor a general preference over all of the liquidation proceeds, and special priorities, that grant the creditor a preference over the proceeds of the sale of one or several specified assets in the debtor’s estate).

Ideally, the courts should accord priority treatment to foreign creditors that comply with the requirements of the priority under national law, and should expect their national creditors to receive the same treatment under foreign law. In practice, there is considerable mistrust. Courts tend to ignore the fact that foreign creditors could be entitled to priority status, and tend to protect local creditors against the risk that their priorities will not be recognized in a foreign insolvency. \footnote{159}

\begin{itemize}
  \item Id. at 294–95.
  \item Id. at 306–19; Anthony M. Vassallo et al., Cross-Border Insolvency and Structural Reform in a Global Economy, 35 INT’L L. 449, 456 (2001).
  \item See Janis Sarra, An Investigation into Employee Wage and Pension Claims in Insolvency Proceedings Across Multiple Jurisdictions: Preliminary Observations, 16 NORTON J. BANKR. L. & PRAC. 835–72 (Oct. 2007) (discussing that the placement of employee claims on the hierarchy of secured and unsecured claims differs considerably across jurisdictions, which position employee claims before or after secured claims; before or after taxing authorities or other government claims; and before or after other specified claims that have been recognized as a public policy priority in a particular country).
  \item See Pottow, supra note 91, at 1931 & n.144 (discussing the concept of meta-norms).
  \item The extent of the priority can also be determined by reference to temporal limits (for instance, a priority for the wages corresponding to the last six months of employment). This can be accompanied by a cap on the amount of the priority.
  \item Tung, supra note 61, at 45–46 (arguing that courts are “leery of granting recognition and giving local effect to determinations of foreign bankruptcy courts” and will therefore apply their own bankruptcy laws to the benefit of local creditors).
\end{itemize}
There is a strong case for recognizing the same priorities under national law: 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. Interestingly, this quotation of Jay Westbrook’s work anticipates the result in a well-known case, In re Collins & Ackman Corp. Group. In Collins, the English court decided to apply the Spanish and German distribution rules, in transgression of the English regime, in order to avoid the opening of ancillary proceedings in Germany and in Spain, so as to allow a sale of the whole corporate group at a better price.

An additional difficulty comes from the nature and structure of priorities: priorities are exceptions to a general principle of equality of creditors. As such, there is a rule against extensive construction of priorities, and against the creation of priorities by analogy. In this regard, what the courts of a national system can do is recognize the foreign priority only in the more restricted version recognized under national law. If the foreign priority is more restrictive than the national one, it is unlikely that the national courts will offer foreign creditors better treatment than the treatment they would receive under their own national law, although that could be a theoretical possibility under the UNCITRAL Model Law. In that situation, it may well be that the foreign creditors would be entitled to receive the same treatment accorded by their national law, in the foreign bankruptcy proceeding.

In Case C2 situations, the difference affects the position of the priority in the general graduation of creditors. This can be the only difference between the two laws, or, as it may be the case, the difference in graduation can be accompanied by differences in the elements of the priority (Case C1). Case C1 and Case C2 can manifest themselves independently, but they may arise at the same time as well. In Case 2, the problem is that both the national law and the foreign law recognize the priority, but the priority is accorded a different treatment in the graduation.

It is evident that a court lacks the discretion to alter the graduation order in its national system, as this order is imposed by the legislature, and there is no degree of discretion in dealing with it. This shows that, even in a situation where both the national and the foreign law recognize a priority that benefits the same group of creditors, the differences in the position in the graduation amount to a substantial conflict between the two laws.

This taxonomy could be further complicated with the introduction of reverse priorities (subordinated creditors). This would create Cases A1, B1, and C3, but in

---

160. Westbrook, supra note 94, at 42.
163. 9D AM. JUR. 2D Bankruptcy § 3305 (2010).
164. Id.
165. See UNCITRAL Model Law, supra note 74, Guide to Enactment para. 104 (discussing UNCITRAL application of provisions that provide for the minimum ranking of claims for foreign creditors). If it is possible to give a special ranking to the claims of foreign creditors, this could include a better treatment than the treatment provided to a similar creditor under the local law of the forum. This is an interesting interpretation, although it is unlikely that this was the intention of the drafters.
166. See Westbrook, supra note 94, at 36 (defining “reverse priorities” as “subordinations or
practice the number of jurisdictions with these reverse priorities is very small. According to this sub-typology, there would be situations in which a preferential creditor in one country is a subordinated creditor in another one, and the opposite. An ordinary creditor is subordinated in another country, and vice versa. Creditors can be subordinated in different ways in two different systems (or different positions in the graduation).

In essence, what these different situations show is that under the umbrella of the “differences in priorities” is a whole range of situations that involve very diverse conflicts of interests, and that deserve separate treatment. Future analysis should concentrate in identifying all of these potential conflict situations, and international legal texts should take into account the issue of the differences in priorities.

V. CONCLUSION

It is not an exaggeration to assert that the differences in priority regimes constitute one of the most important barriers to the treatment of international insolvencies. Even in cases where the courts are willing to co-operate, it can be extremely complicated for the courts to ignore values that have been explicitly advanced by the legislature in national insolvency law. It is submitted that no two priority systems are identical, and that harmonization or unification of the law in this area is extremely unlikely to materialize. In fact, priority systems are but the expression of the hierarchy of values that permeate a given legal system. This means that graduation of creditors is primarily political, and that the influence of powerful groups of creditors, the inertia of legal tradition, or the conscious and deliberate choice to promote certain values are the factors that explain the fundamental differences encountered in various jurisdictions around the world.

Decisions like McGrath v. Riddell show that there are possibilities of co-operation beyond traditional territorialism in international insolvency cases, and illustrate the real implications and consequences of taking specific decisions in insolvency cases beyond the abstract discussions of theoretical approaches to international bankruptcy. The pragmatism that informs the decision of the House of Lords serves as an illustration for the classification of the various situations that differences in priorities can provoke in the context of international bankruptcies. The existence of divergences between gradations of creditors in the different legal system is likely to remain one of the biggest obstacles to co-operation in international insolvencies, and, unfortunately, it is a problem that tends to be consciously omitted in international legal texts. However, a clear understanding of the different conflicts contributes to raising awareness about this issue, and perhaps represents a step forward in the legal treatment of conflicts between different priority systems.