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A Preference Pendulum: Extraterritorial Application Of Avoidance Powers In the SDNY

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The Bankruptcy Court for the Southern District of New York is among the world's leading forums for court-supervised restructuring. As such, it routinely confronts complex flows of funds among affiliates and counter parties across the globe. Among other legal challenges, the extraterritorial application of avoidance provisions of the Bankruptcy Code takes on increased prominence in the district. This question is of particular importance in financial firm wind-downs, shipping restructurings, and other global insolvencies where fiduciaries review such essential functions as payments to vendors, pay-downs of credit facilities, distributions to shareholders, investments redemptions, and professional fees.

While the import of this issue is clear, consensus is not. Jurists have reached alternating conclusions on the issue of whether Congress intended the avoidance provisions to apply to foreign transactions. See *Picard v. Bureau of Labor Ins. (In re BLMIS) (BLI)*, 480 B.R. 501 (Bankr. S.D.N.Y. 2012) (ruling for extraterritoriality). But see *Sec. Investor Prot. Corp. v. BLMIS (BLMIS)*, 513 B.R. 222 (S.D.N.Y. 2014) (ruling against extraterritoriality). Contra *Weisfelner v. Blavatnik, (Lyondell)*, 543 B.R. 127 (Bankr. S.D.N.Y. 2016) (ruling for extraterritoriality). Now, a recent decision by the bankruptcy court for the Southern District of New York in *Spizz v. Goldfarb Seligman & Co. (In re Ampal-American)*, 562 B.R. 601 (Bankr. S.D.N.Y. 2017) has moved the pendulum away from extraterritoriality back toward a nearer reach of avoidance powers.

'Morrison' and Differing Determinations Of Extraterritorial Intent

The "presumption against extraterritoriality" is a long-standing principal

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of statutory construction by which courts presume that federal law does not to apply to conduct or property outside the United States unless a contrary congressional intent is evident. The primary reason for this rule is to avoid unintended clashes between domestic laws and those of other nations. The U.S. Supreme Court analyzed this presumption in *Morrison v. National Australia Bank*, where it articulated a two-step approach to determine whether or not the presumption applies in individual cases. 561 U.S. 247 (2010). First, a court must determine if the presumption has been rebutted by a clear affirmative indication either in the statutory text or the underlying legislative purpose of a law that it is meant to apply extraterritorially, in which case the inquiry ends. Id. at 255. Second, in the absence of a clear affirmative indication, the court must apply the facts of the case and decide if the conduct relevant to the statute's focus occurred within the country (territorial) or outside of the country (extraterritorial). Id. at 266-67. If the presumption is rebutted by clear evidence or the conduct relevant to the statute's focus occurred within the United States, then the presumption is overcome and extraterritorial application may proceed; otherwise the court must dismiss the claim.

Although bankruptcy courts in the Southern District of New York have uniformly followed the standard set out in *Morrison*, they have reached different conclusions on whether the Bankruptcy Code's avoidance provisions contain a clear indication of extraterritoriality. The first post-*Morrison* case to address this issue was *BLI*, where the bankruptcy court examined whether a trustee could apply avoidance powers granted by §550 extraterritorially to recover transfers that were made to the foreign accounts of a foreign subsequent transferee. The court concluded that "Congress demonstrated its clear intent for the extraterritorial application of §550 through interweaving terminology and cross-references to relevant Code provisions." *BLI*, 480 B.R. at 527. The court reasoned that the incorporation of the broad definition of property of the estate contained in §541 ("interests of the debtor in property as of the commencement of the case wherever located and by whomever held") into the preference provisions contained in §547 demonstrated Congress' intent for the avoidance provisions to apply to all property that, absent a pre-petition transfer, would have been property of the estate, which, the court held, included the property in the foreign transfer at issue.

The bankruptcy court in *Lyondell* reached the same conclusion as to the ability of the fraudulent transfer provisions of §548 to recover pre-petition shareholder distributions made by one foreign entity to another foreign entity. In *Lyondell*, the bankruptcy court found that "the combination of these two provisions [11 U.S.C. §§ 541 and 548] demonstrated Congress' intent to include the debtor's worldwide property in the estate, and therefore, that they likely intended to include foreign property transferred before bankruptcy within the reach of the bankruptcy avoidance power … . [§541(a)] strongly suggests that Congress intended the reach of those powers to be coextensive with the broad, global embrace of its definition of estate property" 543 B.R. at 154. See also *French v. Liebmann (In re French)*, 440 F.3d 145 (4th Cir. 2006) (pre-*Morrison* case ruling in favor of extraterritorially based on language of §541).

The recent ruling in *Ampal-American* represents a shift away from the extraterritorial approach in *BLI* and *Lyondell* toward a more limited application of the avoidance provisions. In *Ampal-American*, the bankruptcy court addressed whether a trustee could use §§547(b) and 550 to avoid a transfer made from a foreign bank to a foreign law firm. In contrast to the earlier rulings in *BLI* and *Lyondell*, the court found that Congress had not explicitly expressed an intent that §547(b), or any of the avoidance provisions of the Bankruptcy Code, could be applied extraterritorially. In reviewing the definition of "property of the estate," the bankruptcy court found that "property transferred to a third party prior to bankruptcy … is neither property of the estate nor property of the debtor *at the time the bankruptcy case is commenced*, the only two categories of property mentioned in Bankruptcy Code §541(a)(1)." 562 B.R. at 612. Accordingly, the definition of "property of the estate" did not give rise to any inference that Congress intended for the avoidance provisions to be applied extraterritorially; rather, the court reasoned that the language of §541(a) serves "as a limitation on the trustee's avoiding powers, not as an expansion of those powers." Id.

The court also supported its ruling by contrasting those provisions of the Bankruptcy Code and related jurisdictional statutes that *do* contain clear statements of extraterritorial reach, such as the inclusion of the phrase "property ... wherever located" in the definition of property of the estate in §541(a)(1) and 28 U.S.C. §1334(e)(1)'s grant of jurisdiction over "all the property, wherever located, of the debtors as of the commencement of such case " which are missing from the avoidance provisions of the Bankruptcy Code. Id. The bankruptcy court's ruling in *Ampal-American* is consistent with the earlier ruling in *BLMIS* which similarly held that the avoidance provisions could not be applied to recover foreign transactions as they lacked clear language indicating congressional intent regarding extraterritoriality—which cannot be overcome by reference to, or inference from, other sections of the Bankruptcy Code such as §541. See also *Maxwell Commc'n plc v. Societe Gen. plc (In re Maxwell Commc'n plc)*, 186 B.R. 807 (S.D.N.Y. 1995) (pre-*Morrison* case ruling against extraterritorially), aff'd on other grounds, 93 F.3d 1036 (2d Cir. 1996).

While the application of *Morrison*'s second factor relies on the facts of a particular case, the differing rulings in the Southern District of New York have been fact neutral and instead arise from two distinct and different approaches to statutory interpretation. One line of cases, represented by *BLI* and *Lyondell*, used a broader approach to determining congressional intent as outlined in *BLI*, where the court stated that "[a] statute need not include a clear statement declaring 'this law applies abroad' to rebut the presumption, and statutory context may be consulted 'in searching for a clear indication of statutory meaning.'" *BLI*, 480 B.R. at 526. The other line of cases, represented by *Ampal-American* and *BLMIS* has adopted a stricter construction that requires a clear expression of congressional intent in the relevant avoidance statute in order to support extraterritorial application of the provision.

Navigating Extraterritoriality

The alternating rulings on extraterritoriality raise a number of practical implications for debtors, trustees, and counterparties. One potential alternative for a debtor or a trustee is to commence litigation abroad under foreign law. However, this approach may have a number of practical limitations, as few countries have enacted avoidance laws that have the same substantive legal provisions as the Bankruptcy Code. While this may lead to different results for domestic and foreign counterparties, it may also reflect the expectations of foreign transferees.

Alternatively, even if a U.S. court applies avoidance provisions extraterritorially, debtors and trustees should be aware that there remain other barriers to successful recoveries. For example, there may be issues as to whether the bankruptcy court has jurisdiction to exercise personal jurisdiction over a foreign transferee. Additionally, even if a judgment is ultimately received by a debtor or trustee, a foreign court may refuse to enforce a judgment on the grounds that such judgment is inconsistent with the fundamental principles of its own laws. See, e.g., *Rubin v. Eurofinance SA*, [2012] UKSC 46 (refusing to enforce a judgment from a U.S. Bankruptcy Court on the basis that the defendants had not submitted to personal jurisdiction as required by U.K. law).

In any event, the jurisprudence on this issue will continue to evolve, and the pendulum will likely continue to swing, as global restructurings progress in the Southern District of New York.