

2014

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### Recommended Citation

Edward R. Morrison, *Extraterritorial Avoidance Actions: Lessons from Madoff*, 9 Brook. J. Corp. Fin. & Com. L. (2014).  
Available at: <http://brooklynworks.brooklaw.edu/bjcfcl/vol9/iss1/8>

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# EXTRATERRITORIAL AVOIDANCE ACTIONS: LESSONS FROM MADOFF

*Edward R. Morrison*\*

The Madoff case continues to provide fertile ground for testing boundaries of the U.S. Bankruptcy Code (Code). In July 2014, Judge Rakoff issued an important decision regarding the extraterritorial scope of the Code's avoidance rules.<sup>1</sup> The Trustee for the Madoff Estate, Irving Picard, sought to recover cash withdrawn by "feeder funds." These funds pooled customer assets, invested them in Bernard L. Madoff Investment Securities (Madoff Securities), withdrew proceeds from the investment prior to Madoff's SIPA filing, and distributed the proceeds to customers before the funds themselves collapsed.<sup>2</sup> The funds are located abroad: one, Fairfield Sentry, is a British Virgin Islands (BVI) entity; another, Harley International, is a Cayman Islands fund.<sup>3</sup> Both have commenced insolvency proceedings in their relevant jurisdictions.<sup>4</sup>

The proceeds paid by Madoff to the feeder funds were part of a Ponzi scheme and, therefore, presumptively fraudulent transfers.<sup>5</sup> The Trustee

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1. *SIPC v. Bernard L. Madoff Inv. Sec. (In re Madoff Securities)*, 513 B.R. 222 (S.D.N.Y. 2014). Judge Rakoff addressed the extraterritorial application of §§ 548(a)(1)(a) and 550(a) of the Code. Section 548(a)(1)(a) permits avoidance of fraudulent transfers that were executed "with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted." 11 U.S.C. § 548(a)(1)(a) (2006). If a transfer is avoided under § 548, § 550(a) permits the trustee to "recover . . . 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." *Id.* § 550(a).

2. *In re Madoff Securities*, 513 B.R. at 225.

3. *Id.*

4. *Id.* at 232. Many of the feeder customers are also located abroad, including CACEIS Bank Luxembourg and CACEIS Bank of France. *Id.* at 225.

5. The transfers were attacked as fraudulent transfers under both federal bankruptcy law and New York Debtor Creditor Law. See *Picard v. Fairfield Sentry Ltd.*, Adv. Pro. No. 09-1239, at \*3 (Bankr. S.D.N.Y. July 20, 2010); *Picard v. Harley Int'l (Cayman) Ltd.*, Adv. Pro. No. 09-01187, at \*3 (Bankr. S.D.N.Y. May 12, 2009). Under both laws, transfers in connection with a Ponzi scheme are presumed to be fraudulent transfers done with intent to hinder, delay, or defraud creditors. See, e.g., *In re Bernard L. Madoff Investment Securities LLC*, 458 B.R. 87, 104-05 (Bankr. S.D.N.Y. 2011) ("As a matter of law, the 'Ponzi scheme presumption' establishes the debtors' fraudulent intent as required under both the [Bankruptcy] Code and the [New York Debtor Creditor Law] . . . . The breadth and notoriety of the Madoff Ponzi scheme leave no basis for disputing the application of the Ponzi scheme presumption to the facts of this case, particularly in light of Madoff's criminal admission."); see generally *In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 8 (S.D.N.Y. 2007) ("There is a general rule—known as the 'Ponzi scheme presumption'—that such a scheme demonstrates 'actual intent' as matter of law because 'transfers made in the course of a Ponzi scheme could have been made for no purpose other than to hinder, delay or defraud creditors.'" (citations omitted)).

first brought suit against the funds as initial transferees under § 550(a)(1).<sup>6</sup> He obtained a default judgment against one (Harley) and settled with the other (Fairfield), but obtained incomplete recoveries overall.<sup>7</sup> So he turned next to the funds' customers as subsequent transferees under § 550(a)(2).<sup>8</sup>

The case, for the purposes of this Article, starts here. The Trustee was attempting to recover (a) assets located abroad that were (b) transferred to foreign transferee by (c) a foreign transferor. Does § 550 reach such an extraterritorial transfer?

Judge Rakoff said no.<sup>9</sup> In his view, the Trustee sought extraterritorial application of a statute (§ 550) that has no obvious extraterritorial application.<sup>10</sup> He held that both the presumption against extraterritoriality and the doctrine of international comity bar the Trustee's suit.<sup>11</sup>

Judge Rakoff might be wrong. The Trustee was pursuing a fraudulent transfer that occurred onshore by a domestic debtor. The money moved offshore, but that does not change the underlying focus of the Trustee's suit, which is tracing a transfer from its domestic origin to its final resting place. Even if tracing seems to require an extraterritorial application of § 550, it is fairly straightforward to show that this section overcomes the presumption against extraterritoriality and that its extraterritorial application poses no international comity issues. While arguments can be made on the other side, they are strained.

The issues at play in Judge Rakoff's decision are complex. Part I develops a basic intuition for why we might question his decision. Part II turns to the opinion and explores reasons why Judge Rakoff could have reached the opposite conclusion with respect to the three key issues in the case: (i) whether the Trustee sought extraterritorial application of § 550; (ii) whether these sections overcome the presumption against extraterritoriality; and (iii) whether international comity prevents the Trustee from suing the fund customers.

## I. INTUITION

The principal difficulty with Judge Rakoff's decision is that it creates a loophole in avoidance actions. A transfer can be immunized from recovery

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6. *SIPC v. Bernard L. Madoff Inv. Sec. LLC*, 501 B.R. 26, 28–29 (S.D.N.Y. 2013) (describing initial suit against feeder funds). *See also* *Picard v. Fairfield Sentry Ltd.*, Adv. Pro. No. 09-1239, at \*32 (Bankr. S.D.N.Y. July 20, 2010) (“As a result of the foregoing, pursuant to sections 548(a)(1)(A), 550(a), and 551 of the Bankruptcy Code, the Trustee is entitled to a judgment . . . .”); *Picard v. Harley Int’l (Cayman) Ltd.*, Adv. Pro. No. 09-01187, at \*21 (Bankr. S.D.N.Y. May 12, 2009) (same).

7. *In re Madoff Securities*, 513 B.R. at 225–26.

8. *Id.* at 225.

9. *Id.* at 231.

10. *Id.*

11. *Id.*

simply by interposing a foreign-based transferee between the debtor and the ultimate foreign beneficiary.

It may be helpful to begin with the observation that the Trustee brought two suits—one against the feeder funds and another against the funds' customers.<sup>12</sup> In both, the Trustee was exercising authority under the Code to recover property transferred from the debtor's estate prior to case commencement and in violation of fraudulent transfer or other avoidance rules.<sup>13</sup> The feeder funds were initial transferees under § 550(a)(1) and their customers were subsequent transferees under § 550(a)(2). I am unaware of caselaw suggesting that the first suit is controversial, or that the funds could have avoided liability by arguing that the Trustee's suit against them requires an extraterritorial application of § 550. But the first (seemingly uncontroversial) suit is similar to the second: both the recoverable assets and the transferee-defendants are located abroad.

The suits appear to differ in two key respects. First, they differ with respect to *where* the transaction occurred. In the first suit, the Trustee attacked a transfer by a domestic entity (Madoff) on U.S. soil.<sup>14</sup> In the second, he attacked a transfer by a foreign entity on foreign soil. This difference makes the transaction in the second suit look like a “purely foreign transfer[,]” as Judge Rakoff put it,<sup>15</sup> while the transaction in the first suit has a clear domestic connection. In the abstract, this is an important distinction. Recent caselaw supports the proposition that “purely foreign transfers” are beyond the scope of the Code's avoidance provisions and § 550.<sup>16</sup> But in the context of this particular case, the distinction is problematic. The transfers between the funds and their customers were not “purely foreign.” These transfers were reconveyances of property taken from the domestic estate of Madoff Securities. The Trustee was just following the money from its U.S. source.

Indeed, if we take Judge Rakoff's distinction seriously, odd things happen. The Trustee can recover Madoff's transfers to customers if those transfers are executed onshore, but not if they occurred offshore. If Madoff wires funds from his New York account to London-based investors, the Trustee can bring suit against those investors. But if Madoff carries a briefcase full of cash to London and then hands the cash to his investors, the Trustee apparently cannot bring suit because the cash handoff was a “purely foreign transfer.”<sup>17</sup>

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12. The separate suits are described in *id.* at 225–26, and *SIPC v. Bernard L. Madoff Investment Securities LLC*, 501 B.R. 26, 28–29 (S.D.N.Y. 2013).

13. *Bernard L. Madoff Inv. Sec. LLC*, 501 B.R. at 28–29.

14. *Id.* at 29.

15. *In re Madoff Securities*, 513 B.R. at 232.

16. See discussion of *Morrison v. Nat'l Austl. Bank*, 561 U.S. 247 (2010), *infra*, Part II.A.

17. *In re Madoff Securities*, 513 B.R. at 232.

A second important difference between a suit against the funds and a suit against the customers is the expectation of the defendants. In the first suit, the defendant funds should have been well aware that their dealings with Madoff Securities exposed them to U.S. law. The feeder funds were, after all, investing the bulk of their customers' assets in Madoff Securities.<sup>18</sup> In the second suit, however, the foreign customers were potentially unaware of such exposure. They may not have known that their assets would be invested in Madoff Securities (though this is contested by the Trustee).<sup>19</sup> The difference in expectations is important, but seems relevant to whether the customers have a good faith defense,<sup>20</sup> not whether the Trustee's suit runs aground on the presumption against extraterritoriality or international comity.

## II. THE OPINION

Judge Rakoff's decision rests on two doctrines: the presumption against extraterritoriality and international comity. These doctrines are tools of statutory interpretation.<sup>21</sup> They apply when there is an attempt to enforce a statute extraterritorially but (i) it's unclear whether the statute is intended to have extraterritorial application generally, and (ii) even if the statute is intended to apply extraterritorially, it's unclear whether this particular extraterritorial application is within the intended scope of the statute.<sup>22</sup> The presumption against extraterritoriality addresses ambiguity under (i). International comity addresses ambiguity under (ii).

### A. EXTRATERRITORIAL APPLICATION?

Was the Trustee seeking extraterritorial application of § 550 of the Bankruptcy Code? Judge Rakoff must have thought so because he focused on the offshore transfer between the foreign feeder funds and their foreign investors. That's arguably the wrong focus. The right focus—as argued below<sup>23</sup> (and as Judge Lifland concluded in a related case<sup>24</sup>)—is the onshore transfer between Madoff's domestic estate and the foreign feeder funds.

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18. *Id.* at 225. Fairfield had invested over 95% of its assets in Madoff Securities. *Id.*

19. *Id.* at 232.

20. The Bankruptcy Code offers defenses to a transferee “that takes for value” and “in good faith.” See 11 USC §§ 548(c) (2006) (protecting initial transferees), 550(b) (protecting subsequent transferees).

21. See, e.g., Zachary Clopton, *Extraterritoriality and Extranationality: A Comparative Study*, 23 DUKE J. COMP. & INT'L. L. 217, 224 (2013) (“In sum, Congress can legislate extraterritorially and the courts will enforce expressly extraterritorial statutes. When congressional intent with respect to extraterritoriality is not clear, courts resort to the twin canons. The Charming Betsy rule says that courts should select reasonable interpretations of statutes consistent with the international law of prescriptive jurisdiction; the presumption against extraterritoriality tells courts to presume that ambiguous statutes apply only territorially.”).

22. *Id.* at 222–24.

23. See discussion, *infra*, Part III.

24. *Picard v. Bureau of Labor Ins.*, 480 B.R. 501 (Bankr. S.D.N.Y. 2012).

Although the trustee is suing the feeder fund's foreign investors, the trustee is tracing the funds from their domestic source to their final resting place.

Judge Rakoff began with *Morrison v. National Australia Bank*,<sup>25</sup> which instructs courts to identify “the ‘focus’ of Congressional concern” when assessing whether enforcement of a statute requires extraterritorial application.<sup>26</sup> In Judge Rakoff's view, the “focus” of concern in § 550(a) is “the transfer of property to a subsequent transferee, not the relationship of that property to a perhaps-distant debtor.”<sup>27</sup> With that focus in mind, he concluded that the Trustee was applying § 550 to “predominantly foreign” transfers and transferees:

[The] foreign feeder funds transfer[red] assets abroad to their foreign customers and other foreign transferees . . . . Although the chain of transfers originated with Madoff Securities in New York, that fact is insufficient to make the recovery of these otherwise thoroughly foreign subsequent transfers into a domestic application of section 550(a).<sup>28</sup>

Viewed this way, Judge Rakoff noted,<sup>29</sup> the case is similar to the famous *Maxwell Communications* case.<sup>30</sup> There, an examiner attempted to recover preferential transfers that were executed abroad by an English debtor to its English creditors.<sup>31</sup> Although the transferred funds originated from asset sales in the United States, these domestic sales were merely a “preparatory step” to the primarily foreign transaction.<sup>32</sup>

There are several difficulties with Judge Rakoff's analysis here. One is his application of *Morrison*. Judge Rakoff may have taken an overly narrow view of the “‘focus’ of Congressional concern” in this case.<sup>33</sup> The “focus” of concern in an actual fraudulent transfer action under § 548(a)(1)(A) (or § 544(b)(1)) is a transfer by a debtor seeking to “hinder, delay, or defraud”

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25. *Morrison v. Nat'l Austl. Bank*, 561 U.S. 247, 266 (2010) (quoting *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 255 (2006)).

26. *Morrison*, 561 U.S. at 266.

27. *SIPC v. Bernard L. Madoff Inv. Sec. (In re Madoff Securities)*, 513 B.R. 222, 227 (S.D.N.Y. 2014).

28. *Id.* at 227–28.

29. *Id.*

30. *Maxwell Commc'n Corp. plc v. Société Générale (In re Maxwell Commc'n Corp. plc)*, 186 B.R. 807 (S.D.N.Y. 1995).

31. *Id.* at 817.

32. *Id.* (“First, MCC and the Banks are all foreign entities whose relationship was centered in England. Indeed, the antecedent debts underlying the transfers arose from MCC's overdrafts on accounts maintained with the Banks in England and governed by English law. MCC repaid these debts by transferring the funds to these accounts in the U.K. The only possible U.S. connections are that the transferred funds did consist of proceeds from the sale of U.S. assets and that the sales did deplete the U.S. assets available to satisfy the claims of all creditors against MCC. However, the source of the funds is, at best, only one component of the conduct proscribed by § 547. Even assuming that the transfers were initiated in the U.S. after the U.S. assets were sold, this conduct is more appropriately characterized as a preparatory step to the transfers.”).

33. *Morrison v. Nat'l Austl. Bank*, 561 U.S. 247, 266 (2010).

its creditors.<sup>34</sup> The focus of concern in § 550(a) is tracing the fraudulent transfer to its ultimate resting place (the initial or subsequent transferee). Section 550, in other words, is a utility provision, helping execute the policy of § 548. This is apparent from the text of § 550, which permits recovery of property “to the extent that a transfer is avoided” under § 548 or other avoidance provisions of the Code.<sup>35</sup> Viewed this way, the Trustee’s suits against the foreign customers were efforts to unwind a domestic transaction (withdrawals by the funds) executed by a domestic debtor (Madoff). Although the transaction between the funds and their investors was “predominantly foreign,” the Trustee was not attacking that transaction.<sup>36</sup> The Trustee was attacking the original domestic transaction and using § 550 to trace the funds from their source (Madoff Securities) to their final destination (the foreign customers).<sup>37</sup> Although the funds ultimately settled in the hands of foreign customers, Congressional concern remains fixed on the initial transfer from Madoff’s estate.

Another difficulty in Judge Rakoff’s analysis is the analogy to *Maxwell Communications*. Although the lower courts in that case found that the presumption against extraterritoriality applied, the Second Circuit refused to reach the issue on appeal, relying instead on international comity.<sup>38</sup> It is therefore unclear whether *Maxwell Communication* offers useful guidance on this issue.

More importantly, the voidable transfer in that case occurred *offshore* by a *foreign* debtor: an English debtor favored its English creditors.<sup>39</sup> Here, the voidable transfer occurred *onshore* by a U.S. debtor: a domestic Ponzi scheme distributed U.S.-based assets to its offshore feeder funds. The subsequent movement of the assets from the funds to their customers should not change the character of the underlying voidable transfer.

This view was shared by Judge Lifland.<sup>40</sup> In related Madoff litigation filed by the Trustee against a customer of Fairfield Sentry (the Taiwanese Bureau of Labor Insurance), he reasoned that “the focus of the avoidance and recovery sections is on the initial transfers that deplete the bankruptcy

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34. Judge Rakoff stated that § 548 was “the avoidance provision that is primarily at issue in these proceedings.” *In re Madoff Securities*, 513 B.R. at 227. Section 544(b)(1) also permits avoidance of actual fraudulent transfers under applicable state law. See 11 U.S.C. § 544(b)(1). In this case, that law was New York Debtor Creditor Law § 276, which applies the same “hinder, delay or defraud” standard. See, e.g., *In re Bernard L. Madoff Sec. LLC*, 458 B.R. 87, 104 (Bankr. S.D.N.Y. 2011) (“Under section 276 of the NYDCL, a trustee similarly may avoid any ‘conveyance made with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors.’”).

35. 11 U.S.C. § 550 (2006).

36. *In re Madoff Securities*, 513 B.R. 222, 227–29 (S.D.N.Y. 2014).

37. *Id.*

38. *Maxwell Comm’n Corp. plc v. Société Générale (In re Maxwell Comm’n Corp. plc)*, 93 F.3d 1036, 1055 (2d Cir. 1996).

39. *Id.* at 1040–41.

40. *Picard v. Bureau of Labor Ins.*, 480 B.R. 501 (Bankr. S.D.N.Y. 2012).

estate and not on the recipient of the transfers or the subsequent transfers.”<sup>41</sup> Further, Judge Lifland reasoned that the text of the Code makes this focus clear:

For example, the avoidance sections focus on the transfers themselves, including the timing of the transfers, *see, e.g.*, 11 U.S.C. §§ 547(b)(4), 548(a)(1), (b), their purpose, *see, e.g.*, 11 U.S.C. § 548(a)(1)(A), and their effect on the transferor, *see, e.g.*, § 548(a)(1)(B). Further, the recovery section that governs the Trustee’s claims . . . , Section 550, is titled “Liability of transferee of avoided transfer.” . . . It makes no mention of the transfer from the initial transferee to the subsequent transferee; indeed, recovery from a subsequent transferee is grounded solely on the basis of it possessing a fraudulent transfer. . . . Moreover, as ‘a court’s recovery power is generally coextensive with its avoidance power,’ it is logical that the relevant transfer for purposes of the presumption against extraterritoriality is only the transfer that is to be avoided, namely the initial transfer.<sup>42</sup>

Applying this logic, Judge Lifland concluded that the Trustee’s suit was a domestic application of §§ 548 and 550. The depletion of the debtor’s estate occurred onshore, the Ponzi scheme was operated in the United States, and the funds were paid out in the United States. Because the focus of § 550 is on acts that deplete the estate, and those acts occurred domestically, it was irrelevant that the defendants were foreign customers who received the assets from funds located abroad. Judge Lifland distinguished *Maxwell Communications* for largely the same reasons offered above.<sup>43</sup>

## **B. PRESUMPTION AGAINST EXTRATERRITORIAL APPLICATION**

Let’s assume that the Trustee’s suit requires extraterritorial application of §§ 548 and 550. The next question is whether the statute is ambiguous with regards to its application abroad. If it is, the presumption against extraterritorial application kicks in. This is where the trustee’s case gets thorny. The caselaw on extraterritoriality is in flux, making it hard to predict when a court will find the presumption rebutted. The goal here is to show that several straightforward arguments can be used to show that §§ 548 and 550 overcome the presumption against extraterritorial application. One argument, which rests on the jurisdictional grant to the district courts in bankruptcy and SIPA proceedings, was ignored by Judge Rakoff and, it seems, the trustee too.

Neither § 548 nor § 550 includes express language indicating that these provisions apply abroad. *Morrison* suggests that this might be enough to

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41. *Id.* at 524.

42. *Id.*

43. *Id.*



trigger the presumption against extraterritoriality.<sup>44</sup> That case involved § 10(b) of the Securities and Exchange Act of 1934, which reads:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of *interstate commerce* or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe . . . .<sup>45</sup>

The plaintiffs in *Morrison* were Australians who held shares issued by an Australian corporation, purchased in Australia, and traded on Australian exchanges.<sup>46</sup> They sought to apply § 10(b) to fraud committed abroad by the Australian corporation, which owned assets in the United States. The plaintiffs argued that § 10(b) applies extraterritorially because it uses the term “interstate commerce,” which is defined as “trade, commerce, transportation, or communication . . . between any *foreign country* and any State.”<sup>47</sup> The Court disagreed. The reference to “foreign country” was insufficient, in the Court’s view, to overcome the presumption against extraterritoriality.<sup>48</sup> Although the statute encompasses any “person” engaged in domestic or foreign commerce, it targets only deception involving “purchases and sales of securities in the United States.”<sup>49</sup>

Just as there was no “clear indication of extraterritoriality” in *Morrison*,<sup>50</sup> there is no “clear indication” in §§ 548 and 550 either. Of course, context must be consulted in interpreting a statute. In *Morrison*, the Supreme Court found no extraterritorial indications in related provisions of the Securities and Exchange Act.<sup>51</sup> Context is potentially more helpful in Madoff’s case.

Section 548 permits recovery of “an interest of the debtor in property.”<sup>52</sup> The word “property” is not defined in § 548 (or § 101<sup>53</sup>) and most courts, including the Supreme Court,<sup>54</sup> have turned to § 541 to give that word meaning. In that section, “property of the estate” includes any “legal or equitable interest” in property that exists at the commencement of

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44. *Morrison v. Nat’l Austl. Bank*, 561 U.S. 247, 254 (2010).

45. 15 U.S.C. § 78j(b) (2010) (emphasis added).

46. *Morrison*, 561 U.S. at 250–53.

47. 15 U.S.C. § 78c(a)(17) (2010) (emphasis added).

48. *Morrison*, 561 U.S. at 262–63.

49. *Id.*

50. *Id.*

51. *Id.* at 262–65.

52. 11 U.S.C. § 548(a) (2006).

53. § 101 defines some, but not all, terms of art used in the Code. *Id.* § 101 (2006).

54. *Begier v. IRS*, 496 U.S. 53 (1990).

the case,<sup>55</sup> is recovered via avoidance actions,<sup>56</sup> or enters the debtor's bankruptcy estate by other means.<sup>57</sup> Importantly, property of the estate includes legal or equitable interests "wherever located and by whomever held."<sup>58</sup> This phrase has generally been seen as evidence that § 541 has extraterritorial application,<sup>59</sup> allowing a trustee or debtor in possession to recover property located abroad.<sup>60</sup> If the definition of "property" in § 541 applies extraterritorially, and if the same definition is used by § 548, might we conclude that § 548 also applies extraterritorially?

That is the implication of several Fifth Circuit decisions. In at least two cases, the court has held that "property of the estate" at *commencement* includes property interests that could be recovered via avoidance actions under §§ 547 and 548.<sup>61</sup> Because these sections allow a debtor in possession (or trustee) to recover voidable pre-petition transfers, the logic goes, the debtor's estate at commencement includes at least an *equitable* interest in the property that was transferred in connection with these voidable pre-petition transfers.<sup>62</sup> These cases imply that avoidance actions under § 548 are essentially actions to recover property of the estate.<sup>63</sup> This in turn implies that § 548 applies extraterritorially because it is an effort to recover "legal or equitable" interests of the debtor "wherever located."<sup>64</sup> Under this

55. 11 U.S.C. § 541(a)(1) (2006).

56. *Id.* § 541(a)(3).

57. See generally subsections of § 541(a), especially § 541(a)(7).

58. 11 U.S.C. § 541(a).

59. *French v. Liebmann (In re French)*, 440 F.3d 145, 151 (4th Cir. 2006) ("Pursuant to § 541 of the Bankruptcy Code, all of a debtor's property, whether domestic or foreign, is 'property of the estate' subject to the bankruptcy court's in rem jurisdiction. See *Hong Kong & Shanghai Banking Corp., Ltd. v. Simon (In re Simon)*, 153 F.3d 991, 996 (9th Cir.1998) . . . . Section 541 defines the property of the estate broadly as all property 'wherever located.' 11 U.S.C. § 541(a) (2000). This phrase first appeared in the Bankruptcy Code in 1952; Congress explained that the amendment 'make[s] clear that a trustee in bankruptcy is vested with the title of the bankrupt in property which is located without, as well as within, the United States.' H.R.Rep. No. 82-2320, at 15 (1952), *reprinted in* 1952 U.S.C.C.A.N. 1960, 1976. Thus, 'property of the estate' includes both foreign and domestic property.").

60. *But see* T. Brandon Welch, Comment, *The Territorial Avoidance Power of the Bankruptcy Code*, 24 EMORY BANKR. DEV. J. 553, 564-65 (2008) (arguing that the "'wherever located' language of § 541(a) reflects the type of statutory boilerplate the presumption against extraterritoriality was conceived to defeat . . . . Even though the language of § 541(a) comprises simple words, non-domestic application still requires inference. Such inference precludes the affirmative evidence of congressional intent necessary to apply § 541 extraterritorially.").

61. *Cullen Ctr. Bank & Trust v. Hensley (In re Criswell)*, 102 F.3d 1411, 1417 (5th Cir. 1997); *Am. Nat'l Bank v. MortgageAmerica Corp. (In re MortgageAmerica Corp.)*, 714 F.2d 1266, 1275 (5th Cir. 1983).

62. *In re Criswell*, 102 F.3d at 1417 ("when a soon-to-be-bankrupt debtor . . . fraudulently transfers property to shield it from his creditors, that debtor/transferor should be considered to have retained an *equitable* interest in the property so that it will continue to be considered 'property of the estate.'").

63. The trustee made largely the same argument, as Judge Rakoff discusses in *SIPC v. Bernard L. Madoff Inv. Sec. (In re Madoff Securities)*, 513 B.R. 222, 228-29 (S.D.N.Y. 2014).

64. *In re Madoff Securities*, 513 B.R. at 228-29.

view, recovery of property under § 550 is analogous to the turnover authority of § 542.

A difficulty with this “clever”<sup>65</sup> theory is that, if taken seriously, it means that the automatic stay applies to property transferred prior to the filing. This author is unaware of a court that has taken this position. A greater difficulty, at least for Madoff-related litigation, is that the theory has been rejected by the Second Circuit.<sup>66</sup> Key to the theory is the notion that property of the estate *at commencement* includes property that can be recovered via avoidance actions. This interpretation of the statute is arguably inconsistent with the structure of § 541. Subsection (a)(1), includes as property of the estate “all legal or equitable interests of the debtor in property as of the commencement of the case.”<sup>67</sup> Subsection (a)(3) *additionally* includes “[a]ny interest in property that the trustee recovers under section . . . 550.”<sup>68</sup> This implies, the Second Circuit held in *Colonial Realty*, that property of the estate *at commencement* does not include property that can be recovered via avoidance actions.<sup>69</sup> The court concluded that “the inclusion of property recovered by the trustee pursuant to his avoidance powers in a separate definitional subparagraph clearly reflects the congressional intent that such property is not to be considered property of the estate until it is recovered.”<sup>70</sup>

This analysis (apparently) shuts down one argument for § 548’s extraterritorial application.<sup>71</sup> But the Fourth Circuit has pointed to another, simpler argument in *In re French*.<sup>72</sup>

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. . . . Through this incorporation, Congress made manifest its intent that § 548 apply to all property that, absent a prepetition transfer, would have been property of the estate, wherever that property is located.<sup>73</sup>

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65. Judge Rakoff called the theory “clever,” but “neither logical nor persuasive” in light of *F.D.I.C. v. Hirsch (In re Colonial Realty)*, 980 F.2d 125 (2d Cir. 1992), as discussed in the next paragraph. See *Madoff Securities*, 513 B.R. at 229.

66. *In re Colonial Realty*, 980 F.2d 125.

67. 11 U.S.C. § 541(a)(1) (2006).

68. 11 U.S.C. § 541(a)(3).

69. *In re Colonial Realty*, 980 F.2d at 131.

70. *Id.* (quoting *In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989)).

71. Actually, the Second Circuit’s decision may not be inconsistent with the Fifth Circuit approach. The debtor’s estate at commencement includes an *equitable* interest in property previously conveyed to third parties via voidable transfers. A *possessory* interest enters the estate when the property is recovered under Section 550(a)(2).

72. *French v. Liebmann (In re French)*, 440 F.3d 145 (4th Cir. 2006) (although this case predates *Morrison*, the court applied the same “clear statement” rule).

73. *Id.* at 151–52.

This argument is compelling, but potentially debatable because it predates the Supreme Court's decision in *Morrison*, which requires a "clear indication" that a statute applies extraterritorially.<sup>74</sup>

Judge Rakoff rejected the Fourth Circuit approach in *French*<sup>75</sup> because it is, in his view, inconsistent with the Second Circuit's analysis in *Colonial Realty*. He also argued that *French* is factually distinguishable from the case at hand.<sup>76</sup> Both arguments are problematic. First, *Colonial Realty* rejects the theory that the debtor's estate at commencement includes property that can be recovered via avoidance actions.<sup>77</sup> *French* does not rest on that theory. Indeed, the Fourth Circuit made clear that it was taking no position on the correctness of the theory.<sup>78</sup> Second, although *French* is factually distinguishable from the Madoff case, that distinction has little or no bearing on whether the Fourth Circuit's approach is a convincing test of Congressional intent regarding the extraterritorial reach of §§ 548 and 550.

There is another, perhaps more powerful argument for the extraterritorial reach of §§ 548 and 550. The argument begins with 28 U.S.C. § 1334(e), which gives district courts exclusive jurisdiction over "all the property, wherever located, of the debtor as of the commencement of the case, and of the property of the estate."<sup>79</sup> Here we see the same extraterritorial language as we see in § 541 ("wherever located"). But the extraterritorial language in § 1334 applies to both "property of the estate" and "property of the debtor."<sup>80</sup> The latter encompasses "property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings."<sup>81</sup> Applying these principles, it seems fairly straightforward to conclude that funds transferred by Madoff Securities via voidable prepetition transfers are "property of the debtor" at

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74. The Fourth Circuit did, however, apply the *Aramco* standard—that Congressional intent must be clearly expressed in order to overcome the presumption against extraterritoriality. *Id.* at 151 ("Although the presumption against extraterritoriality is important to 'protect against unintended clashes between our laws and those of other nations which could result in international discord,' it nevertheless must give way when Congress exercises its undeniable 'authority to enforce its laws beyond the territorial boundaries of the United States.'" (quoting *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (*Aramco*))). This is the same standard applied by *Morrison*, at 255 ("Thus, 'unless there is the affirmative intention of the Congress clearly expressed' to give a statute extraterritorial effect, 'we must presume it is primarily concerned with domestic conditions.' *Aramco*, at 248, 111 S. Ct. 1127 (internal quotation marks omitted).").

75. *SIPC v. Bernard L. Madoff Inv. Sec. (In re Madoff Securities)*, 513 B.R. 222, 230 n.2. (S.D.N.Y. 2014).

76. *Id.*

77. *F.D.I.C. v. Hirsch (In re Colonial Realty)*, 980 F.2d 125, 131 (2nd Cir. 1992).

78. *French v. Liebmann (In re French)*, 440 F.3d 145, 151 n.2 (4th Cir. 2006).

79. 28 U.S.C. § 1334(e) (2006).

80. *Id.* ("The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction—(1) of all the *property*, wherever located, *of the debtor* as of the commencement of such case, and of *property of the estate* . . .") (emphasis added).

81. *Begier v. I.R.S.*, 496 U.S. 53, 65 (1990).

case commencement.<sup>82</sup> Whether those funds sit on- or off- shore is irrelevant because § 1334(e) provides courts with jurisdiction over property “wherever located.”

### C. INTERNATIONAL COMITY

Like the presumption against extraterritoriality, international comity is a canon of statutory interpretation.<sup>83</sup> Indeed, there is considerable overlap between the two interpretive doctrines. The presumption against extraterritoriality asks whether Congress intended application of the statute abroad.<sup>84</sup> Even if a statute applies abroad, the comity doctrine asks whether a particular application of the law to foreign conduct is consistent with the statute’s intent.<sup>85</sup> Roughly speaking, the presumption against extraterritoriality asks a threshold question (Does this law apply abroad?) while comity asks a scope question (To what conduct abroad does the law apply?).<sup>86</sup>

82. This “seems straightforward” because the Madoff “bankruptcy” was a proceeding under the Securities Investor Protection Act (SIPA), 15 U.S.C. §§ 78aaa–78lll (2012), which vests the trustee in such a proceeding with the same powers as a bankruptcy trustee. *See* 15 U.S.C. § 78fff-1. The district court’s jurisdiction in a SIPA proceeding is coextensive with its jurisdiction in a bankruptcy case. *See* 15 U.S.C. § 78eee(b)(2)(A)(iii).

83. *In re Maxwell Commc’n Corp. plc*, 93 F.3d 1036, 1044 (2d Cir. 1996). The focus in this essay is on the “prescriptive jurisdiction” branch of international comity, not “comity of courts.” *See generally* *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 817 (1993) (Scalia, J., dissenting) (“More recent lower court precedent has also tempered the extraterritorial application of the Sherman Act with considerations of ‘international comity.’ . . . The ‘comity’ they refer to is not the comity of courts, whereby judges decline to exercise jurisdiction over matters more appropriately adjudged elsewhere, but rather what might be termed ‘prescriptive comity’: the respect sovereign nations afford each other by limiting the reach of their laws. That comity is exercised by legislatures when they enact laws, and courts assume it has been exercised when they come to interpreting the scope of laws their legislatures have enacted. It is a traditional component of choice-of-law theory. *See* J. Story, *Commentaries on the Conflict of Laws* § 38 (1834) (distinguishing between the ‘comity of the courts’ and the ‘comity of nations,’ and defining the latter as ‘the true foundation and extent of the obligation of the laws of one nation within the territories of another’).”).

84. *See supra* Part II.B.

85. *Maxwell Commc’n Corp. plc v. Société Générale (In re Maxwell Commc’n Corp. plc)*, 93 F.3d 1036, 1044 (2d Cir. 1996).

86. The difference between the doctrines is illustrated by *F. Hoffman-LaRoche v. Empagran*, 542 U.S. 155 (2004). That case involved the Foreign Trade Antitrust Improvements Act (FTAIA), which makes the Sherman Act applicable abroad, but only when the anticompetitive conduct has a “direct, substantial, and reasonably foreseeable effect” on domestic commerce, imports, or American exporters. *Id.* at 159 (quoting 15 U.S.C. § 6a (2014)). The presumption against extraterritoriality is overcome both in the FTAIA and in the Sherman Act. The FTAIA expressly applies the Sherman Act abroad, and the Sherman Act has long been interpreted to apply extraterritorially. *Id.* at 169–70. Indeed, the presumption is nowhere mentioned in the Supreme Court’s opinion. But the comity doctrine was still relevant to the Court’s analysis because, even if these statutes applied abroad, it remained unclear whether Congress intended the statutes to capture foreign actions that cause foreign harms. The Court concluded that, absent express language to the contrary, it would be unreasonable to assume Congress wanted to regulate foreign conduct that causes foreign harms. *Id.* at 169 (“Where foreign anticompetitive conduct plays a significant role and where foreign injury is independent of domestic effects, Congress might have

This means that, even if §§ 548 and 550 apply extraterritorially, the comity doctrine can help delimit the scope of that extraterritorial reach. The key question, however, is whether the statute is ambiguous about its scope. Comity is only an interpretive tool.

There is little or no ambiguity about the scope of §§ 548 and 550. Section 548 avoids fraudulent transfers; § 550 recovers the transferred interests from immediate and subsequent transferees. Unlike *Empagran*, where the text of the statutes at hand could have reached foreign conduct that causes no domestic harms, §§ 548 and 550 have expressly limited scope: in a case involving a domestic debtor (such as Madoff's estate), they can be used only to recover property that would have been part of the debtor's (domestic) estate, had there been no voidable transfer. Put differently, the statutes are drafted in such a way that any extraterritorial application will be closely connected to a domestic harm (the harm to creditors from voidable transfers).

At a more fundamental level, international comity seeks to avoid conflict between domestic and international law. "International comity comes into play only when there is a true conflict between American law and that of a foreign jurisdiction."<sup>87</sup> A "true conflict" exists when compliance with the laws of both countries is impossible.<sup>88</sup> This can occur when U.S. law forbids conduct that is mandated by foreign law. It can also occur, in a bankruptcy context, if it is "impossible to distribute the debtor's assets in a manner consistent with both rules."<sup>89</sup> In *Maxwell*, for example, the examiner sought to recover pre-petition transfers made by a U.K. debtor to a U.K. bank.<sup>90</sup> The transfer was potentially voidable under U.S. law (§ 547) but not under U.K. law.<sup>91</sup> This difference in law, the Second Circuit held, created a "true conflict" because the debtor's assets could not be distributed in "a manner consistent with both rules."<sup>92</sup>

In Madoff's case, by contrast, the Trustee's suit against foreign customers does not raise the specter of a *true conflict*. To be sure, Judge Rakoff emphasized that the feeder funds commenced their own insolvency proceedings abroad, and that the laws of these foreign jurisdictions differ from U.S. law.<sup>93</sup> In *Fairfield Sentry's* case, for example, the BVI courts

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hoped that America's antitrust laws, so fundamental a component of our own economic system, would commend themselves to other nations as well. But, if America's antitrust policies could not win their own way in the international marketplace for such ideas, Congress, we must assume, would not have tried to impose them, in an act of legal imperialism, through legislative fiat.").

87. *In re Maxwell*, 93 F.3d at 1049.

88. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 799 (1993).

89. *In re Maxwell*, 93 F.3d at 1050.

90. *Id.* at 1040–41.

91. *Id.* at 1050.

92. *Id.*

93. *SIPC v. Bernard L. Madoff Inv. Sec. (In re Madoff Securities)*, 513 B.R. 222, 232 (S.D.N.Y. 2014).

have “already determined that Fairfield Sentry could not reclaim transfers made to its customers under certain common-law theories.”<sup>94</sup> That determination by the BVI courts, Judge Rakoff said, is “in conflict with what the Trustee seeks to accomplish here.”<sup>95</sup>

That’s not quite right. If the Trustee were seeking to apply U.S. law to the foreign feeder funds, then there would indeed be a conflict. It would be the same conflict that we saw in *Maxwell Communications*. But the Trustee is instead seeking to apply U.S. law to a U.S. Debtor (*Madoff Securities*). Although foreign law does not require the foreign customers to return assets to the *feeder funds*, U.S. law does require them to return those assets to *Madoff Securities*. There is no conflict. From the perspective of the foreign insolvency proceedings, the Trustee’s suit is a dispute between two third parties, the resolution of which has no bearing on the administration of the foreign proceedings.

The Trustee’s suit, therefore, creates no conflict with foreign law. Nor is there ambiguity about the scope of §§ 548 and 550. Nonetheless, many courts consider the “center of gravity” of a transaction when they assess whether international comity bars application of U.S. law to the transaction.<sup>96</sup> Here, Judge Rakoff noted that the foreign customers “had no reason to expect that U.S. law would apply to their relationships with the feeder funds” and that the “foreign jurisdictions have a greater interest in applying their own laws than does the United States.”<sup>97</sup>

Judge Rakoff was implicitly relying on the multi-factor test set out by the widely applied § 403 of the *Restatement (Third) of Foreign Relations Law*.<sup>98</sup> The various factors boil down to three questions: (i) What is the relevant activity?; (ii) How weighty are the United States’ interests in the relevant activity or the person responsible for it?; and (iii) To what extent

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94. *Id.*

95. *Id.*

96. *See, e.g., In re Maxwell*, 93 F.3d at 1044; *In re Florsheim Grp. Inc.*, 336 B.R. 126, 130 (Bankr. N.D. Ill. 2005); *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991).

97. *In re Madoff Securities*, 513 B.R. at 232.

98. For a succinct summary of the factors, *see Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 818–19 (1993) (Scalia, J., dissenting) (“Under the Restatement, a nation having some ‘basis’ for jurisdiction to prescribe law should nonetheless refrain from exercising that jurisdiction ‘with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable.’ Restatement (Third) § 403(1). The ‘reasonableness’ inquiry turns on a number of factors including, but not limited to: ‘the extent to which the activity takes place within the territory [of the regulating state],’ *id.*, § 403(2)(a); ‘the connections, such as nationality, residence, or economic activity, between the regulating state and the person principally responsible for the activity to be regulated,’ *id.*, § 403(2)(b); ‘the character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted,’ *id.*, § 403(2)(c); ‘the extent to which another state may have an interest in regulating the activity,’ *id.*, § 403(2)(g); and ‘the likelihood of conflict with regulation by another state,’ *id.*, § 403(2)(h).”).

does extraterritorial application conflict with foreign law or the expectations of the foreign defendants?

Judge Rakoff emphasized question (iii), but the Trustee questioned whether the foreign customers were truly unaware that they were investing in Madoff Securities and potentially subject to U.S. law.<sup>99</sup> Putting that aside, however, questions (i) and (ii) suggest that the United States is a plausible “center of gravity” in this case. With respect to (i), the “relevant activity” is a fraudulent transfer of monies by a U.S.-based Ponzi scheme from U.S.-based accounts. The Trustee’s suit is following the money to its final resting place. With respect to question (ii), the relevant issues include “the connections . . . between the regulating state and the person principally responsible for the activity to be regulated”<sup>100</sup> and “the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted.”<sup>101</sup> There is a direct connection between the United States and a domestic Ponzi scheme that defrauded many domestic investors by transferring funds to foreign funds that existed solely to invest in the Ponzi scheme. The importance of fraudulent transfer laws to the United States, and their general acceptance globally, is shown by their ancient origin (dating at least to the Statute of 13 Elizabeth in 1570<sup>102</sup>) and enforcement throughout the United States and most countries. Of course, any multi-factor test can be bent to the user’s purpose. The point here is that the “center of gravity” does not point in an obvious way to jurisdictions outside the United States.

This is not to say that the expectations of foreign customers are unimportant. They are not decisive in this case for purposes of international comity, but they are relevant to the defenses available to the customers. Their expectations may show that they lacked knowledge of the voidability of the transfers and may therefore benefit from the § 550(b) defense.

## CONCLUSION

The foregoing analysis suggests that neither the presumption against extraterritoriality nor international comity should be a barrier to clawing

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99. See Trustee’s Memorandum of Law in Opposition to Defendant’s Motion to Dismiss Concerning Extraterritoriality as Ordered by the Court on June 6, 2012 at 4, *SIPC v. Bernard L. Madoff Investment Securities LLC* (*In re Madoff Securities*), 501 B.R. 26 (ECF No. 310) (“The Moving Defendants received initial and/or subsequent transfers of fraudulent conveyances of BLMIS customer property. They include . . . Feeder Fund investors who invested in both U.S. and non-U.S. based Feeder Funds knowing that all, or nearly all, of the Feeder Funds’ assets were to be forwarded to BLMIS, which maintained custody of the assets purportedly to invest in U.S. Securities and U.S. Treasuries.”).

100. RESTATEMENT (THIRD) OF CONFLICT OF LAWS § 403(2)(c) (1987).

101. *Id.* at § 403(2)(e).

102. On the origins of fraudulent conveyance law, see, e.g., *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 541 (1994).



back pre-petition fraudulent transfers by a domestic debtor such as Madoff Securities. The trustee's (or debtor's) authority to recover the fraudulent transfer does not disappear because the initial transferee is located abroad. Nor does it disappear if that offshore transferee reconveys the assets to another transferee located abroad.

The focus in this essay has been on the presumption against extraterritoriality and international comity because they are the barriers identified by Judge Rakoff. There are other, potentially insurmountable barriers to clawing back fraudulent transfers that have wound their way into the hands of foreign transferees (initial or subsequent). One of these barriers is personal jurisdiction. Another is enforcement of a U.S. court's judgment by a foreign court. Even if a U.S. court concludes that exercising personal jurisdiction is consistent with the requirements of due process in the United States, the foreign court may find that enforcing the judgment would be inconsistent with fundamental principles of its law.<sup>103</sup> These are the obstacles—not the presumption against extraterritoriality or international comity—that should have worried the litigants and the court.

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103. A recent example of this phenomenon is offered by *Rubin v Eurofinance SA*, [2012] UKSC 46. The Bankruptcy Court for the Southern District of New York issued a default judgment against the debtor's shareholders and managers, all of whom resided abroad and none of whom appeared in the court or participated in the bankruptcy case. *Rubin v. Roman (In re The Consumers Trust)*, Ch. 11 Case No. 05-60155 (REG), Adv. No. 07-03138 (REG), (Bankr. S.D.N.Y. July 18, 2008). The court held that it could exercise personal jurisdiction over the defendants because of their contacts with the United States. *Id.* at 23–24 (“The Defendants specifically sought out the United States as a place to do business and specifically sought out U.S. merchants and U.S. consumers with whom to do business.”). The debtor's trustee subsequently sought to enforce the judgment in the United Kingdom. In a closely-watched case, the U.K. Supreme Court held that the bankruptcy court's judgment was not enforceable under English law because the defendants had not submitted to the jurisdiction of the U.S. bankruptcy court. *Rubin*, [2012] UKSC at 47–48. Absent that submission, longstanding English common law (Dicey Rule 36) bars enforcement of the judgment in the U.K. *Id.* Technically, the court found that some of the defendants had not submitted to the bankruptcy court's jurisdiction. With respect to the others, no argument was made during the U.K. proceedings that they had submitted to the court's jurisdiction (though a plausible argument could be made that they had).