

Safer Harbor: Foreign Transactions May Be Beyond The Reach of a Bankruptcy Trustee

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A recent decision by Judge Jed Rakoff of the District Court for the Southern District of New York, *Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities LLC*, provides reassurance to foreign investors in off-shore funds that payments they receive are beyond the reach of avoidance actions brought under the U.S. bankruptcy laws.

The Madoff decision concerned actions brought by Irving Picard, the trustee in the Madoff liquidation, against foreign persons and entities that had invested in foreign so-called feeder funds that in turn invested in Madoff Securities. The trustee alleged that feeder funds had received fraudulent conveyances from Madoff Securities, and further alleged the defendants in question were liable as “subsequent transferees” of those fraudulent conveyances pursuant to section 550(a) of the Bankruptcy Code. Section 550(a) generally provides that an avoidable transfer (such as a fraudulent conveyance) can be recovered from a subsequent transferee unless the subsequent transferee received the transfer in good faith and for value.

Judge Rakoff ruled that section 550 should not be applied to transfers that took place entirely outside of the United States. He reasoned that U.S. laws are presumed not to be applied to transactions outside the United States unless the statute clearly states that extraterritorial application is intended, and found no clear expression of extraterritorial intent in section 550. As an alternative basis for his decision, Judge Rakoff ruled that U.S. bankruptcy law should not be applied to foreign transactions as a matter of comity. Accordingly, he ruled that the trustee could not avoid transfers made from foreign feeder funds to their foreign investors.

One particular notable point of the decision is that a transaction is considered foreign for these purposes even if the defendants used correspondent banks in the United States. Instead, what is dispositive is that both the feeder fund and its investor are foreign.



It is expected that the trustee will appeal this decision to the Court of Appeals for the Second Circuit, so the final word in this regard has not been spoken.

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