

Bankruptcy in the Czech Republic, Hungary, and Poland and Section 304 of the United States Bankruptcy Code, Proceedings Ancillary to Foreign Bankruptcy Proceedings

Helmut Gerlach

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Recommended Citation

Helmut Gerlach, *Bankruptcy in the Czech Republic, Hungary, and Poland and Section 304 of the United States Bankruptcy Code, Proceedings Ancillary to Foreign Bankruptcy Proceedings*, 22 Md. J. Int'l L. 81 (1998).

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**BANKRUPTCY IN THE CZECH REPUBLIC, HUNGARY, AND
POLAND AND SECTION 304 OF THE UNITED STATES
BANKRUPTCY CODE, PROCEEDINGS ANCILLARY TO
FOREIGN BANKRUPTCY PROCEEDINGS**

HELMUT GERLACH¹

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1. Associate, Jacobs & Dembert, P.A.; J.D. University of Maryland School of Law, 1997. The author extends his gratitude to Professor William L. Reynolds for his helpful comments and encouragement with this article. Additional thanks goes to Jan Čížek, Counselor and Consul, Embassy of the Czech Republic; Dr. Zoltán Bányász, Consul, Embassy of the Republic of Hungary; Gregor Kiczor, Counselor, Embassy of the Republic of Poland, for their help in obtaining relevant documents.

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I. INTRODUCTION

“Bankruptcy is a gloomy and depressing subject.”¹ A Chinese saying goes: “May you live in interesting times.”² The end of the twentieth century which brought the collapse of Communism undoubtedly presents such “interesting times.” Hungary, Czechoslovakia, and Poland were satellites states of the former Soviet Union. When traveling in any of the former East Bloc Countries as late as early 1988, one would not have thought it possible that Communism was at the verge of its collapse. When Hungary took down the barbed wires between her border with Austria, many East Germans took advantage of that fact by traveling to Austria through Hungary and then, by applying within the West German

1. CHARLES WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 3 (1972).

2. Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 51 (1995).

embassy, automatically becoming a citizen of West Germany.³ The events sped up and on November 9, 1989, tens of thousands of Germans climbed across the Berlin Wall.

Similarly, people in Hungary and Czechoslovakia were taking to the streets and demanding their governments' resignation. Poland had been in a different situation since the early 1980s when the Solidarity Labor Union received many concessions from the Polish government. Everybody was scared to see how the Soviet Union, usually referred to as Russia, would react to those demands. Nevertheless, people saw hope because Mikhael Gorbachev (and possibly a lot of the old Soviet establishment) recognized that one cannot permanently oppress the people of other nations. As a result of this recognition, political and economic changes lay ahead for those nations.

The three countries in Eastern Europe that have made the most progress toward transition to market economies are: the Czech Republic, Hungary, and Poland.⁴ This paper will first take a look at how privatization of formerly state-owned property was facilitated. Next, there will be a brief look at how bankruptcy works in the Czech Republic, Hungary, and Poland. The paper then will look at Section 304 of the U.S. Bankruptcy Code and how likely it would be for a bankruptcy estate trustee from any of the three nations to succeed under Section 304, which governs cases ancillary to foreign bankruptcy proceedings.

As a preliminary matter, there is no case law to this point, which is understandable given the fact that an estate in bankruptcy in one of the three nations is unlikely to include debtor's property within the United States. However, with those countries having the potential of becoming well-developed and industrialized or service-oriented economies, it is very likely that such a situation will arise in the future.

II. THE CONVERSION FROM STATE-OWNED ENTERPRISES TO PRIVATELY-OWNED ENTERPRISES AS WELL AS THE CREATION OF PRIVATE PROPERTY

Under Communism, the government owned most assets and planned the actions of most economic actors, such as banks, enterprise managers, and labor.⁵ Through centralized control, the state ensured an artificially

3. Grundgesetz der Bundesrepublik Deutschland, Präambel (The German Constitution or the Basic Law, preamble). The German constitution never recognized an independent East German state and therefore, there was only one German citizenship. *Id.* Although one had to go through an official paper process, it was a formality.

4. Pamela Bickford Sak & Henry N. Schiffman, *Bankruptcy Law Reform in Eastern Europe*, 28 INT'L LAW 927, 928 (Winter 1994).

5. Roman Frydman & Andrzej Rapaczynski, *Institutional Reform in Eastern Europe: Evolution or Design?*, 1992 BYU L. REV. 1, 2 (1992); Jonathan R. Macey & Enrico

stable economy through its control of the allocation of investment, credit, and wages.⁶ This artificially stable economy ignored profits;⁷ moreover, it distorted the statistics of the financial health of the economy.⁸ This instilled the perception of a stable socio-economic system⁹ not only in banks and state-owned enterprises,¹⁰ but also in the general public.¹¹ Two results of this planned economy were the absence of bankruptcies and full employment.¹² Therefore, economic actors, as we understand them in a market economy, were not financially disciplined, but were indifferent about profits or economic success.¹³ Under Communism, people were insulated from competition and therefore, had no profit motive.¹⁴

Colombatto, *Public Choice Theory and the Transition Market Economy in Eastern Europe: Currency Convertibility and Exchange Rates*, 28 CORNELL INT'L L. J. 387, 388 (1995).

6. Carolyn Brzezinski, *Competition and Antitrust Law in Central Europe: Poland, the Czech Republic, Slovakia, and Hungary*, 15 MICH. J. INT'L L. 1129, 1130 (1994).

7. Fred Luthans et al., *Doing Business in Central and Eastern Europe: Political, Economic, and Cultural Diversity*, BUS. HORIZONS, Vol. 38, No. 5, Sept. 1995, at 12 [hereinafter Luthans, *Doing Business*]; Alisa Yamnarm, Note, *The Crisis of Unemployment and the Future of Reform in Central and Eastern Europe: Hungary as a Model*, 3 CARDOZO J. INT'L. & COMP. L. 181, 189-90 (1995).

8. See, e.g., Steve Campbell, Comment, *Brother, Can You Spare a Ruble? The Development of Bankruptcy Legislation in the New Russia*, 10 BANKR. DEV. J. 343, 354-55 (1994) (noting the former Soviet Russian practice of supporting inefficient firms).

9. Ronald Daniels & Robert Howse, *Reforming the Reform Process: A Critique of Proposals for Privatization in Central and Eastern Europe*, 25 N.Y.U. J. INT'L L. & POL. 27, 67 (1992); see Luthans, *Doing Business*, supra note 5, at 12; see also Frydman & Rapaczynski, *Institutional Reform*, supra, note 5, at 15 (commenting on the "long tradition of government paternalism").

10. Paul Marer, *Transformation of a Centrally-Directed Economy: Ownership and Privatization in Hungary During 1990*, in *Privatization and Entrepreneurship in Post-Socialist Countries* 173, 178 (Bruno Dallage et al. eds., 1992).

11. See, e.g., Michele Balfour & Cameron Crise, *A Privatization Test: The Czech Republic, Slovakia and Poland*, 17 FORDHAM INT'L L. J. 84, 85 (1993) ("[P]rivatization will impose economic hardship on the public, which will demand the relief it is accustomed to receiving from political leadership.").

12. David C. Bangert, *Hungary: Exploring New European Management Challenges*, INT'L STUD. OF MGMT. & Org., Vol. 24, No. 1-2, Mar. 22, 1994, at 209, available in LEXIS, News Library, ARCNEWS file.

13. See Macey & Colombatto, supra note 5, at 389.

14. See, e.g., Marton Tardos, *Property Relations in the Period of Transition*, in *PRIVATIZATION AND ENTREPRENEURSHIP IN POST-SOCIALIST COUNTRIES* 59 (Bruno Dallage, et al. eds., 1992). See also Brzezinski, supra note 6, at 1129-30, 1129 n.3 (noting how Communist "non-competitive" economic systems created a need for competition law); Stephen S. Cohen & Andrew Schwartz, *The Tunnel at the End of the Light: Privatization in Eastern Europe*, 7 TRANSNAT'L LAW. 7, 12-17 (1994); George Bogdan, *The Economic and Political Logic of Mass Privatization in Czechoslovakia and Poland*, 4 CARDOZO J. INT'L & COMP. L. 43, 43-45 (1996) (noting that, as a result of an extensive history of

In contrast, capitalism attempts to allocate scarce resources in the best way possible. As a consequence, multinational companies become insolvent. It is not unusual for such occasions that bankruptcy proceedings are commenced in every country which does business or has assets.¹⁵

Within the twentieth century, the countries under Communist regimes saw their most complete legal reforms in that the revolutionaries replaced the law, politics, and economics of the old regime with a centrally-planned economy.¹⁶ With the demise of Communism, those countries faced the problem of how to revert back to pre-Communist conditions and how to achieve a fast and smooth transition to a market economy. For reasons discussed above, there had been no need for basic market mechanisms, such as bankruptcy laws¹⁷ or competition laws.¹⁸ With the end of Communism, the Central and Eastern European (CEE) nations hurried to start their socio-economic transition toward market economies.¹⁹ Although the three countries had made the political transition, a more serious issue was how to establish private property, which is one of the building blocks of a free market economy. The three countries undertook different approaches in achieving the privatization of their economies.

Before discussing each country's approach, it is important to note that in CEE nations the rationale for privatization varied, but was dominated by the need for economic reform. As such, it is essential to recognize that privatization in those countries was not just a simple transfer of ownership from the state to private individuals, but rather a process by which the very institution of property, as it is understood by lawyers and economists of a western ideology, was reintroduced into Eastern European societies.²⁰ Privatization in former centrally-planned economies nec-

centralized planning, post-Communist Eastern European countries "have to recreate private property and capital markets virtually from scratch"). For a definition of profit-maximization, see A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 10 (2d ed. 1989).

15. Charles D. Booth, *Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of the United States Courts*, 66 *AM. BANKR. L. J.* 135 (Spring, 1992).

16. Robert D. Cooter, *The Theory of Market Modernization of Law*, 16 *INT'L REV. L. & ECON.* 141, 146 (1996).

17. See Brzezinski, *supra* note 6, at 1130; Campbell, *supra* note 8, at 346.

18. See Brzezinski, *supra* note 6, at 1130.

19. See Balfour & Crise, *supra* note 11, at 85; see, e.g., Sak & Schiffman, *supra* note 4, at 927 (noting that CEE nations "formerly had centrally planned economies and decided in the past few years to adopt new economic systems").

20. Jeremy Leaman, *Regulatory Reform and Privatization in Germany in PRIVATIZA-*

essarily has some social costs, which are usually associated with loss of employment, a condition unknown under Communism. Some examples will illustrate this point. In Poland, the official rate of unemployment rose from zero percent in 1989 to 11.4% at the end of 1991.²¹ In Czechoslovakia, the rate of unemployment went from zero percent to 5.5% at the end of 1992.²² Lastly, in Hungary unemployment went from zero percent to 8% by the end of 1991.²³ Another social cost is the loss of traditional business. One such example is the closing of the shipyard in Gdansk, Poland, where in 1980 the "Solidarity Labor Union" under the leadership of Lech Walesa achieved tremendous success in gaining concessions from the Polish government.²⁴

Privatization continued, however, and the three CEE nations under discussion approached it in different ways.²⁵ There appeared to be two paradigmatic approaches to effectuate privatization, these being the "fast" track privatization and the "moderate" track privatization.²⁶

A. *The Czech Republic and the Fast Privatization Track*

The Czech Republic attempted to convert its state-owned enterprises as fast as possible. To effectuate such a change, the government undertook a series of actions, these being: reduction of state spending/subsidies, lifting of price controls, and making the Czech currency, the Ko-

TION AND REGULATORY CHANGE IN EUROPE 14, 19-33 (Michael Moran & Tony Prosser, eds., 1994); see also J.A. Kay & D.J. Thompson, *Privatisation: A Policy in Search of a Rationale*, 96 ECON. J. 18-32 (1986); see generally COSMO GRAHAM & TONY PROSSER, *PRIVATIZING PUBLIC ENTERPRISES* (1991).

21. Andrew Berg & Olivier Jean Blanchard, *Stabilization and Transition: Poland, 1990-91*, in 1 THE TRANSITION IN EASTERN EUROPE: COUNTRY STUDIES 54 (Olivier Jean Blanchard et al. eds., 1994) [hereinafter COUNTRY STUDIES].

22. Karel Dyba & Jan Svejnar, *Stabilization and Transition in Czechoslovakia*, in COUNTRY STUDIES, *supra* note 21, at 93, 96.

23. Kemal Dervis & Timothy Condon, *Hungary—Partial Successes and Remaining Challenges: The Emergence of a "Gradualist" Success Story?*, in COUNTRY STUDIES, *supra* note 21, at 123, 134-35.

24. Daniel Michaels, *Emerging Europe: Gdansk Yard Falls Victim to Capitalism*, WALL ST. J. EUR., Mar. 7, 1997, at 4.

25. See *infra* Part II.A-C, discussing the approaches to privatization undertaken by the Czech Republic, Hungary and Poland.

26. Different terms are used to describe the same approaches. See Ronald A. Cass, *The Optimal Pace of Privatization*, 13 B.U. INT'L L.J. 413, 433-34 (1995) (using the terms 'rapid' or 'quick' privatization); Cohen & Schwartz, *supra* note 14, at 9-11 (juxtaposing 'gradualists and radical capitalists'). Depending on what method of privatization was utilized by the various countries, the bankruptcy codes created differed accordingly. See *infra* Part III.

runa, convertible.²⁷ Next, the government implemented a voucher system.²⁸ Under the voucher system, people were permitted to buy vouchers or coupons with a value equivalent to one week's wages and use them to bid during the auctioning of state-owned enterprises.²⁹ The auctioning off of government or state-owned enterprises took place in two steps. In 1990, approximately 100,000 to 120,000 restaurants, shops, and small businesses were privatized in what was called the "small privatization" program.³⁰ This was followed by the "large privatization" program in April of 1991, whereby the state sold mid-size and larger state-owned enterprises.³¹ This system worked rather fast and within a short time the majority of state-owned operations had been converted into privately-owned enterprises.³² One can only speculate as to the rationale underlying the Czech Republic's fast track approach. One reason could have been the facilitation of foreign investment.³³

B. *Hungary and the Slow Track Approach to Privatization*

Hungary took a somewhat slower approach and attempted to convert state-owned enterprises at a more moderate pace. Hungary did not believe in the speedy approach set forth by Czechoslovakia "Czech Republic" because such a quick approach would not guarantee enterprises achieving market efficiency.³⁴ More important, the Hungarian government believed that a speedy conversion would not generate the new capital re-

27. *The New Bohemians*, ECONOMIST, Oct. 2, 1994, 23 [hereinafter *The Bohemians*], available in LEXIS, News Library, MAGS File.

28. *Id.* at 23-24 (recognizing Czech privatization as a 'big bang' and as a 'fast and efficient privatisation programme'); *East European Privatisation, Making It Work*, ECONOMIST, Mar. 13, 1993, at 90-93; William C. Philbrick, *The Task of Regulating Investment Funds in the Formerly Centrally Planned Economies*, 8 EMORY INT'L L. REV. 539, 554 (1994).

29. See *The Bohemians*, *supra* note 27, at 24.

30. ROMAN FRYDMAN *et al.*, THE PRIVATIZATION PROCESS IN CENTRAL EUROPE 63, 77-78 (1993) (describing Act 427 of 1990, entitled, "About the Transfer of State Property and Some Things to Other Legal or Physical Persons").

31. *Id.* at 79-80.

32. Jan Winiecki, *Privatization in East-Central Europe: Avoiding Major Mistakes*, in THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE (Christopher Clague and Gordon C. Rausser, eds.) 271, 276.

33. It is generally understood that recourse can be had much easier against a privately-owned enterprise in the court of a country than can be had against a government-operated/owned enterprise, if only because of the sovereign immunity doctrine which is common to most modern legal systems. See Teresa D. Baer, Note, *Injunctions Against the Prosecution of Litigation Abroad: Towards a Transnational Approach*, 37 STAN. L. REV. 155 (Nov. 1984).

34. Cohen & Schwartz, *supra* note 14, at 33.

quired to support its newly-created private enterprises.³⁵

In contrast, the gradual approach envisioned a system where the government would rebuild a regional network of industrial markets, yet at the same time preserve a functioning, reliable state administration.³⁶ Although there were some voices for faster privatization, the ruling Socialist Party prevailed with the gradual approach.³⁷ Accordingly, in 1989, the Hungarian Parliament passed the Act on Transformation,³⁸ pursuant to which, in September of 1990, Hungary began the gradual initial privatization of twenty large companies through competitive tenders, public offerings, or employee share ownership plans.³⁹ Hungary chose not to expose herself to a speedy, mass privatization.⁴⁰ It actually left the pace of privatization to the spontaneity of the market. The state did not adopt a strict set of privatization rules but took a decentralized approach, which was seen as a "case-by-case, market driven approach to transactions."⁴¹

C. *Poland and the Non-Paradigmatic Approach to Privatization*

Under the Polish socialist regime, private ownership was the rule rather than the exception.⁴² As a result, the transformation to private ownership of land was easier than in the Czech Republic and Hungary.⁴³ In the past, ownership was divided into various classes with social ownership, which included ownership by the state, cooperatives, and social organizations, given the highest status.⁴⁴ The Polish Constitution of 1989

35. *Id.* at 31-32; see also Peter Rutland, *Privatization in East Europe: Another Case of Words that Succeed and Policies That Fail?*, 5 *TRANSNAT'L. L. & CONTEMP. PROBS.* 1, 3 (1995).

36. Cohen & Schwartz, *supra* note 14, at 32-33.

37. See Marer, *supra* note 10, at 182. (The Association of Free Democrats believed that "it was counterproductive to attach too many conditions and constraints" to prices and sale or transfer terms).

38. See *id.* at 180.

39. See *id.* at 182-83.

40. See Philbrick, *supra* note 28, at 550-51; Rachel Wood & Éva Talmácsi, *Privatisation in Hungary*, 23 *INT'L BUS. LAW* 243, 244 (1995).

41. See Wood & Talmácsi, *supra* note 40, at 244; see also FRYDMAN, *supra* note 30, at 132-33.

42. CHERYL W. GRAY ET AL., *THE LEGAL FRAMEWORK FOR PRIVATE SECTOR DEVELOPMENT IN A TRANSITIONAL ECONOMY: THE CASE OF POLAND 2-9* (Country Economics Dept., The World Bank, Policy Research Papers No. WPS 800, Nov. 1991).

43. See *id.*

44. See *id.* at 3. Under Polish socialist law, "social ownership" was the highest category of ownership and was protected by the Constitution and the Civil and Criminal Codes. Examples of such property included means of production, i.e., land, mineral resources and public utilities. "Personal property," in contrast, included property used for personal consumption, i.e., one's own dwelling house (but not a rental house, which was

and the Civil Code of 1990 eliminated these classes and different property strata.⁴⁵

In order to privatize "social ownership" property, one first had to determine ownership. Vast amounts of property was determined to be state-owned, which included municipalities and other local governments.⁴⁶ The newly-designated state property could now be privatized.⁴⁷ The privatization process has been somewhat slow and foreign investment has not realized as much as the country had hoped for,⁴⁸ partly because of the heavy foreign debt and the hostile attitude of the Polish people themselves.⁴⁹ Another problem with privatization is that in 1990 the Antimonopoly Office ("AMO") was created in accordance with the Act on Counteracting Monopolistic Practices.⁵⁰ The AMO can veto any privatization process and has done so frequently.⁵¹ Finally, in Poland, the liquidation process is the preferred means of privatization.⁵² The liquidation process will be discussed in the next section.

III. BANKRUPTCY LAW REFORM IN THE THREE CEE NATIONS

Of all the countries in Eastern Europe, the Czech Republic, Hungary and Poland have made the most progress towards transition to market economies.⁵³ One factor determining whether a market economy exists is the presence of a bankruptcy code, which under Communism and a centrally-planned economy was not needed.⁵⁴ Overnight, it became evident that all three countries faced a need for a forced structuring of the mar-

considered a means of production). Personal property was afforded less constitutional protection and was subject to a heavy taxation and limitation on use and transferability. *Id.* (footnote omitted).

45. *See id.* at 3-4.

46. *See Balfour & Crise, supra* note 11, at 116-17.

47. *See GRAY ET AL., supra* note 42, at 4.

48. Blaine Harden, *Town Sews, Reaps Against the Odds*, WASH. POST, Feb. 10, 1992, at A1, A22. *See also* Balfour & Crise, *supra* note 11, at 122-23 (discussing that Poland, with a population larger than the population of Hungary, the Czech Republic and Slovakia combined, has attracted less foreign investment than each of the other three nations on its own).

49. *See* Harden, *supra* note 48, at A22 (discussing the Polish people's lack of receptiveness toward foreign capital).

50. Act of Feb. 24, 1990 on Counteracting Monopolistic Practices art. 17 (Pol.), NITS NO. PB92-961022, 1992 WL 563320.

51. *See* Balfour & Crise, *supra* note 11, at 118.

52. *See id.* at 120. In 1992, 62% of the firms undergoing privatization applied for liquidation as the route to privatization. *Id.*

53. *See* Sak & Schiffman, *supra* note 4, at 928.

54. *See supra* Part II.

ket. It was necessary to establish a cooperative market that linked its participants, i.e., government, labor, suppliers, manufacturers, and consumers.⁵⁵ Under Communism, these links did not exist; in fact, they were not needed because the state made impossible the very concept of market failure.⁵⁶ Further, the banking industry needed an overhaul and could no longer be just a means of the authority to reallocate resources from healthy enterprises to debtor enterprises which otherwise would have become insolvent.⁵⁷ Last, the former CEE nations needed to develop a system that provided free market concepts such as property and equity ownership,⁵⁸ profit-motive,⁵⁹ and, more importantly, market failure, thus recognizing bankruptcy as the final market corrective.⁶⁰

All three nations are looking toward the West, in particular, Germany, in an attempt to emulate an important element of the commercial law of the economically very successful West Germany.⁶¹ Communism created a lot of problems which needed rectification, and Western advisors deem bankruptcy laws an essential element in the restructuring of the former CEE economies.⁶²

There are four reasons why Western advisors recommended bankruptcy law in the post-Communist context. First, bankruptcy laws provide a mechanism which deals with failed enterprises, i.e., the information provided allows creditors to make more efficient investment decisions.⁶³

55. See Cohen & Schwartz, *supra* note 14, at 21.

56. See *Eastern Metamorphosis Is Radical but Uneven*, INVESTORS CHRON., THE FIN. TIMES LIMITED, Oct. 14, 1994, available in LEXIS, News Library, ARCNEWS file (stating that banks are often unwilling to file bankruptcy suits against borrowers because they do not want to appear responsible for mass company closures).

57. See generally FRYDMAN, *supra* note 30.

58. See *Prepared Statement of the Honorable Ralph R. Johnson Before the Subcommittee on Small Business*, Federal News Service, May 12, 1994, at 92, available in LEXIS, News Library, ARCNEWS file.

59. See Cohen & Schwartz, *supra* note 14, at 13.

60. Scott Horton, *The Death of Communism and Bankruptcy Reorganization*, 13 AM. BANKR. INST. J. 12, 12 (1994).

61. See Einführungsgesetz zur Insolvenzordnung, BGB1.I (Oct. 5, 1994), applicable in the former West Germany; see also Gesamtvollstreckungsordnung, BGB1. I (June 1991), applicable in the former East Germany. The German legislature approved a new bankruptcy law in April and July of 1994. It will be in effect beginning January 1, 1999. See *Germany to Revise Insolvency Law*, BUS. EUR., Nov. 29, 1991, at 5 (announcing the introduction of a bill providing for total revision of Germany's bankruptcy laws).

62. Chris Aujard, *The Legal Dimension*, CENT. EUR., 1995, at 13, available in LEXIS, News Library, ARCNEWS file; see also Peggy Simpson, *No Easy Fix for Ineffective Bankruptcy Laws*, WARSAW BUS. J., May 5, 1995, at 7.

63. See Campbell, *supra* note 8, at 345; Evan D. Flaschen & Timothy B. Desieno, *The Development of Insolvency Law as Part of the Transition from a Centrally-Planned to a Market Economy*, 26 INT'L LAW. 667, 669-70 (1992).

Second, pressure is put on inefficient and insolvent firms, thus promoting the voluntary reallocation of assets.⁶⁴ Third, a debtor can re-enter the market and start anew after the work-out is arranged without having his post-bankruptcy earnings made subject to prior creditors' claims.⁶⁵ Lastly, bankruptcy can facilitate a transition of ownership from state ownership to private ownership via the liquidation process.⁶⁶ Although Western advisors promoted the introduction of a bankruptcy code for the former CEE nations, they did not suggest specific bankruptcy models for each nation.⁶⁷ Depending on the mode of privatization used in different nations, countries created varying bankruptcy codes.⁶⁸ The discussion below will look at each of the three countries with regard to the following issues: 1) the definition of insolvency and administration of the bankruptcy proceeding; 2) the rights and obligations of both debtors and creditors; 3) the distribution of assets—priorities and post-bankruptcy creditors; 4) fraudulent conveyances and avoidance powers; and 5) discharge - treatment of the debtors pre-bankruptcy debts.

A. *The Czech Republic*

1. Definition of Insolvency and Administration of the Bankruptcy Proceeding

In the Czech Republic, bankruptcy is regulated by the Bankruptcy Act.⁶⁹ Bankruptcy is triggered when the debtor is unable to meet obliga-

64. See Campbell, *supra* note 8, at 346. Advisors recommend not to leave any discretion with either the creditors or the debtors, but rather to proceed in a strict fashion to effectuate a speedy reallocation of the resources, thereby ignoring any concern of the local managers for unemployment. See also FRYDMAN, *supra* note 30, at 129; Flaschen & Desieno, *supra* note 63, at 679-80.

65. See Campbell, *supra* note 8, at 346; Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 497 (1996); Carolyn Hochstadter Dicker, *Minimizing Risk: Securing a Loan with an Anticipated Tax Refund*, 13 BANKR. STRATEGIST 3, 4 (1996); see generally Mark A. Frankel, *Federal Taxation of Corporate Reorganizations*, 66 AM. BANKR. L. J. 55 (1992).

66. See Stilson Nestor & Scott Thomas, *Privatization Through Liquidation: Economies in Transition: Industry Overview*, OECD OBSERVER, No. 192, Feb. 1995, at 36; Horton, *supra* note 60, at 12; Flaschen & Desieno, *supra* note 63, at 670-72.

67. See Flaschen & Desieno, *supra* note 63, at 668-69; David Fondler, *Seminar Focuses on Flaws in the Country's Bankruptcy Laws*, PRAGUE POST, June 7, 1995; Sak & Schiffman, *supra* note 4, at 927-29; Horton, *supra* note 60, at 12; Balfour & Crise, *supra* note 11, at 90; Simpson, *supra* note 62, at 7.

68. See *supra* Part II.A-C, discussing the fast, moderate and non-paradigmatic approaches to privatization in the Czech Republic, Hungary and Poland, respectively.

69. The Bankruptcy and Composition Act (No. 328/1991 Coll.) Of 11 July 1991 [hereinafter CRBA], amended by Act No. 122/1993 Coll. Of 25 March 1993.

tions to a number of creditors for an extended period of time.⁷⁰ A debtor is deemed to be unable to pay creditors when he has ceased to make payments.⁷¹ How long is an extended period of time? Practice shows that when several creditors lose their patience and file a suit, an extended period of time has passed.⁷² The CRBA theoretically also provides for a balance-sheet insolvency.⁷³ Since the inception of the CRBA, the number of creditor-initiated bankruptcies has increased enormously.⁷⁴

Jurisdiction of the bankruptcy proceeding lies with the regional or municipal court where the debtor has its seat or residence.⁷⁵ The court has the discretion to appoint and supervise the bankruptcy trustee.⁷⁶ The court is afforded a high degree of discretionary power with regard to both the appointment of the trustee and the supervision of the bankruptcy proceeding; in fact, the CRBA denies any right of appeal against the court's supervision of the proceeding.⁷⁷ Claims made by a creditor against the debtor are disposed of within the bankruptcy proceeding.⁷⁸ The resolution of all bankruptcy claims is sometimes very time-consuming.⁷⁹

2. The Rights and Obligations of Debtors and Creditors

Once a debtor has filed a petition for bankruptcy, the bankruptcy code provides for an automatic stay whereby creditors cannot proceed

70. *See id.* § 1(2).

71. *Id.* § 4(2).

72. *See Sak & Schiffman, supra* note 4, at 933 n.11.

73. *See CRBA, supra* note 69, § 1(3). This appears to be less important because assets are often overvalued and therefore, the inability of the debtor to pay will be the dominant test.

74. As many as 1,592 bankruptcy petitions were filed by February 1, 1994. James B. Varanese & Antje Westphal, *Debt-for-Equity: The Czech Republic's Swapping for Survival Game*, 5 SURV. E. EUR. L. 1, 9 (Apr. 1994). In fact, it appears as if the laws embody a policy that promotes liquidation rather than reorganization. *See Sak & Schiffman, supra* note 4, at 934. Interestingly, no provision is made in the CRBA for a debtor to initiate a liquidation bankruptcy proceeding, but only to have a compulsory settlement (reorganization) forced on the creditor. *See infra* notes 88-91 and accompanying text.

75. *See CRBA, supra* note 69, § 3(1).

76. *Id.* §§ 11(a), 12(1).

77. *Id.* §§ 12(a)(1)-(2).

78. *Id.* §§ 23, 24. Should one creditor oppose the claim of another creditor, the bankruptcy code requires that such creditors file a separate lawsuit outside the bankruptcy proceeding at which the claim is at issue. *Id.* § 23(2). Should there be a claim asserted by the trustee against a creditor, then the trustee may choose to proceed within the bankruptcy proceeding or may bring a separate action. *Id.* § 24(1).

79. *See supra* note 78.

against the debtor.⁸⁰ Generally, a creditor has to assert a claim against the debtor and the bankruptcy code provides both for settlement and for compulsory settlement of such claims,⁸¹ thus creating a potential for restructuring before a declaration of bankruptcy by the court.⁸² A debtor who would qualify for bankruptcy proceedings can propose such a settlement proceeding.⁸³ A settlement proceeding is seen as an attempt to restructure and, therefore, the debtor proposing such a proceeding must include a reorganization plan.⁸⁴ The plan must provide for a minimum of forty-five percent satisfaction of unsecured creditors' claims⁸⁵ and the creditors whose rights are impaired will vote on whether to accept the settlement.⁸⁶ Even if the creditors as a whole approve of the plan, the final decision is with the court.⁸⁷

A debtor may petition the court to have a compulsory settlement forced on the creditors.⁸⁸ The court will review the debtor's proposal⁸⁹ and, given the compliance with certain criteria, ⁹⁰will grant the compulsory settlement. The court must make an "integrity" judgment over the debtor's managerial and economic skills and, should it find that the debtor acted dishonestly or unreasonably, the court is required to reject the settlement.⁹¹ Should the settlement plan be rejected, a liquidation pro-

80. See CRBA, *supra* note 69, § 14(1)(e).

81. *Id.* §§ 34-43, 46-66.

82. See Varanese & Westphal, *supra* note 74, at 9 (discussing that before declaring bankruptcy, the court may allow a restructuring period of three to six months, or longer, during which a newly founded enterprise is protected from creditors' claims).

83. See CRBA, *supra* note 69, § 46(1).

84. *Id.* § 46(3). During such a "reorganization," however, the code imposes rather stringent conditions, i.e., the debtor's rights to transfer property, incur new debt, or otherwise impair the rights of the creditors are suspended, meaning, the debtor cannot conduct business as usual. *Id.* § 49(1).

85. *Id.* § 50(d).

86. *Id.* § 58. Interestingly, the code does not provide a percentage of how many creditors need to accept the settlement plan.

87. *Id.* § 61(2)(a), (c). Some of the criteria for the court's decision in approving or denying a settlement plan include: the debtor is financially in a much better situation and could make higher payments than the plan calls for, or the settlement is very disadvantageous to the dissenting creditors. *Id.*

88. *Id.* § 34.

89. *Id.* §§ 20-25.

90. Creditors having seventy-five percent of the claims must approve of the settlement, *id.* § 38(1); a secured creditor's right cannot be involuntarily impaired, *id.* § 36(1); the costs of administration or claims of employees must be paid in full, *id.* § 36(b); at least one-third of non-priority claims must be scheduled to be paid within one year, *id.* § 40(1)(e).

91. *Id.* § 40(1)(f). What is unreasonable is not defined in the code. Presumably, it falls within the discretionary power of the court to determine the scope of

ceeding is the next step.

A bankruptcy proceeding can also be initiated by a creditor. In that situation, the amended bankruptcy code provides for a period of three to six months during which the court will not formally initiate bankruptcy proceedings.⁹² During the protective period, the debtor must make good faith efforts to negotiate with the creditors over the possibility of a settlement.⁹³ During the three to six month period, the debtor is protected from most claims asserted by creditors.⁹⁴ The code is very specific with regard to waiver of rights, and failure to comply with statutory deadlines results in waiver of claims.⁹⁵

3. Distribution of Assets—Priorities and Post-Bankruptcy Creditors

The highest priority is afforded to secured claims.⁹⁶ A settlement (restructuring or reorganization) is doomed to fail if the reorganized business will not be able to obtain new financing. Therefore, the CRBA accords claims to first-class status for credits initiated after the bankruptcy proceeding.⁹⁷

With regard to unsecured claims, the CRBA arranges the claims into first, second, and third-class claims. Within the first-class claims, administrative expenses are accorded the highest priority,⁹⁸ followed by employees' claims for three years prior to the bankruptcy.⁹⁹ Governmental

unreasonableness.

92. *Id.* § 5c.

93. *Id.* §§ 5d, e, f. Somewhat troublesome is the question of what constitutes good faith effort. Should the debtor be allowed to continue in conducting his business and thereby, possibly, impair any creditors' interests? The law should make a provision that any activity undertaken in the ordinary course of business does not constitute an impairment of any creditors' interests. However, article 5d(d) of the amended code sets forth that no action of the debtor should infringe on the interests of the creditor. This does not square well with an attempt in reorganization of a business.

94. The exceptions are employee claims and claims with regard to tax, and social and health insurance. *Id.* § 5d(b).

95. *Id.* § 5a(2) (granting a debtor fifteen days to apply for such a three to six month protection period and creditors have fifteen days after the commencement of proceedings to file claims).

96. See Sak & Schiffman, *supra* note 4, at 948. This is the same situation in most countries, *cf.* United States, Germany, and most of the EU countries. The flow of credit is one of the building stones of the economy and for creditors to lend money, they want to have the assurance that they have the first right of access to the collateral.

97. See CRBA, *supra* note 69, §§ 31(2), 32(1), 52(2).

98. *Id.* § 67.

99. *Id.* Section 67a, as amended, provides, however, that claims made by management personnel shall be considered a first-class claim only up to the amount of Czech Koruna 10,000 (\$300) per month. Any excess will be bifurcated into a non-priority claim.

claims for taxes, fees, duties, and social security withholdings within three years prior to and while in bankruptcy constitute the second-class of priorities.¹⁰⁰ All other non-priority claims are third-class claims.¹⁰¹ Finally, interest on both pre-bankruptcy and post-bankruptcy claims as well as extra-contractual penalties are not recognized as a valid claim altogether.¹⁰² Should two creditors dispute the classification of a claim,¹⁰³ the court as supervisor of the proceeding gives deference to the original classification of the claim by either the trustee or statute.¹⁰⁴ Therefore, such disputes are without much chance of changing the priority status of a claim.

4. Fraudulent Conveyances and Avoidance Powers

What happens when a debtor shortly before petitioning for bankruptcy conveys property or makes payments to selected people or classes of creditors? Those assets will not be available for the trustee to distribute or for other creditors to assert claims against. It can be said that such a transfer is not fair to either of the last two groups. It is the debtor who knows best about his intention to file for bankruptcy without giving the other creditors a fair chance. As a matter of equitable treatment of all creditors, no debtor should be given the discretionary power to determine which creditor gets paid in full and which creditor ends up empty-handed. Therefore, any such transfer should be declared void.¹⁰⁵

The CRBA provides that under a regular bankruptcy proceeding, any security interest granted to a creditor within two months before the formal petitioning of the debtor for a bankruptcy proceeding is void.¹⁰⁶ In the case of a creditor-initiated bankruptcy proceeding whereby the debtor

100. *Id.* § 32(b).

101. *Id.* § 32(c). Interestingly, the code does not address claims such as child-support or alimony, which, for example, under the U.S. Bankruptcy Code are non-dischargeable claims. *See* 11 U.S.C.A. § 523 (1993 & Supp. 1998). One should remember, however, that the CRBA initially did not really focus on personal bankruptcies, a term that was not within the Communism vocabulary at all.

102. *See* CRBA, *supra* note 69, § 33(1)(a), (d).

103. *See* discussion *supra* Parts III.A.1-2 (describing procedure in such a context).

104. Outcomes of disputed claims are given deference to the original classification of a claim by either the statute or by the trustee and said discretion within the court is not subject to appeal. *Id.*

105. *Cf.* Uniform Fraudulent Transfer Act, 7A U.L.A. 427 (1985) and Uniform Fraudulent Conveyance Act, 7A U.L.A. 639 (1985). In the United States, both those acts protect creditors from fraudulent transfers of property. Moreover, the U.S. Bankruptcy Code confers powers on the trustee to avoid specific pre-petition transfers. *See* 11 U.S.C.A. §§ 544, 547-548 (1993 & Supp. 1998).

106. *See* CRBA, *supra* note 69, § 14(1)(f).

seeks a protective proceeding,¹⁰⁷ any preferences granted to any creditor during that time are subject to rescission.¹⁰⁸ Both the CRBA as well as the Criminal Code of the Czech Republic will void and punish collusive actions between a debtor and the creditor as far back as three years before the bankruptcy filing.¹⁰⁹

Although this treatment of pre-bankruptcy conveyances appears to be equitable in nature, no provision in the law deals with the situation where several creditors have been paid shortly before bankruptcy and other creditors have not been paid at all. This could give rise to a rebuttable presumption that if the code applies to a single creditor it will also apply to many creditors. One could speculate that payments made in the ordinary course of business would not fall under the category of fraudulent conveyances, however, there is no case law on this issue yet.

5. Discharge—Treatment of the Debtor's Pre-Bankruptcy Debts

The most important question for a debtor in any bankruptcy proceeding will be the status of the pre-bankruptcy debt. There are different approaches throughout the world. Some, primarily, the United States, Great Britain, France, and Germany, believe the main goal of the bankruptcy proceeding is to reallocate resources in a way most beneficial to the economy. By giving the debtor the opportunity for a new start, new business opportunities are created.¹¹⁰ Unlike in the past, a debtor who declares bankruptcy does not face imprisonment.¹¹¹ The next paragraph discusses how the CRBA provides for the discharge of pre-bankruptcy debts.

The CRBA speaks only to discharge of debts under either the settlement or compulsory settlement situation; under either, the debtor must come up with a plan which provides for scheduled payments.¹¹² If the debtor satisfies all the claims under the plan, he is discharged from all

107. See *supra* Part III.A.2.

108. See CRBA, *supra* note 69, § 14. Under normal circumstances, such a protective proceeding lasts from three to six months. See *supra* Part III.A.2. However, in the case of a farm, such a protective proceeding can last up to nine months. See CRBA, *supra* note 69, §§ 67(c), 5a, 5b, 5d.

109. See CRBA, *supra* note 69, § 15(2); see also Criminal Code of the Czech Republic, § 256.

110. 11 U.S.C.A. §§ 522-524, 727, 1141, 1328 (1993 & Supp. 1998); see also Sak & Schiffman, *supra* note 4, at 938.

111. For general discussion of the imprisonment of debtors, see Vern Countryman, *Bankruptcy and the Individual Debtor and A Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U. L. REV 809 (1983).

112. See *supra* Part III.A.2.

claims that did not come under the plan.¹¹³ The CRBA again is silent on the treatment of discharge under a liquidation proceeding. However, one could draw an analogy with the U.S. Bankruptcy Code, which does not discharge bankrupt enterprises that are continuing to do business from their debt.¹¹⁴ One can only guess why this is the case. Most likely, it will be considered a disincentive for other corporations to buy such bankrupt companies and use the operating losses of such companies to offset corporate income tax liabilities. There remains one other question with the liquidation of a business entity. Does a creditor have recourse against the person who personally guaranteed the business entity's debt? The answer is yes; a creditor can pursue an action against guarantors in state court.¹¹⁵

B. Hungary

1. Definition of Insolvency and Administration of the Bankruptcy Proceeding

Hungary's insolvency law was passed in 1991 and amended in July 1993.¹¹⁶ Under pre-amendment Hungarian law, a business was required to declare bankruptcy within eight days of realizing its impossibility to pay a debt, and within ninety days of the debt becoming due.¹¹⁷ This provision was removed in 1993 because of the high number of 14,000 bankruptcy petitions filed in 1992.¹¹⁸

Venue in Hungary lies with the county court where the debtor has a registered office. The HLBA does not provide for a special bankruptcy court.¹¹⁹ Once the petition is filed, the law mandates the appointment of a trustee, commonly referred to as a liquidator.¹²⁰ The court then adjudicates the debtor to be insolvent under three scenarios: 1) the debtor fails to settle the claim within sixty days of the filing of the petition; 2) the debtor successfully defends his interests in an execution (collection) proceeding; or 3) the debtor defaults on a payment pursuant to a reorganiza-

113. See CRBA, *supra* note 69, §§ 42, 63.

114. 11 U.S.C. § 727(a)(1) (1994).

115. *Id.* It is essential that the CRBA eventually address these claims in order to give a fresh start to unsuccessful business ventures in the Czech Republic.

116. Hungarian Rules of Law in Force, Law IL of 1991 on Bankruptcy Procedures, Liquidation Procedures and Final Settlement, Nr. II./23. [hereinafter HLBA].

117. See *id.* § 9.

118. Cheryl W. Gray, *Evolving Legal Frameworks for Private Sector Development in Central and Eastern Europe*, 10-11 (World Bank Discussion Papers No. 209, 1993) [hereinafter Gray, *Evolving Legal Frameworks*].

119. See HLBA, *supra* note 116, § 6(1).

120. *Id.* § 14.

tion plan.¹²¹

2. The Rights and Obligations of Debtors and Creditors

A debtor may voluntarily file for either liquidation or reorganization, whereas a creditor can only file a petition for liquidation.¹²² Generally, a creditor has to assert a claim against the debtor by submitting his claim to the liquidator, unless legal proceedings were commenced before the liquidation proceeding occurred.¹²³

The law provides for an automatic stay of any claims as of the day of the filing.¹²⁴ Hungary's law, among the three under consideration, is the most favorable toward reorganization as opposed to liquidation; in fact, liquidation is to occur only when reorganization is not possible.¹²⁵

A reorganization or compromise agreement works as follows: a debtor, within fifteen days of filing for a reorganization, must meet with the creditors who will vote on the moratorium.¹²⁶ Under the amended insolvency law, only a certain percentage of the creditors must approve the moratorium (which shall lead to a plan).¹²⁷ Should the court approve and grant the stay, the debtor must produce a plan setting forth specific information for restoring the insolvency.¹²⁸ Within three days before the expiration of the moratorium, the debtor shall report the results of the negotiations with the creditors.¹²⁹

Once the plan is approved, i.e., the creditors as a whole and the

121. *Id.* § 27(2).

122. *Id.* §§ 7, 22, 23(2).

123. *Id.* § 38(2).

124. *Id.* §§ 9, 12(2), 41-45 (exempting from the automatic stay claims for wages, other benefits—presumably social security, health insurance, and unemployment benefits and value-added taxes). *Id.* § 12(2).

125. *Id.*, pmb1. The numbers, however, speak to the contrary. In 1992, more than twice as many liquidation cases were filed in Hungary. See Gray, *Evolving Legal Frameworks*, *supra* note 118, at 83; see also *Prepared Statement of the Honorable Ralph R. Johnson before the Subcommittee on Small Business*, Federal News Service, May 12, 1994, at 92 (discussing how Hungary, by forcing larger enterprises into liquidation, created smaller, more viable pieces available for purchase by private investors or funds).

126. Timothy John Smith, *Hungary Irons out Insolvency Wrinkles*, 28 INT'L CORP. L. 58 (September 1993). The moratorium is a time during which a creditor cannot enforce a collection against the debtor. See HLBA, *supra* note 116, § 9.

127. Over fifty percent of the parties with claims that have matured by the day of the petition as well as over twenty-five percent of the parties with unmatured claims as of the day of the petition must approve of the plan. See HLBA, *supra* note 116, § 9. In addition, the above-required claims must count for at least two-thirds of the total creditors' claims. *Id.*

128. See Sak & Schiffman, *supra* note 4, at 940.

129. See HLBA, *supra* note 116, § 21(1).

court have approved the plan, all creditors are bound by it.¹³⁰ Given the limited time available to a debtor corporation, many entities may refrain from seeking reorganization. Fifteen days is an exceedingly short period of time to produce an alternative plan. Therefore, many debtors initially may file a liquidation proceeding to avail themselves of the automatic stay.¹³¹

3. Distribution of Assets—Priorities and Post-Bankruptcy Creditors

Hungary is the only one of the three countries discussed that does not give secured claims the highest priority, but subordinates them to administrative costs.¹³² Arguably, this regulation is contrary to the best interest of the economy because creditors might be less willing to lend money to customers.¹³³ On the other hand, an equally valid argument could be made that if the trustee is not assured that all expenses associated with the bankruptcy estate are paid, the administration of the bankruptcy proceeding will not be carried out in the most efficient manner.¹³⁴

Under the reorganization or compromise agreement, the creditors, by approving the plan, agree on the order in which the debts will be satisfied.¹³⁵ In the context of a liquidation proceeding, the following hierarchy has been established. Following administrative expenses, liquidation costs such as employee severance pay must be paid.¹³⁶ If any money remains, secured debts, followed by wages and employee benefits are accorded the next highest priority.¹³⁷ Claims from private persons for non-economic activities, such as a private loan extended to the debtor, is next in line.¹³⁸ Social security obligations and taxes, other claims, and interest and penalties, in that order, close out the hierarchy.¹³⁹

130. *Id.* §§ 19(4).

131. *See* Smith, *supra* note 126, at 58. In comparison, it is not unusual for many Chapter 11 reorganizations in the United States to take years before a viable plan is designed.

132. *See* Gray, *Evolving Legal Frameworks*, *supra* note 118, at 12.

133. *See supra* Part II.A.

134. *See* Sak & Schiffman, *supra* note 4, at 947-48. It is not unheard of for the liquidation of an estate in a bankruptcy proceeding to barely cover the administrative expenses.

135. *See* HLBA, *supra* note 116, § 43.

136. *Id.* § 57(2).

137. *Id.* § 57(1).

138. *Id.* Presumably, the reasoning for according a relatively high priority to claims of this type is that many private lenders are more affected by a bankruptcy than commercial lenders.

139. *Id.* The provision for "other claims" is presumably an allowance for post-bankruptcy claims. However, the HLBA is silent on such matters.

4. Fraudulent Conveyances and Avoidance Powers

Under the HLBA, both a creditor and a liquidator can challenge pre-bankruptcy filing contracts and conveyances.¹⁴⁰ Secured debts will not be challenged, unless the security interest was created within six months of the filing of the bankruptcy proceeding.¹⁴¹ The code provides for such securities to be converted into unsecured claims.¹⁴²

5. Discharge—Treatment of the Debtor's Pre-Bankruptcy Debt

Under a reorganization (settlement), all creditors are bound by the plan as long as dissenting creditors receive equal or better treatment as those creditors approving the plan as a whole.¹⁴³ Thus, dissenting creditors in a reorganization procedure receive at least as much as they would in a liquidation proceeding.¹⁴⁴ The HLBA does not expressly state that all claims against the debtor in a liquidation process are discharged upon the completion of the bankruptcy proceeding.¹⁴⁵

C. Poland

1. Definition of Insolvency and Administration of the Bankruptcy Proceeding

Poland has had a formalized bankruptcy code since 1934.¹⁴⁶ While originally a presidential order, it was amended into Poland's new bankruptcy act in 1990.¹⁴⁷ Under the Polish PLBA, an entity is bankrupt under two situations. First, when the debtor has stopped paying debts.¹⁴⁸

140. *Id.* § 40.

141. *Id.* § 57(1)(b). The code does not give any broad provision, other than voiding security interests given within the six months or transfers which were made gratuitously or to relatives within that time frame.

142. *Id.*

143. *Id.* Presumably the acceptance of the plan by a creditor as a whole is the equivalent to a discharge for all claims not covered under the plan.

144. If one compares this notion with U.S. law, the Hungarian standard is less objective. Under U.S. law the standard is that of how much a creditor would have received in a liquidation proceeding. 11 U.S.C.A. § 1129(a)(7)(A)(ii) (1993 & Supp. 1998). Of course, many times in a Chapter 7 proceeding no money is accorded to a creditor. Therefore, even if that is a more objective criteria, under Hungarian law, the dissenting creditor receives at least as much money as the accepting creditor and it is rather unlikely that the accepting creditors would accept a plan calling for no money.

145. *See Sak & Schiffman, supra* note 4, at 939.

146. Regulation by the President of Poland of October 1934.

147. Bankruptcy Act, DZ U. No. 14, item 87 (1990) [hereinafter PLBA].

148. *Id.* art. 1, § 1.

Second, utilizing the balance sheet insolvency approach, a legal person can be declared bankrupt where the assets are not sufficient in value to satisfy liabilities.¹⁴⁹ The debtor has to file a bankruptcy petition within fourteen days of either of the two scenarios described above.¹⁵⁰ Should the debtor fail to file within the fourteen-day time limit, the judge-commissioner has the discretion to refuse any future plan of reorganization and to impose civil or criminal penalties.¹⁵¹ The number of companies filing for liquidation proceedings in the first six months of 1993 numbered in the thousands.¹⁵²

Venue of the proceeding lies with the district court where the debtor has her principal establishment.¹⁵³ The PLBA explains in detail what the following must contain: the bankruptcy petition,¹⁵⁴ the provisions for the automatic stay,¹⁵⁵ dismissal if the costs of the proceeding exceed the debtor's assets,¹⁵⁶ and the contents of the court's bankruptcy declaration.¹⁵⁷ Once a petition for liquidation is filed, the court will appoint a judge commissioner and a receiver (trustee).¹⁵⁸ The PLBA provides for appellate review of the initial determination of bankruptcy and the final approval of the plan under reorganization.¹⁵⁹

2. The Rights and Obligations of Debtors and Creditors

A debtor can petition for the opening of a reorganization proceeding.¹⁶⁰ If a debtor so elects, he can be exempted from having to file

149. *Id.* art. 1, § 2.

150. *Id.* art. 5.

151. *Id.* art. 5, §§ 3, 177(4). This paper, however, is not concerned with any such penalties.

152. Pawel Wrabec, *Bankruptcy: The Fall Artists*, POLISH NEWS BULL., Aug 13, 1993.

153. See PLBA *supra* note 147, art. 8, § 1. In the case where the debtor has several places of principal establishments in districts of various courts, the petition has to be filed within one of those district courts. Should the debtor have no principal place of business in Poland, then residence of the debtor determines venue. Should the debtor satisfy none of the foregoing criteria, then venue lies with the district court in whose district the estate of the debtor is situated. *Id.*

154. *Id.* art. 9.

155. *Id.* art. 12.

156. *Id.* art. 13.

157. *Id.* art. 14.

158. *Id.* art. 14, § 1(3); arts. 87-109. The judge-commissioner supervises the course of the proceeding, inspects the acts of the trustee, and limits the discretionary power of the trustee as regards acts performed by same. *Id.* art. 87. The receiver takes possession of the estate and administers its liquidation. *Id.* art. 90.

159. *Id.* arts. 17, 192.

160. *Id.* arts. 171-201. Creditors' banks are accorded a special status whereby they

within the fourteen-day time period.¹⁶¹ A creditor may initiate a petition at any time.¹⁶²

Once a reorganization petition is filed and the judge-commissioner is appointed, it is the judge-commissioner who draws up the schedule of payments (reorganization plan).¹⁶³ If the plan does not call for the 100% satisfaction of unsecured debts, unsecured creditors who hold a total of no less than two-thirds of the value of debts must approve the plan.¹⁶⁴ Once the plan is approved by the creditors, both the judge-commissioner and the court must also approve it; their approach is subject to different criteria. The judge-commissioner can only reject the plan if 1) it is unrealistic or 2) the debtor is barred from entering into such an arrangement.¹⁶⁵ The judge-commissioner's determination of the appropriateness of a plan is not subject to appeal.¹⁶⁶ The judge, in determining the approval of the plan, will look at criteria such as whether the plan is contrary to the bankruptcy law, the information provided to the creditors prior to voting on the plan, conformity of the plan with public order, or whether the dissenting creditors are put in too much of a disadvantage by the plan.¹⁶⁷ The court's decision can be appealed.¹⁶⁸ Once the plan has been given final approval by all parties, the plan can be set aside for only one of two reasons: 1) fraudulent conveyance of assets by the debtor or 2) default on the plan.¹⁶⁹

are allowed to implement restructuring arrangements, such as debt-for-equity swaps, before full privatization of an enterprise. See Law on Mutual Agreement (1934) and Law on Financial Restructuring of Enterprises and Banks, DZ.U. No. 18, item 82 (1993). However, this issue is beyond the scope of this paper.

161. See PLBA, *supra* note 147, art. 2.

162. *Id.* A creditor, who initiates the proceeding can be required by the court to advance the costs of the proceeding, otherwise, the court has the discretion to dismiss the creditor's petition. *Id.* art. 11.

163. *Id.* art. 171.

164. *Id.* arts. 174, 185. Cf. 11 U.S.C.A. § 1129 (1993 & Supp. 1998). One hundred percent payment can still mean impairment and therefore, a class of creditors is not deemed to automatically have approved of the reorganization plan.

165. See PLBA, *supra* note 147, arts. 176-177. Reasons for not allowing a debtor to enter into such an agreement can include, for example, prior bankruptcy within the last five years or not cooperating with the receiver in attempting to coordinate the estate.

166. *Id.* art. 178.

167. *Id.* arts. 189-192. Creditors objecting to a plan are allowed to present their issues at a hearing. *Id.*

168. *Id.* art. 192.

169. *Id.* arts. 197-201.

3. Distribution of Assets—Priorities and Post-Bankruptcy Creditors

The PLBA sets forth a list of priorities. Absolute priority is accorded to debts secured by mortgages and liens.¹⁷⁰ Next in priority are the costs of the proceeding, i.e., administrative expenses, followed by claims for expenses incurred by the trustee.¹⁷¹ Thereafter, the priorities are in order of declining importance: taxes for two years prior to the petition; social security payments for one year prior to the petition; other claims plus interest; contractual damages and related costs; other interests; penalties and fines; and donations and bequests.¹⁷²

4. Fraudulent Conveyances and Avoidance Powers

If a debtor fraudulently conveys assets, a previously approved plan may be set aside.¹⁷³ The PLBA has different time frames for different types of conveyances.¹⁷⁴ The courts will void any gratuitous act that occurred within one year prior to the filing.¹⁷⁵ Any security interests granted within two months prior to the filing will be declared null and void and have no effect on the estate.¹⁷⁶ Another act that constitutes a fraudulent conveyance is when a debtor enters into a contract with certain extended family members within the six months prior to the petition.¹⁷⁷ Moreover, the PLBA accords creditors the power to file an appeal against any of the debtor's actions which place the creditor at a major disadvantage.¹⁷⁸

5. Discharge—Treatment of the Debtor's Pre-Bankruptcy Debt

Under the reorganization plan (or the court-approved arrangement) between the debtor and the creditors, the discharge of any claims not provided for in the plan is binding and final on all of the parties in-

170. *Id.* art. 207. Strangely, the PLBA does not provide for those portions of the secured debts that are unsatisfied by the creditor's mortgage and lien to go into the unsecured claims, i.e., there appears to be no bifurcation. *Id.*

171. *Id.* art. 203. Strangely, administrative expenses seem to include wages and pension monies owed by the debtor.

172. *Id.* art. 203, § 2.

173. *Id.*

174. *Id.* arts. 53-58.

175. *Id.* art 53, § 1.

176. *Id.* art 53, § 2. However, a bona fide creditor can petition the court to declare his security interest valid. *Id.*

177. *Id.* art. 54.

178. *Id.* art. 55. This is probably less a question of fraudulent conveyances and more of general avoidance powers.

volved.¹⁷⁹ It can only be circumvented when there is a default on the plan.¹⁸⁰ In the case of a liquidation proceeding, the PLBA does not discharge the debtor from claims that were not recognized by the bankruptcy proceeding, and therefore the creditor can still bring those claims once the bankruptcy proceeding has terminated.¹⁸¹ The debtor, however, has the right to have those claims quashed one year after the completion or discontinuation of the bankruptcy proceeding.¹⁸² This last provision presumably gives the debtor some leverage against creditors. Even so, the PLBA does not afford a debtor protection after bankruptcy against discrimination, which includes the termination or denial of employment, a refusal to sell a new car on credit, or the refusal to rent an apartment to the debtor.¹⁸³ Therefore, before having a claim quashed, debtors should consider its effect on their future dealings with creditors and their reputation within the community.

IV. 11 U.S.C. § 304: ANCILLARY PROCEEDINGS

With the collapse of Communism, a huge market opened up for investments and interconnected companies between the former East Bloc and the West. Each year more international companies are chartered, creating a greater potential for transnational bankruptcies. Transnational bankruptcies cause problems when the debtor owns assets in several countries and becomes insolvent.¹⁸⁴ The International Bar Association's Model International Insolvency Cooperation Act, the European Union's Convention on Insolvency Proceedings, and the United Nations' Commission on International Trade Law have all attempted to create an international code harmonizing cross-border bankruptcy proceedings.¹⁸⁵ The United States however, is not a signatory or subscriber to any international agreement on general insolvency matters.¹⁸⁶ This section will

179. *Id.* art. 193.

180. *Id.* art. 197, §§ 1-2. *See supra* Part III.C.1.

181. *Id.* art. 169.

182. *Id.* art. 170, § 2. Unless the debtor has acknowledged the claim in bankruptcy proceedings, a valid judgment over the claim has not been made. *Id.*

183. *Cf.* 11 U.S.C.A. § 525(a), (b) (1993 & Supp. 1998) (stating that governmental units and private employers may not discriminate with respect to employment). A salesperson, when deciding whether to extend credit to a potential customer, will presumably be influenced by the fact that the customer has had a debt quashed in the past.

184. Todd Kraft & Allison Aranson, *Transnational Bankruptcies: The Section 304 and Beyond*, 1993 COLUM. BUS. L. REV. 329, 331-32 (1993).

185. *See generally* Gerold Herrmann, *International Cooperation on Cross-Border Insolvency Issues*, 24 INT'L BUS. LAW. 218 (1996).

186. Harold S. Burman, *Harmonization of International Bankruptcy Law: A United States Perspective*, 64 FORDHAM L. REV. 2543, 2544 (1996).

briefly look at the U.S. Bankruptcy Code's ("USBC") attempt at creating a mechanism whereby the U.S. Bankruptcy Courts recognize foreign bankruptcy proceedings. Once the criteria under which foreign proceedings are recognized has been discussed, the last part of this section will look at whether a bankruptcy proceeding, initiated in any of the three countries discussed earlier, will meet the requirements of Section 304(c) of the USBC provision.

A. *Cases Ancillary to Foreign Proceedings*

1. Development of USBC Section 304

Before the enactment of Section 304 in 1978, a foreign bankruptcy trustee could only succeed in a cross-border insolvency proceeding when there was compliance with the common law doctrine of comity.¹⁸⁷ Comity is generally granted only when the foreign law is similar to U.S. law.¹⁸⁸

The territoriality and the universality doctrines are two methods that have emerged to determine whether a foreign bankruptcy proceeding would be recognized.¹⁸⁹ Under the territoriality approach, only property that is located within the country's jurisdiction is distributed to creditors who appear before the court and assert a claim.¹⁹⁰ In contrast, under the universality approach, one main proceeding is initiated, presumably in the country where the debtor is domiciled or has its principal place of business, and the debtor's property, regardless of location, is distributed uniformly to all creditors.¹⁹¹ After Congress added Section 304 to the USBC

187. Eric W. Lam, *Bankruptcy Code Section 304(b)(3): "Other Appropriate Relief" for Multinational Bankruptcy*, 16 BROOK J. INT'L L. 479, 482 (1990).

188. *Can. S. Ry. Co. v. Gephard*, 109 U.S. 527, 539 (1883) (granting comity to a Canadian citizen because Canadian law is similar to United States law); *Cunard S.S. Co. v. Salen Reefer Servs.*, 773 F.2d 452, 459 (2d Cir. 1985) (granting comity to a Swedish bankruptcy proceeding); *In re Petition of Brierley*, 145 B.R. 151, 165-66 (Bankr. S.D. N.Y. 1992) (extending recognition to an English proceeding under Bankruptcy Code § 304(d), due in large part to comity).

189. Barbara K. Unger, *United States Recognition of Foreign Bankruptcies*, 19 INT'L LAW. 1153, 1154 (1985).

190. Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 460 (1991).

191. See Kraft & Aranson, *supra* note 184, at 336; Donald T. Trautman, *Foreign Creditors in American Bankruptcy Proceedings*, 29 HARV. INT'L L.J. 49, 56-57 (1988). Prior to Congress adding § 304 to the USBC, courts tended to recognize foreign bankruptcy proceedings. Stacy Allen Morales & Barbara Allen Deutsch, *Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity*, 39 BUS. LAW. 1573, 1586-87 (1984); *In re Petition of Brierley*, 145 B.R. 151, 162 n.5 (Bankr. S.D. N.Y. 1992); *In re Enercons Virginia, Inc.*, 812 F.2d 1469, 1472 (4th Cir.

in 1978, a foreign representative¹⁹² was able to file for protection of a debtor's U.S. property in an ancillary proceeding.¹⁹³ It appears that Section 304 serves more the universal approach than the territorial approach by allowing U.S. courts to forego jurisdiction over U.S. property, thereby permitting the distribution of that property in accordance with a foreign bankruptcy court's plan.¹⁹⁴ The USBC does not, however, mandate the universalist approach on the court, but leaves it to the discretion of the individual bankruptcy judge.¹⁹⁵ Congress has set forth six guidelines for judges to use when dealing with petitions from foreign bankruptcy trustees.¹⁹⁶ Once the court has considered those guidelines, it may grant the relief requested by the foreign representative in the form of a turnover of property, an injunction, or other relief.¹⁹⁷

2. Proceedings Available to the Foreign Trustee

A foreign trustee could always commence an involuntary proceeding under Chapter 7 or 11 against a foreign debtor as an ancillary case to a foreign proceeding.¹⁹⁸ The foreign trustee could also file a petition under Section 305 of the USBC asking the court to abstain from any adjudica-

1987); *In re Gee*, 53 B.R. 891, 896, 899 (Bankr. S.D. N.Y. 1985); *Daniels v. Powell*, 604 F. Supp. 689, 693 (N.D. Ill. 1985); *Kenner Products Co. v. Societe Fonciere et Financiere Agache-Willot*, 532 F. Supp. 478, 479 (S.D. N.Y. 1982).

192. A foreign representative is a trustee or similar official of an estate in a foreign insolvency proceeding. 11 U.S.C. § 101(24) (1994). It is not required that the foreign trustee be an entity of the type that would be required under Section 109. *In re Goerg*, 844 F.2d 1562, 1566 (11th Cir. 1988).

193. 11 U.S.C. § 304(a) (1994). Property located in the United States is now seen as part of a larger estate of the debtor that should be turned over to a foreign representative. Even so, a foreign representative can still file a full bankruptcy proceeding under Section 303(b)(4) of the USBC. 11 U.S.C. § 303(b)(4) (1994).

194. 11 U.S.C. § 304(b)(2) (1994). There are, however, proponents of the theory that the United States has adopted neither the universalist nor the territorial approach, but rather accepts pieces of both. *See Unger, supra* note 189, at 1155-56. But even these proponents recognize that the trend clearly goes towards the universalist approach. *Id.*

195. 11 U.S.C. § 304 (1994). There are no sections of the USBC that require a bankruptcy judge to apply a universal distribution approach to U.S. property. One might argue that this notion would be contrary to public policy and therefore, even forbearing jurisdiction over any U.S. property, would be unconstitutional.

196. 11 U.S.C. § 304(c) (1994). *See infra* Part V.A.3.

197. 11 U.S.C. § 304(b) (1994) (describing the relief available).

198. 11 U.S.C. §§ 303(b)(4), 304(a) (1994). Prior to the amended USBC of 1978, foreign representatives could not commence proceedings in the United States courts unless they convinced local creditors to file on their behalf. John D. Honsberger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W. RES. L. REV. 631, 639-40 (1980). Nevertheless, relief was often available to foreign representatives under the doctrine of comity. *See supra* Part V.A.1.

tion of issues relating to a debtor or its property.¹⁹⁹ Lastly, a foreign trustee may file a petition under Section 304 of the USBC asking the court to: 1) enjoin the commencement or continuation of any actions against the debtor or its property; 2) enjoin the enforcement of a judgment or lien against such property; 3) turn over the property to the foreign representative as part of the foreign proceeding; or 4) ask for other appropriate relief.²⁰⁰ The factors that a court must consider when determining the type of petitions available to the foreign trustee will be discussed in the next section.

3. Section 304(c) Guidelines for Granting the Appropriate Relief

Section 304(c) directs bankruptcy courts to:

be guided by what will best assure an economical and expeditious administration of such estate, consistent with:

- (1) just treatment of all holders of claims or interest in such estate;
- (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceedings;
- (3) prevention of preferential or fraudulent dispositions of property of such estate;
- (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
- (5) comity; and
- (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.²⁰¹

One needs to look at each of the six criteria individually before arriving at an overall picture. The first two criteria appear to contradict each other. The court is to consider the just treatment of all claims or interest in such an estate, including those arising outside of the United

199. 11 U.S.C. § 305(b) (1994). The court might grant such relief if, for example, an out-of-court workout arrangement is in the making; no prejudice arises to any creditor; and any involuntary proceeding is recalcitrant. 11 U.S.C. § 305 (1994) (Historical and Revision Notes, Senate Rep. No. 95-989). A decision by the court to dismiss under Section 305 is not reviewable by appeal or otherwise. 11 U.S.C. § 305(c) (1994).

200. 11 U.S.C. § 304(b)(1)-(3) (1994).

201. 11 U.S.C. § 304(c) (1994). Section 304(c) specifically directs the court to look at these factors.

States, while simultaneously protecting the interests of United States claim holders. Can the two be reconciled? Congress must not have intended for the second guideline to be interpreted too strictly; otherwise, any Section 304 proceeding would be without merit from the outset. What are the criteria in determining whether something is too prejudicial or inconvenient to a United States creditor in the foreign bankruptcy proceeding? Case law generally holds a foreign proceeding to be too inconvenient or prejudicial if, for example, a foreign law does not provide American creditors with similar procedural and substantive protections as would the American law;²⁰² or forces them to travel to the foreign forum.²⁰³ The inconvenience of travel, however, is far from being a conclusive factor. Courts often allow foreign forums despite the inconvenience to the U.S. creditor as long as the claims processing procedure is fundamentally fair.²⁰⁴ Where the laws of the foreign forum are in harmony with those of the United States and where they are not repugnant to American laws, courts will usually find no inconvenience or prejudice.²⁰⁵

The next guideline for courts to consider, is how the foreign proceeding handles the prevention of fraudulent conveyances and transactions.²⁰⁶ The prevention of fraudulent transactions is a major policy underlying U.S. bankruptcy law.²⁰⁷ As with the first two guidelines, if one were to apply this guideline strictly, there would be no need for Section 304.²⁰⁸ Therefore, the courts should not compare whether the foreign proceeding has the exact same type of protection to prevent fraudulent conveyances, but rather whether the foreign law would protect the U.S. creditor substantially the same way as they would be protected in a U.S. bankruptcy proceeding. Case law seems to support the substantially similar approach.²⁰⁹

202. *Interpol, Ltd. v. Certain Freights of M/V Venture Star*, 102 B.R. 373, 377 (Bankr. D. N.J. 1988), *appeal dismissed*, 878 F.2d 111 (3rd Cir. 1989); *In re Papeleras Reunidas, S.A.*, 92 B.R. 584, 591 (Bankr. E.D.N.Y. 1988).

203. *In re Lineas Areas de Nicaragua*, 13 B.R. 779, 780 (Bankr. S.D. Fla. 1981) (stating that having U.S. creditors seek payment in Nicaragua is an alternative that should be avoided if possible).

204. *In re Brierley*, 145 B.R. 151, 162-63 (Bankr. S.D.N.Y. 1992).

205. *In re Culmer*, 25 B.R. 621, 629-30 (Bankr. S.D.N.Y. 1982). *See In re Banco de Descuento*, 78 B.R. 337, 339 (Bankr. S.D. Fla. 1987).

206. 11 U.S.C. § 304(c)(3) (1994).

207. Ulrich Huber, *Creditor Equality in Transnational Bankruptcies: The United States Position*, 19 VAND. J. TRANSNAT'L L. 741, 752 (1986).

208. Given the very strict view of prevention of fraud and preference in the U.S. courts, there is a risk that courts applying the foreign law may find that the same protection is not granted to U.S. creditors as would be the case if the creditor were to submit himself to the foreign proceeding. *Id.*

209. *See In re Metzler*, 78 B.R. 674 (Bankr. S.D.N.Y. 1987) (holding that foreign

The fourth guideline requires the courts to look at the distribution of proceeds according to a Title 11 order. The question again is how closely must the distribution scheme in the foreign proceeding match the scheme under the USBC.²¹⁰ If the match required is too close, the court will disallow the foreign petition.²¹¹ One case seems to suggest that the foreign countries' laws must be an exact match or otherwise, the Section 304 proceeding is doomed to fail.²¹²

The strongest case in support of turning over U.S. property for distribution in the foreign proceeding is *In re Culmer*,²¹³ in which the court held that where the foreign law is not "inherently vicious, wicked, immoral or shocking to the prevailing American sense," there is no reason not to recognize the foreign proceeding and grant relief according to Section 304.²¹⁴ If one were to adopt this standard, the United States would be a big step closer to a truly universal approach, thus opening the way for becoming a signatory to international insolvency treaties.

The fifth guideline, comity, has been discussed in Part V.A.1. The last guideline directs the court to look at whether the debtor is afforded a fresh start. Because the fresh start provision can only apply to a natural person,²¹⁵ the likelihood of the court facing a transnational bankruptcy in-

preference and fraudulent transfer actions seeking to recover property located in the United States provided sufficient basis on which to allow a case ancillary to foreign proceeding); *In re Egeria Societa Per Azioni di Navigazione*, 26 B.R. 494 (Bankr. E.D.Va. 1983) (holding that preference action can be brought in foreign ancillary bankruptcy proceeding); *In re Gercke*, 122 B.R. 621 (Bankr. D.D.C. 1991) (holding that in determining whether to grant relief in case ancillary to foreign bankruptcy proceeding, the court has to be concerned with whether the foreign law provides for the prevention of preferential disposition of estate property and not with just treatment of holders of claims in the resolution of the claims).

210. Given the fact that foreign laws are almost always different from U.S. laws, this guideline potentially can eliminate any request for relief.

211. See *Interpool Ltd. v. Certain Freights of M/V Venture Star*, 102 B.R. 373 (Bankr. D.N.J. 1988) (holding that the absence of an equitable subordination doctrine in Australian law is dispositive in granting a § 304 relief, *appeal dismissed*, 878 F.2d 111 (3d Cir. 1989). The court ignored that there are differences between the United States and the Australian bankruptcy systems of which the creditor was aware before entering into business in Australia. Gene Cheever, *Australian International Bankruptcy Law*, 12 U. PA. J. INT'L BUS. L. 153, 155 (1991).

212. *In re Toga Manufacturing Ltd.*, 28 B.R. 165 (Bankr. E.D.Mich. 1983) (holding that although the creditor would not be inconvenienced by litigating his claim in Canada and furthermore would receive just treatment in the Canadian courts, nevertheless, the property could not be turned over because of the difference in classification in the Canadian as opposed to the U.S. proceeding).

213. 25 B.R. 621 (Bankr. S.D.N.Y. 1982).

214. *Id.* at 629-31.

215. If a natural person files for a liquidation proceeding, a new start is the next

volving a natural person is marginal at best.

Courts take different approaches with regard to the six criteria in Section 304(c) of the USBC. Some courts require that all six elements are satisfied before awarding relief, thus changing the guidelines into prerequisites.²¹⁶ Other courts have found the element of comity to be the dominant element when it comes to awarding relief under Section 304.²¹⁷

B. The Czech Republic, Hungary, and Poland's Insolvency Proceedings and the Six Criteria of Section 304(c) of the USBC

There is no case law that deals with a foreign bankruptcy trustee from any of the three countries filing a petition for relief under Section 304.²¹⁸ In determining whether a petition by a foreign bankruptcy trustee from any of the three countries would succeed, one necessarily will have to look to the specific regulations of an individual country's bankruptcy proceeding. Case law takes three approaches to a Section 304 proceeding: 1) the strict comity approach, that is, the foreign law must be the same in all respects; 2) the prerequisite approach, that is, all six guidelines of Section 304(c) must be complied with; and 3) the substantially similar approach. It is apparent that neither of the three nations' laws would satisfy the first two approaches; therefore, this Article will analyze only the situations where the courts apply the substantially similar approach or the "not inherently vicious, wicked, immoral or shocking to the prevailing American sense" approach.²¹⁹ The analysis will only touch briefly on the guideline of comity because there is not enough case law as to whether comity exists in the Czech Republic, Poland or Hungary to make an informed decision.²²⁰ The next three subsections will address

step. If a non-natural legal entity files for liquidation, the owners of the bankrupt company can start under a new name. Should a company file for reorganization, there is no need for a fresh start.

216. See *In re Toga Manufacturing Ltd.*, 28 B.R. at 165; *In re Gee*, 53 B.R. 891, 900 (Bankr. S.D.N.Y. 1985).

217. See *In re Brierley*, 145 B.R. 151, 163 (Bankr. S.D.Fla. 1987).

218. This should not come as a surprise given the fact that the three countries are still in the infancy stage as regards privatization and insolvency law matters.

219. See *supra* Part V.A.3.

220. This does not mean, however, that one should not engage in speculation. Presumably, all three nations will become members of the European Union. See *Six Countries to Begin EU Membership Talks Next Year*, AGRA EUR., July 18, 1997, at E3. Furthermore, the United States, after Germany, is the country with the highest amount of investment in either country. Eventually, this process will allow for Czech, Hungarian, and Polish companies to invest in the United States and before long, one is facing the problem of transnational insolvencies. Facing reality, the legislatures of those three nations will have to enact provisions in their respective bankruptcy laws that allow for ex-

problems each country's bankruptcy trustee will be confronted with in a Section 304 proceeding before a U.S. bankruptcy judge.

1. The Czech Republic

Looking at reasons why a Section 304 proceeding initiated by a foreign trustee from the Czech Republic might fail, one criteria comes to mind: fraudulent Conveyances. The policy of voiding unfair preferences is not unknown under the CRBA, but the Act does not provide guidelines as detailed as the USBC accords to a creditor.²²¹ However, looking at the fact that voidance provisions exist in the CRBA, one might argue that the Czech Republic's law is not repugnant to American law. Case law seems to support the rationale of not requiring an exact match of the foreign law, but only a substantially similar protection afforded to American creditors under the foreign proceeding.²²²

Presumably, one could find difficulties with some of the criteria. For example, the CRBA does not specifically provide for a fresh start, i.e., the total discharge of all pre-bankruptcy debts in a liquidation proceeding.²²³ However, it does provide for the discharge of all claims that were not payable under a reorganization plan.²²⁴ Given the novelty of bankruptcies to CEE countries, initially many bankruptcies involved government entities and not natural persons. Therefore, law makers might not have seen a need to provide for a fresh start of an individual in a personal liquidation proceeding, something which was even more remote than a state enterprise failure under the old Communist system.

Another potential problem is the non-appealability of bankruptcy decisions.²²⁵ One should, however, look beyond a strict analysis of this issue. Two reasons exist why not to hold this idea against the foreign petitioner: the fast track approach of privatization, and the novelty of the topic itself. Under the fast track approach, the Czech Republic was attempting to facilitate foreign investment, thus boosting the economy and counteracting the side effects of liquidating enterprises.²²⁶ Once reality catches up, amendments to the CRBA presumably will remedy this deficiency and the CRBA will provide for the appealability and disposition of a bankruptcy proceeding.

actly such situations and therefore, out of necessity, the doctrine of comity will guide the three nations' legislatures with respect to Bankruptcy law.

221. See *supra* Part IV.A.3. Cf. 11 U.S.C.A. §§ 546-551 (1993 & Supp. 1998).

222. *Id.*

223. See *supra* Part III.A.5.

224. *Id.*

225. See CRBA, *supra* note 69 and accompanying text.

226. See *supra* Part II.A.

Yet another problem is the way the CRBA classifies claims and thus affects priorities and distribution. However, one should not interpret the meaning of Section 304(c)(4) of the USBC to require that a foreign proceeding exactly classify and distribute the assets in the exact same manner as under Title 11. If this were the situation, no relief in an ancillary case could be granted. Regarding the treatment of claims, the CRBA provides for a hierarchy of claims, which is somewhat dissimilar²²⁷ from the priorities afforded a U.S. creditor. Nevertheless, the CRBA provides for a classification of claims into priorities, something which is also done in the USBC.²²⁸

U.S. case law purports to emphasize the voidability of preferences.²²⁹ The mere existence of some differences in treating preferential transfers should not constitute a problem for the courts in recognizing a Czech bankruptcy proceeding. As discussed above, the CRBA provides for equitable treatment of similarly situated creditors, meaning that a U.S. creditor, if he were forced to litigate a claim under a Czech bankruptcy proceeding, would be given the same rights as similarly situated creditors. In addition, the CRBA provides for time limitations as to how long before the petition for bankruptcy any conveyances made will be declared null and void. The time limit and provisions are not exactly the same as in the USBC; however, they afford protection to a creditor which are similar to the protection afforded a creditor in a U.S. bankruptcy proceeding.

2. Hungary

A Hungarian trustee presumably will face difficulties satisfying the requirement of just treatment and distribution under Section 304(c) of the USBC. To revisit briefly the Hungarian classification of priorities, the biggest discrepancy between the HLBA and the USBC is that under Hungarian law a secured creditor is not given the highest preferential status, but rather finds his claims subordinated to administrative costs.²³⁰ If one recalls *In re Toga Manufacturing*,²³¹ the court dismissed the applica-

227. This is especially so for claims pertaining to wages and social security and pension benefits. But under the Communist system, there was no unemployment and everybody was entitled to a pension. Therefore, to soften the initial shock wave created by the onset of capitalism, the legislature made mass unemployment a high priority. In so doing, a burden was lifted from the government's shoulders.

228. 11 U.S.C.A. § 507 (1993 & Supp. 1998).

229. See Huber, *supra* note 210, at 752.

230. See *supra* Part III.B.3. See also Gray, *Evolving Legal Frameworks*, *supra* note 118, at 12.

231. *In re Toga Manufacturing Ltd.* 28 B.R. 165 (Bankr. E.D.Mich. 1983).

tion of the Canadian trustee for a turnover of property located in the United States on the grounds that, although the creditor would receive just treatment in Canadian courts, a difference in classification in the Canadian as opposed to the U.S. proceeding would impair the American creditor's claim.²³² Even if the court were to find that a U.S. creditor would receive just treatment in the Hungarian Courts, undoubtedly, a U.S. bankruptcy judge must deny a Section 304 proceeding because the classification discrepancy is too big, thus impairing the U.S. creditor enormously. Leaving the above aside, the Hungarian proceeding classifies claims and prioritizes these claims in a similar fashion to the USBC.²³³

With regard to the treatment or prevention of fraudulent conveyances, the HLBA will declare null and void any conveyance within a six month period prior to the bankruptcy filing. Moreover, it converts any secured claim derived at in said fashion into an unsecured claim.²³⁴ The USBC treats conveyances similarly. However, the USBC calls for a one-year voidance time frame.²³⁵ Conceivably, the additional six months provided for under the USBC affords a U.S. creditor better protection in a U.S. proceeding. Nevertheless, the concept is the same, i.e., fraudulent conveyances are not tolerated by the law.

With respect to other guidelines, both systems reflect similar approaches to a liquidation or reorganization, albeit somewhat differently.²³⁶ The Hungarian system of affording dissenting creditors in a reorganization at least equal or better treatment than what an approving creditor receives is not as objective of a standard as the U.S. system, where dissenting creditors must receive at least as much as under a liquidation.²³⁷ The counterargument would be that the provision is useless when a creditor is not entitled to receive anything under the liquidation procedure.

There is another potential problem which a Hungarian trustee in a liquidation proceeding might face under Section 304(c) analysis, i.e., the HLBA does not expressly state that upon conclusion of the liquidation proceeding all claims against the debtors will be discharged. The rationale behind this is similar to the one explained under the Czech Republic's analysis discussed *supra*. That is, the concept is too new and amendments need to be made accordingly.

232. *Id.*

233. *See supra* Part III.B.3. *Cf.* 11 U.S.C.A. § 507 (1993 & Supp. 1998).

234. *See supra* Part III.B.4.

235. 11 U.S.C.A. § 548 (1993 & Supp. 1998).

236. *See supra* Part III.B. *Cf.* 11 U.S.C. chs. 7, 11, 13 (1994).

237. 11 U.S.C.A. § 1129(a)(7)(A)(ii) (1993 & Supp. 1998).

3. Poland

The PLBA appears to be very similar to the USBC. If one applies the six guidelines set forth in Section 304(c) of the USBC to the Polish proceeding, there are no major apparent flaws. The Polish bankruptcy code accords just treatment to all claims by allowing creditors to vote on the plan or to challenge bankruptcy decisions by the judge.²³⁸ Presumably, a U.S. creditor will not be prejudiced and inconvenienced by having to litigate a claim in Poland.²³⁹ The PLBA has three time limitations with regard to the prevention of fraudulent conveyances, thus voiding such preferential transfers if they fall within the time frame.²⁴⁰ With regard to the fourth guideline, the distribution or proceeds from the estate of the debtor, the PLBA accords absolute priority to secured claims followed by a well-developed hierarchy of priorities.²⁴¹ Comity as of this moment is non-existent. Nevertheless, as explained *supra* in Part V.A.1, discussing the Czech Republic, it will be just a matter of time until comity is embedded in the relation between the United States and Poland, whether through statutory law or case law. Finally, a new start will be no problem for a debtor under a reorganization. With regard to a fresh start after a liquidation, currently, the PLBA does not discharge a debtor from all his debts after the proceeding is completed. Nevertheless, the PLBA affords the debtor to file a petition with the court to have its debts quashed one year after the disposition of the bankruptcy proceeding and therefore, the PLBA indirectly provides for a new start.²⁴²

V. CONCLUSION

This article has shown that the three former Communist countries have come a long way from a centrally-planned economy to a free market economy. Each of the three nations approached the economic transition in a somewhat different way and pace. Each nation completed an economic transition but, equally important, achieved a legal transition as well.

Bankruptcy is an important element in a free market society. The three CEE countries have either reinvented, or newly created, their bankruptcy laws. There can be no doubt that the legislators had the socio-economic and cultural identities of their people in mind when they wrote the insolvency laws. Unemployment was a major concern, yet at the

238. See PLBA, *supra* note 147, arts. 17, 192.

239. See *supra* Part IV.A.3.

240. See *supra* Part III.C.4.

241. See *supra* Part III.C.3.

242. See *supra* Part III.C.5.

same time, the desire to close the gap between their countries and the West was a pushing factor. All three nations are on their way to becoming members of the European Union.

This Article attempted to show whether a foreign bankruptcy trustee from each of the CEE nations would be able to satisfy the guidelines of Section 304 of the USBC. To date no such situation has occurred, but with U.S. companies increasingly investing in the three nations, eventually, a U.S. bankruptcy judge will be faced with that exact situation. If one were to apply the guidelines verbatim and in a matter of strict interpretation, presumably no Section 304 proceeding applied for by a trustee from any of the three nations would be successful. The global community, however, is growing closer together and, in the spirit of future interaction between the United States and the Czech Republic, Hungary, or Poland, each nation's bankruptcy proceedings are capable of meeting the guidelines of Section 304(c) of the USBC. Admittedly, in subordinating secured claims, which are generally recognized by modern bankruptcy laws as the foremost claims in an insolvency proceeding, to administrative expenses, Hungary has to overcome the biggest obstacle. Leaving this aside, there is no apparent reason why a foreign trustee from any of the nations should fail to complete successfully a Section 304(c) proceeding.

Finally, one should look to three more reasons for recognizing the three CEE nation's bankruptcy proceedings under Section 304 of the USBC. First, the three countries modeled their insolvency laws after the German insolvency code, which is given full recognition under Section 304 of the USBC. Second, all three nations eventually will become members of the European Union and thus will utilize the European Union Convention on International Insolvencies—an international treatise the United States cannot afford to ignore. Lastly, the three countries are still experiencing a learning curve, and being imperfect should not be held against them. It appears that the so-called "Tunnel at the End of the Light"²⁴³ has become a light at the end of the tunnel.

243. See Cohen & Schwartz, *supra* note 14, at 7.

