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Court Holds That US Bankruptcy Code Does Not Permit Recovery of Extraterritorial Transfers

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In a decision that could significantly limit the power of U.S. bankruptcy trustees to challenge cross-border transactions, the United States District Court for the Southern District of New York has held that the trustee overseeing the Madoff liquidation may not recover transfers made by Madoff's foreign customers to other foreign entities. *SIPC v. Bernard L. Madoff Investment Securities LLC*, No. 12-mc-115 (S.D.N.Y. July 7, 2014). The court held that recovery of such "purely foreign" transfers would run afoul of the presumption against extraterritoriality reaffirmed by the Supreme Court in *Morrison v. National Australia Bank*.

Section 550 of the Bankruptcy Code permits a trustee to recover fraudulent transfers made by a debtor not only from the person who initially received the transfers but also, in specified circumstances, from subsequent transferees. The Madoff trustee has invoked section 550 to sue foreign "feeder funds" that withdrew funds from their Madoff customer accounts, and foreign banks and investors that in turn received transfers from the feeder funds. The defendants in the second category, the subsequent transferees, moved to dismiss the trustee's claims, arguing that the Bankruptcy Code should not be construed to permit recovery of transfers made abroad from one foreign entity to another.

As required by *Morrison*, Judge Jed Rakoff considered two questions in deciding the motion: first, whether the factual circumstances at issue required an extraterritorial application of section 550; and second, if so, whether Congress intended for the statute to apply extraterritorially. To answer the first question, the Court identified the transaction regulated by the statute as "the transfer of property to a subsequent transferee, not the relationship of that property to a perhaps-distant debtor." The Court then concluded that, even though the "chain of transfers" originated with a New York brokerage firm, the subsequent transfers at issue involved companies that were organized and operated abroad and were thus "foreign."

As to whether Congress intended for Section 550 to apply extraterritorially, Judge Rakoff cited *Morrison* for the proposition that any such intent must be "clearly expressed." The Court, however, found no such intent in the language of Section 550. The court also rejected the trustee's invocation of Section 541(a) of the Bankruptcy Code, which defines "property of the estate" to include debtor property "wherever located and by whomever held." Instead, the court concluded that fraudulently transferred property is not "property of the estate" unless and until it is actually recovered by the trustee. Finally, the court held that, even if the presumption against extraterritoriality were rebutted, the Trustee's use of Section 550 to reach purely foreign transfers would be precluded by concerns of international comity.

Judge Rakoff's decision once again underscores the broad reach of *Morrison* to areas beyond securities law. It also reaffirms, as discussed in a prior memo relating to the Madoff case (discussed on the Forum here), that the powers of a bankruptcy trustee are limited to those conferred by statute.