Maryland Journal of International Law

Volume 1 | Issue 2 Article 11

Fotochrome, Inc. v. Copal Company Limited

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INTERNATIONAL ARBITRATION — BANKRUPTCY — THE IMPACT OF THE U.N. CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS ON THE U.S. BANKRUPTCY ACT.

Fotochrome, Inc. v. Copal Company, Ltd., 517 F.2d 512 (2d Cir. 1975)

Fotochrome, Inc., a United States corporation, and Copal Company, Limited, a Japanese corporation neither present nor doing business in the United States, joined issue where the laws of arbitration and bankruptcy overlap. In 1966 the corporations entered into a contract which called for Copal Company, Limited (Copal) to manufacture cameras according to specifications provided by Fotochrome, Inc. (Fotochrome); Fotochrome was to distribute the cameras in the United States. A dispute arose, and the parties proceeded to arbitration before the Japanese Commercial Arbitration Association (JCAA) in Toyko as provided in the contract. Before the Japanese board had reached its decision, but after more than two years of arbitration, Fotochrome filed a chapter XI bankruptcy petition in the United States.[1]

Thereupon the Referee in the U.S. bankruptcy proceeding, pursuant to authority vested in him under the Bankruptcy Act,[2] enjoined all creditors of Fotochrome from "commencing or continuing any actions, suits, arbitrations, or the enforcement of any claim in any court against this debtor. . . ."[3] The JCAA, having received notice of the Referee's stay, nevertheless determined that the stay was legally ineffective as to them, and continued the proceedings. Shortly thereafter, they issued an award in favor of Copal. Copal filed the award with the Tokyo District Court, rendering it a final judgment under Japanese law.[4] Copal then filed a proof of claim in Fotochrome's bankruptcy proceedings in the amount of the arbitral award. In response to Fotochrome's challenge to this claim, the Referee determined that the Japanese award would not be treated as a final judgment

1. Bankruptcy Act § 301 *et seq.*, 11 U.S.C. § 701 *et seq.* (1970).

2. *See* Bankruptcy Act §§ 2(a)(15), 11(a), 302, 311, 314, 11 U.S.C. §§ 11a(15), 29(a), 702, 711, 714 (1970).

3. 517 F.2d 512, 514 (2d Cir. 1975).

4. *See* Articles 799, 800, JAP. C. CIV. PRO., Book VIII, Law No. 29 (April 29, 1890).

in the bankruptcy proceeding and that the bankruptcy court could reexamine the underlying dispute. The Court of Appeals for the Second Circuit affirmed the district court's[5] reversal of the Referee's decision.

The court of appeals was faced with the difficult task of reconciling potential conflicts between the U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (UN Convention)[6] and the U.S. Bankruptcy Act.[7] Basically the court addressed two issues: 1) whether an award issued by the JCAA after the filing of a Chapter XI petition in the U.S. Bankruptcy Court is binding on the merits of the claim, and 2) whether such an award must be confirmed and reduced to a domestic judgment before it is entitled to enforcement.

The court of appeals determined that, even assuming that the Bankruptcy Court had the authority to stay domestic arbitration, the stay issued by the Referee had no legal effect on the JCAA or Copal, because the Bankruptcy Court lacked the requisite *in personam* or territorial jurisdiction over them. As a result, the arbitral award issued by the JCAA, based on arbitration begun before the petition in bankruptcy was filed, was valid on its face.

The court of appeals determined that under Section 63a(5) of the Bankruptcy Act,[8] the Bankruptcy Court may recognize a provable debt reduced to judgment after the bankruptcy petition is filed but before discharge. The court concluded, however, that an arbitral award could not be considered a judgment *ipso facto*, because under the UN Convention[9] the process of procuring a

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5. 377 F. Supp. 26 (E.D.N.Y. 1974).

6. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Dec. 29, 1970, [1970] 3 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38. The UN Convention was implemented in the United States by 9 U.S.C. § 201 *et seq.* (1970) and added to the statutory provisions for implementation of domestic awards, 9 U.S.C. § 1 *et seq.* (1970).

7. Bankruptcy Act § 301 *et seq.*, 11 U.S.C. § 701 *et seq.* (1970).

8. Bankruptcy Act § 63a(5), 11 U.S.C. § 103a(5) (1970).

9. Article III of the UN Convention requires enforcement of arbitral awards in accordance with domestic procedure. 9 U.S.C. § 207 (1970) provides:

> The court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in Article V of the said Convention.

The court thus determined that these sections imply that the losing party must be given the opportunity to raise the limited Article V defenses in a domestic court. 9 U.S.C. § 207 (1970) gives the federal district court jurisdiction over such matters.

judgment based on an arbitral award involves the due process right to contest the award on the limited statutory grounds outlined in Article V.[10] The court thus merged treaty law with bankruptcy law, and concluded that without the opportunity to contest the confirmation of the arbitral award, the award could not be submitted as proof of claim in the bankruptcy proceedings. The award must be merged into domestic judgment before it can be considered a provable debt under Section 63a(5) of the Bankruptcy Act.[11] The court concluded that Copal must first seek to reduce the award to judgment in federal district court.[12] If successful, Copal may then submit the judgment as a proof of claim in the bankruptcy proceedings.

However, the court determined that the award, once merged into judgment, is binding on the merits and unreviewable by the Bankruptcy Court. In reaching this conclusion the court of appeals relied on Article III of the UN Convention,[13] which provides that each contracting state must recognize arbitral awards as binding, and on Article V,[14] that enforcement of foreign arbitral awards is subject to attack only on the specific grounds listed therein. The court also bolstered its conclusion by pointing to domestic case law. It cited *Thompson v. Magnolia*[15] for the principle that the Bankruptcy Court does not necessarily have exclusive jurisdiction over a debtor's assets; *Riehle v. Margolies*[16] was relied upon for the proposition that a judgment

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10. *See* Article V, UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Dec. 29, 1970, [1970] 3 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38.

11. *Supra,* note 9.

12. 9 U.S.C. § 207 (1970).

13. *See* Article III, UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Dec. 29, 1970, [1970] 3 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38.

14. *Supra,* note 11.

15. 309 U.S. 478 (1940).

16. 279 U.S. 218 (1929). The court's reliance on *Riehle v. Margolies* appears to have been misplaced because this case involved an equity receivership where the receiver did not have the power to stay the state court proceedings involved. *Fotochrome* deals with a Chapter XI arrangement where the Referee does have the power to stay suits. Further, the court in *Riehle* recognized that other federal court decisions have held that judgments obtained by another court after the bankruptcy petition was filed but before discharge are not necessarily binding on the merits for purposes of

rendered in a court other than the Bankruptcy Court is binding on the Bankruptcy Court, for the purpose of establishing the amount of a claim, as long as the original court had jurisdiction over the debtor. The court ultimately allowed the creditor, Copal, to secure a judgment in federal district court.

In an effort to resolve this dispute without admitting potential conflict between applicable treaty and statutory law, the court left several troublesome issues unresolved. The court did not deal with the fact that Copal's award had attained the status of a final judgment in Japan. Judge J. Gurfein's opinion acknowledged but did not resolve the inconsistency of this decision with a prior case, *Island Territory of Curaçao v. Solitron Devices, Inc.*[17] That case also involved an arbitral award that had attained the status of a judgment in Curaçao. The Second Circuit held in that case that if an arbitral award results in a judgment in a foreign country, it may be directly enforced in a state court as a foreign money judgment. Although the UN Convention was also in effect at the time of the *Solitron* decision, the court there concluded that, because the UN Convention only goes to the enforcement of foreign arbitral awards and not foreign judgments, it does not preempt existing state legislation providing for enforcement of foreign country judgments. However, even if the court determined that Copal's award could have been enforced as a foreign money judgment, it was still faced with the Referee's stay of any proceedings in domestic courts to enforce any claims.

Another troublesome issue concerned the court's acceptance of the district court's determination that the UN Convention was binding on the parties, although the United States did not accede to the UN Convention until four years after the contract

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proof of claim in the Bankruptcy Court, and in fact the court deliberately distinguished those cases from a receivership situation.

17. 489 F.2d 1313 (2d Cir. 1973), *cert. denied,* 416 U.S. 986 (1974). In *Solitron,* the American company had entered into an agreement with the Curaçao Government to build a factory in Curaçao and provide employment for local employees. After a change in local law, the venture became less profitable for Solitron Devices, Inc. and they breached their contract. The Curaçao Government pursued arbitration as provided in the contract, and although Solitron did not participate in the arbitration proceedings, it received notice of all procedures. An arbitral award was issued in the government's favor and reduced to a foreign money judgment in Curaçao. The judgment was enforced against Solitron in New York under the Uniform Foreign Country Money Judgment Recognition Act, N.Y. CIV. PRAC. §§ 5301–5309 (McKinney).

had been signed, and after the arbitral award had been issued.[18] The UN Convention contains no retrospective language. The court also deliberately left open the question whether the Bankruptcy Court even has the authority to stay domestic arbitration. If the Bankruptcy Court does have such authority, this decision creates the potential for an asymmetry, in that a domestic contracting party might be restrained from pursuing his arbitration remedy upon the filing of a bankruptcy petition, whereas a similarly situated foreign party may proceed to an arbitral award. The award might then be confirmed in the federal district court and ultimately submitted as a proof of claim in the bankruptcy proceedings. While the court conceded that this might be an anomalous result, they avoided the issue and attempted to justify the inconsistency saying only that "an American company might procure an arbitral award in the U.S. against a Japanese firm in financial trouble whose judgment creditors might be under a stay from a Japanese court."[19]

Vacating the Referee's restraining order with respect to Copal would appear to have a clear, although perhaps limited effect on the Bankruptcy Court's authority to control claims against the debtor's estate. The court does not examine whether such an infringement of the Bankruptcy Court's authority might circumvent the purposes of the Bankruptcy Act. Curiously, the court stated at the outset of the case:

> [T]his appeal can be decided without the necessity of determining whether the Bankruptcy Act involves a "public policy" which is contrary to the enforcement of arbitral awards under the Convention.[20]

The court seemed intent on reaching its decision for policy reasons. It pointed to recent Supreme Court cases[21] which have stressed the need for encouraging international arbitration as a means of settling transnational business disputes. Further, since the U.S. recently acceded to the UN Convention the court took

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18. *Supra,* note 8.

19. 512 F.2d at 519.

20. 512 F.2d at 516.

21. Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974), and Island Territory of Curaçao v. Solitron Devices, Inc., 489 F.2d 1313 (2d Cir. 1973), *cert. denied,* 416 U.S. 986 (1974).

this opportunity to show good faith adherence to the UN Convention's provisions. Arguably the same conclusion could have been reached by dealing more squarely with the issues, thereby alleviating some of the confusion which results from this decision. Even assuming there was a conflict between the Bankruptcy Act and the UN Convention, basic principles of statutory construction dictate that as between an earlier statutory provision and a subsequent Convention (duly incorporated into the municipal law of the forum), the later in time prevails to the extent of the conflict.[22]

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22. *See* J. G. SUTHERLAND, STATUTORY CONSTRUCTION 179 (1891), and 5 G. HACKWORTH, DIGEST OF INTERNATIONAL LAW 185 (1943).