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Dozens of Madoff clawback cases dismissed as out of reach of U.S. Courts

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On Monday, November 22, Judge Bernstein of the U.S. Bankruptcy Court dismissed the majority of nearly 100 lawsuits brought by Irving H. Picard (the "Trustee"), the trustee for the liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS"), against dozens of defendants, including Koch Industries, to recover nearly $2 billion in profits from Madoff's Ponzi scheme held in offshore accounts.

Bankruptcy Code § 550(a)(2) permits a trustee to recover an avoided fraudulent transfer or its value from "any immediate or mediate transferee." In a number of the cases brought by the Trustee, the initial transferee was a foreign feeder fund and the subsequent transferee was also a foreign entity. The cases resolved by Judge Bernstein on Monday primarily concerned the application of section 550(a)(2) to subsequent transfers between foreign parties.

Importantly, in a 2014 earlier decision, Judge Rakoff of the Federal District Court for the Southern District of New York held that the Trustee could not pursue recovery of "purely foreign subsequent transfers" due to the application of the presumption against extraterritoriality in § 550(a)(2), *SIPC v. BLMIS* (*In re BLMIS*), 513 B.R. 222, 231 (S.D.N.Y. 2014) ("*ET Decision*"), *supplemented by*, No. 12-mc- 1151 (JSR), 2014 WL 3778155 (S.D.N.Y. July 28, 2014), and international comity. *Id.* at 231-32.

The scope of the ET decision

The high-level issue in the cases was the scope of the *ET Decision*. The Trustee argued that the *ET Decision* was limited to resolving the "purely legal" issue of whether SIPA and the Bankruptcy Code apply extraterritorially to allow the Trustee to recover purely foreign transfers. Defendants (comprised of both subsequent transferees of Madoff monies who participated in the cases underlying the *ET Decision* (the "Participating Subsequent Transferees") and those who did not (the "Non-Participating Subsequent Transferees")) argued that the *ET Decision* was issued upon consideration of both factual and legal arguments and therefore was binding on the Participating Subsequent Transferees and persuasive as to the Non-Participating Subsequent Transferees. As to the comity prong of the *ET Decision*, the Trustee argued that Judge Rakoff's ruling was limited to

comity's "potential application" in the cases at bar. The Subsequent Transferees argued that the comity ruling provided an alternative basis for complete dismissal of the Trustee's claims.[1]

Judge Bernstein came down between the parties' dueling positions on the *ET Decision*. He rejected it as a mandate for dismissal and as a purely abstract legal determination. He explained that Judge Rakoff had ruled that a complaint required extraterritorial application of § 550(a)(2) if "the relevant transfers and transferees are predominantly foreign: foreign feeder funds transferring assets abroad to their foreign customers and other foreign transferees." On this basis, the Bankruptcy Court was required to examine the allegations in the complaints and the Trustee's proposed amendments to determine if the complaints warranted dismissal because (i) transfers required the extraterritorial application of § 550(a)(2) because "the conduct relevant to the statute's focus occurred in the United States"; or (ii) because international comity dictated dismissal. Having established this guideline, Judge Bernstein then reviewed the parties' arguments.

The comity prong of § 550(a)(2)

Due to its relative simplicity, Judge Bernstein first turned to the comity determination. He noted that there were a number of complaints in which the defendants were also in liquidation proceedings abroad. Judge Bernstein explained that because of "the indirect relationship between [BLMIS] and the transfers at issue here, these foreign jurisdictions have a greater interest in applying their own laws than does the United States," *See ET Decision*, 513 B.R. at 232. On the basis that "[t]he United States has no interest in regulating the relationship between the Funds and their investors or the liquidation of the Funds and the payment of their investors' claims," he dismissed dozens of cases on the basis of comity.

The extraterritoriality prong of § 550(a)(2)

As to extraterritoriality, Judge Bernstein analyzed whether the allegations supplied in the Trustee's complaints and proposed amendments rebutted the presumption against extraterritoriality by alleging a domestic transfer.

Judge Bernstein rejected most of the Trustee's arguments based on a chart of nineteen factors the Trustee suggested were germane to the determination of extraterritoriality. The chart included factors like venue clauses in agreements, the Subsequent Transferee's knowledge that its investment was ultimately an investment in U.S. equity and Treasury securities in the U.S. and due diligence conducted in the U.S. Judge Bernstein noted that the *ET Decision* set forth just four factors relevant to whether the Trustee has rebutted the presumption against extraterritoriality: (i) the location of the account from which the transfer was made, (ii) the location of the account to which the transfer was made, (iii) the location or residence of the subsequent transferor and (iv) the location or residence of the Subsequent Transferee (the "ET Factors"). The critical question, according to Judge Bernstein, was where the transfer was made.

On this basis, Judge Bernstein dismissed dozens more complaints against the Subsequent Transferees in which the Trustee did not allege that the Subsequent Transferee used a U.S. bank in

[1] The parties also disagreed over the Trustee's attempts to amend its complaints in light of the ET Decision. The Subsequent Transferees asserted that their motions to dismiss the existing claims should be granted because the Trustee failed to respond to their arguments against those claims, and relied solely on new allegations (designed to get around the ET decision) in his proposed amended complaints.

connection with the transactions, that the transferor maintained its principal operations in the United States, that the transferee is a U.S. citizen, or that the transferee maintained a U.S. office utilized in connection with the transfer.

Transfers into and out of U.S. survive dismissal

Finally, Judge Bernstein denied a handful of motions to dismiss with leave to amend. These included the following:

As to a number of Cayman Islands-based funds (the "Rye Cayman Funds"), Judge Bernstein noted that although the funds were registered offshore, they were exempted in the Cayman Islands and were managed from and maintained their principal places of business and headquarters in Rye, New York. He ruled that dismissal was not warranted because facts before the court indicated that subsequent transfers to the Rye Cayman Funds were received in a U.S.-based bank account.

As to an entity entitled FG Investors, Judge Bernstein noted that it was formed under Cayman Islands law but controlled from New York by Charles Murphy, a Fairfield Greenwich Group partner, a U.S. citizen and New York resident. He ruled that dismissal was not warranted because the Trustee alleged that subsequent transfers were made by an entity registered to do business in New York from a New York account, and because there were no facts before the court as to where the transfers were received.

Conclusion

Judge Bernstein's opinion builds on Judge Rakoff's 2014 ruling making it very clear that purely foreign subsequent transfers are beyond the reach of U.S. Bankruptcy Courts. Applying these rulings more broadly to liquidation proceedings in U.S. courts, funds and their lawyers will be more empowered to obtain quick dismissals against U.S. trustees where the entities and the transactions at issue very clearly have no U.S. ties or where foreign liquidation proceedings are underway.

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