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The Recovery of Extra Territorial Transfers: Do Sections 548 and 550 Apply to Transactions Outside of the United States?

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The laws of the United States generally have no extraterritorial effect. There is a presumption against the extraterritorial application of a federal statute; to overcome that presumption, there must be a clearly expressed congressional intent. In *Kiobel v. Royal Dutch Petro. Co.*, 569 U.S. 108 (2013), the Supreme Court applied the statutory presumption against extraterritoriality to the Alien Tort Statute, holding: "[E]ven where the claims touch and concern the territory of the United States, they must do so with sufficient force to displace the presumption against extraterritorial application." *Id.* at 124-25. This article explores the application of these non-bankruptcy principles in the context of the avoidance and recovery of transfers under Sections 548 and 550 of the Bankruptcy Code.

I. Principles of Extraterritoriality Generally (RJR Nabisco, Inc. v. European Cmty., 136 S.Ct. 2090 (2016)).

To understand when a U.S. law can apply extraterritorially, consider the Supreme Court's decision in *RJR Nabisco, Inc.* In this case, the European Community sued RJR Nabisco in the U.S. District Court for the Eastern District of New York for alleged RICO violations, money laundering and other causes of action arising from the way RJR sold its products in the EU. "Greatly simplified, the complaint alleges a scheme in which Colombian and Russian drug traffickers smuggled narcotics into Europe and sold the drugs for euros that—through a series of transactions involving black-market money brokers, cigarette importers, and wholesalers—were used to pay for large shipments of RJR cigarettes into Europe." *Id.* at 2098.

The Court again applied the

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presumption against extraterritoriality. "Absent clearly expressed congressional intent to the contrary, federal laws will be construed to have only domestic application." *Id.* at 2100 (citing *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 255 (2010)). The Court further employed a two-part test when analyzing extraterritoriality issues: First, "whether the presumption against extraterritoriality has been rebutted—that is, whether the statute gives a clear, affirmative indication that it applies extraterritorially." *Id.* at 2101. Second, if the answer to the first question is no, then the court must examine "whether the case involves a domestic application of the statute, and *we do this by looking to the statute's 'focus.'*" *Id.* (emphasis added). If the conduct that is relevant to the statute's focus occurred in the United States, then the case involves a permissible domestic application. *Id.*

The Court, per Justice Alito, held that although RICO does apply to some foreign racketeering activity, and that the facts alleged in the complaint stated "sufficient tie[s] to U.S. commerce," the private cause of action provided by RICO – Section 1964(c), allowing "'[a]ny person injured in his business or property by reason of a violation of section 1962' to sue for treble damages, costs, and attorney's fees" – did not overcome the presumption against extraterritoriality. In other words, the Court required that there be a "domestic injury," in order to take advantage of the private right of action provided by Section 1964(c). Therefore, because the alleged harm accrued exclusively in the EU, the EU's RICO claims were subject to dismissal.

Justice Ginsberg, joined by Justices Bryer and Kagan (Justice Sotomayer took no part in the case) dissented, arguing that the Court's decision left the EU with a right without a remedy. *Id.* at 2116 Further, Justice Ginsberg stated: "I would resist reading into § 1964(c) a domestic-injury requirement Congress did not prescribe." *Id.*

II. Bankruptcy Avoidance Actions and Extraterritoriality

Can Trustees, Debtors in Possession or Liquidating Plan Trustees bring actions to avoid transfers that were made to transferees outside of the United States? The Fourth Circuit addressed this issue in 2006 in the case of *French v. Liebmann (In re French)*, 440 F.3d 145 (4th Cir. 2006). More recently, the Second Circuit in *In re Picard*, 917 F.3d. 85 (2nd Cir. 2019) issued an opinion addressing this question.

However, before reviewing these cases, it is important to identify the Bankruptcy Code Sections at issue. The three key sections are Sections 541, 548 and 550(a).

Section 541 defines property of the estate. The relevant provisions read:

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, *wherever located* and by whomever held:

1. Except as provided in subsections (b) and (c) (2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 541(a) (emphasis added).

Section 548 gives the parameters and requirements for how a Trustee would avoid a fraudulent transfer or obligation:

(a)(1) The trustee may avoid any transfer . . . of an interest of the debtor in property… that was made or incurred on or within 2 years before the date of the filing of the petition if the debtor voluntarily or involuntarily

(A) made such transfer . . . with actual intent to hinder, delay, or defraud . . . or

(B) (i) received less than reasonably equivalent value in exchange for such transfer or obligation; and

(ii)

(I) was insolvent on the date that such transfer was made . . . ;

(II) was engaged in business or a transaction . . . for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur . . . debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider . . . under an employment contract and not in the ordinary course of business.

11 U.S.C. § 548(a).

Finally, Section 550(a) of the Code provides as follows:

Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

11 U.S.C. § 550(a).[1]

The rebuttal of the presumption against extraterritoriality depends on how courts interpret the interplay between Sections 541, 548 and 550(a).

A. *In re French*, 440 F.3d 145 (4th Cir. 2006).

The *French* case involved the transfer of property in the Bahamas by the Debtor, a resident of Maryland, to her children, residents of Maryland and Virginia. The Trustee sought to avoid the transfer under Section 548(a)(1)(B), as a transfer for lack of reasonably equivalent value. The transferees were alleged to be direct recipients of the transfer under Section 550(a)(1).

The Fourth Circuit held that the presumption against extraterritoriality did not prevent the application of Section 548 to avoid a transfer of a debtor's interest in property in the Bahamas. The Fourth Circuit held:

> Section 541 defines "property of the estate" as, *inter alia*, all "interests of the debtor in property." 11 U.S.C. § 541(a)(1). In turn, § 548 allows the avoidance of certain transfers of such "interest[s] of the debtor in property." 11 U.S.C. § 548(a)(1). By incorporating the language of § 541 to define what property a trustee may recover under his avoidance powers, § 548 plainly allows a trustee to avoid any transfer of property that would have been "property of the estate" prior to the transfer in question—as defined by § 541—even if that property is not "property of the estate" *now*.

440 F.3d at 151-52 (emphasis in original). The Fourth Circuit found it "significant" that: (a) the conduct giving rise to the avoidance of the transfer (that is, the Debtor's insolvency, and the lack of reasonably equivalent value) occurred in the United States, even though the Deed was recorded in the Bahamas; and (b) the effects of the transfer were felt almost exclusively by creditors within the United States.

The Fourth Circuit also rejected an appeal to international comity by the transferees, finding that the interests of the U.S. creditors outweighed any interests of the Bahamas in the transaction. *Id.* at 154 ("The United States has a strong interest in extending these personal protections to its residents—including the vast majority of the interested parties here. The Bahamas, by contrast, has comparatively little interest in protecting nonresidents.")

The Fourth Circuit did not rely on Section 550(a) in its decision. In contrast, the Second Circuit in *Picard* (discussed below) relied heavily on Section 550(a). The transferees in *French* were immediate transferees under Section 550(a)(1), while the transferees in *Picard* were mediate transferees under Section 550(a)(2). One would think that the case for the extraterritorial application of Section 550(a) would be stronger with respect to immediate transferees under Section 550(a)(1) since they may be more aware of the financial circumstances of their transferor.

B. In re Picard, 917 F.3d. 85 (2nd Cir. 2019).

In February 2019, the Second Circuit addressed the application of Sections 548 and 550 in the case of *In re Picard*, 917 F.3d. 85 (2nd Cir. 2019). Picard was appointed as the SIPA Trustee in the well-known *Madoff* insolvency proceedings in the Southern District of New York. Picard brought eighty-eight avoidance actions against hundreds of recipients of transfers from Madoff Securities, almost all of whom were located outside of the United States. In these actions, the initial transferees were the feeder funds that invested billions of dollars from foreign investors. The foreign investors, who received repayment and fictitious profits via the feeder funds, were alleged to be mediate transferees under Section 550(a)(2) of the Code, and the transfers were alleged to have been actually fraudulent under Section 548(a)(1)(A).

The District Court, which had withdrawn the reference, held that: (a) Section 550 came within the presumption against extraterritoriality, and the Trustee did not sufficiently allege a domestic nexus; and (b) international comity required dismissal of the Trustee's claims. The District Court remanded the cases to the Bankruptcy Court, which then dismissed the Trustee's avoidance actions. *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 513 B.R. 222, 232 (S.D.N.Y. 2014). Picard appealed to the Second Circuit.

The Second Circuit, recognizing the presumption against extraterritoriality, reversed, holding that the focus of Sections 548 and 550(a) is the recovery of property fraudulently transferred by the debtor to the initial transferee. The Second Circuit held that the focus is on the initial transfer because the debtor only "makes" the initial transfer under Section 548(a)(1)(A), which is recoverable against the initial transferee under Section 550(a)(1). The focus, in the Second Circuit's view, is not on the subsequent transfer under Section 550(a)(2). 917 F.3d. at 98. It held:

> The language of § 548(a)(1)(A) reflects this focus. It allows a trustee to avoid certain transfers "the debtor voluntarily or involuntarily ... made." 11 U.S.C. § 548(a)(1)(A) (emphasis added). This can mean only the initial transfer, because the debtor has not made the subsequent transfer. Consequently, when a trustee seeks to recover subsequently transferred property under § 550(a), the only transfer that must be avoided is the debtor's initial transfer.

Id. (emphasis in original).

Moreover, the Second Circuit held that the actions involved domestic conduct because Madoff Securities, a domestic entity, caused the transfers to be made to the initial transferees, the feeder funds, from the United States. In the Second Circuit's view, focusing on the transferees' receipt of the property from the feeder funds outside of the U.S. would "open a loophole" – transferees could use straw parties outside of the U.S. and then have the funds transferred to themselves.

Finally, the Second Circuit rejected the transferees' appeal to international comity, as did the Fourth Circuit in *French*. The issue in *Picard* was made more complex, and closer, by the added fact that many of the feeder funds were in their own liquidation proceedings in the foreign courts. The Second Circuit noted that where the *same debtor* is in liquidation proceedings in the U.S. and in a foreign court at the same time, then "the foreign state has at least some interest in adjudicating property disputes. In appropriate cases, that interest will trump our own." *Id.* at 103. But, where the Debtor, Madoff Securities, was in liquidation solely in the U.S., and the feeder funds were in foreign liquidation proceedings, then "the absence of such [parallel] proceedings seriously diminishes the interest of any foreign state in our resolution of the Trustee's claims." *Id.* at 103-04.

Conclusion

Courts reviewing this issue always start with the presumption against extraterritoriality. The Fourth Circuit and the Second Circuit have, however, gone on to allow the avoidance of transfers to foreign transferees where the effects of the transfers are felt by creditors in the United States. There does not appear to be a split among the Circuits at this time, so it is unlikely that the Supreme Court will weigh in on the issue soon. As such, the issue of the extraterritoriality of U.S. bankruptcy law continues to develop in the lower courts.

Endnotes

1. Immediate or mediate transferees of an initial transferee (that is, subsection (a)(2) transferees) have the defenses of subsection 550(b)(2) available to them, while initial transferees (subsection (a)(1) transferees) do not. Subsection (b)(2) provides:

> The trustee may not recover under [sub]section (a)(2) of this section from—
> (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or
> (2) any immediate or mediate good faith transferee of such transferee.

11 U.S.C. § 550(b)(2).