Can § 547 Be Used to Avoid Foreign Transaction?

The Extraterritorial Application of Preference Laws

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There have been a number of multinational bankruptcy filings in recent years, including the mega cases *In re Lehman Brothers Holdings Inc.*,[1] *In re Quebecor World (USA) Inc.*[2] and *In re Lyondell Chemical Company*,[3] where large corporations and dozens of their domestic and foreign affiliates have sought economic relief from the courts. As a consequence, there have been thousands of preference actions filed, and many more are sure to come. Many of these recent adversary proceedings involve foreign entities and ostensibly foreign transactions. These preference actions raise the following issues: Does § 547 of the Bankruptcy Code apply extraterritorially, and if not, when is a potentially avoidable transaction extraterritorial? For example, can a payment by a foreign entity to another foreign entity occurring outside of the United States be avoided pursuant to § 547 simply because of a tangential connection to the United States?

This article examines this increasingly pertinent issue, which has arisen several times over the years, most importantly in *Maxwell Communication Corp. v. Barclays Bank (In re Maxwell Communication Corp.) (Maxwell I)*, a case of first impression, which held that United States preference laws are not extraterritorial in their reach and where (1) a foreign debtor makes a preferential transfer to (2) a foreign transferee and (3) the transfer's "center of gravity" is abroad, § 547 may not be used to avoid the transfer.[4] The implications of this decision are significant for any transnational debtor groups who anticipate utilizing U.S. laws to avoid preferential transfers or foreign creditors with potential U.S. preference liability. Each side should review its tactical position in relation to *Maxwell I* and subsequent case law in order to best obtain or escape the application of U.S. preference laws.

Maxwell I

The *Maxwell* bankruptcy case arose as a consequence of the dramatic and untimely drowning death of Ian Robert Maxwell, the controlling owner of Maxwell Communications Corp. Plc (MCC), an English holding company with vast assets in the United States. Following Maxwell's death, speculation arose as to the cause of his drowning. Even more shocking than Maxwell's sudden death was the news that emerged in the succeeding weeks of the financial irregularities involving Maxwell and MCC.

Feature

Maxwell's empire ultimately collapsed, leading MCC to file for chapter 11 protection with the Bankruptcy Court for the Southern District of New York. Following MCC's filing, the company also filed for protection in England under the English Insolvency Act 1986. The U.S. and English proceedings were coordinated by a court-appointed examiner. The court approved a reorganization plan, which provided that all of MCC's assets, both domestic and abroad, would be pooled together. In addition, MCC's disclosure statement informed creditors of potential recoveries from MCC's asset sales and causes of action, including adversary proceedings under U.S. preference laws.

The bankruptcy court's *Maxwell I* decision involved three foreign-preference defendants, each of which provided credit facilities to MCC at their English bank branches. The source of the transferred funds at issue, in regard to two of the defendants, was a sale, which occurred in the U.S. in dollars, of MCC's U.S. assets. However, in both of these cases, MCC concluded its transactions at its accounts in London. The last preference defendant's 90-day transfers took place in London. However, unlike the first two preference defendants, MCC did not allege that the 90-day transfers to this defendant were made from funds originating from the sale of a U.S. asset.

Main Holding

The court's analysis in *Maxwell I* was based on the Supreme Court's holding in *Equal Employment Opportunity Comm. v. Arabian American Oil Co. (Aramco),*[5] where the Court articulated what is referred to as a "clear statement" rule.[6] In other words, the Court held that "legislation of Congress, unless a contrary intent appears [in the statutory text], is meant to apply only within the territorial jurisdiction of the United States."[7] This extraterritoriality rule of statutory construction is based on a question of "substantive law turning on whether, in enacting [§ 547], Congress asserted regulatory power over the" transactions at issue.[8] In the *Aramco* decisions, the Court did not consider two other modes of statutory construction, whether (1) legislative history speaks to congressional intent for the statute at issue to have extraterritorial application, and (2) administrative agency decisions interpreting the relevant statute shed light on congressional intent.[9] However, the Court did not overrule prior case law utilizing these forms of statutory construction.[10]

Following *Aramco* and before *Maxwell I*, the Second Circuit held in *Kollias* that courts may examine extrinsic *indicia* of legislative intent, such as congressional reports, when making an extraterritoriality determination.[11] The Second Circuit stated that the Supreme Court itself considered legislative history in deciding *Aramco*, although it excluded this mode of analysis from its

1 Docket No. 08-13555 (Bankr. S.D.N.Y. Sept. 15, 2008).
2 Docket No. 08-13814 (Bankr. S.D.N.Y. Sept. 30, 2008).
3 Docket No. 09-10023 (Bankr. S.D.N.Y. Jan. 6, 2009).
4 170 B.R. 800, 814 (Bankr. S.D.N.Y. 1994) (Brozman, J.), *aff'd sub nom., Maxwell Communication Corp. v. Societe General PLC (In re Maxwell Communication Corp.) (Maxwell II)*, 186 B.R. 807 (S.D.N.Y. 1995) (Scheindlin, J.), *aff'd on other grounds, Maxwell III*, 93 F.3d 1036 (2d Cir. 1996). 170 B.R. at 814.

5 499 U.S. 244, 248 (1991).
6 *See Kollias v. D & G Marine Maintenance*, 29 F.3d 67, 73 (2d Cir. 1994).
7 *Maxwell I*, 170 B.R. at 809 (quoting *Aramco*, 499 U.S. at 247).
8 *Hartford Fire Ins. Co. v. Cal.*, 509 U.S. 764, 813 (1993) (Scalia, J., dissenting) ((noting that extraterritoriality rule is not subject-matter jurisdiction issue) (citing *Aramco*, 499 U.S. at 248) (cited by *In re Maxwell*, 170 B.R. 800, 809 n.14 ("[W]here the extraterritoriality presumption is not overcome, the court does not dismiss for want of subject matter jurisdiction... for what is at issue is not my subject matter jurisdiction (which I plainly have), but instead whether I may extend section 547...across the seas.")).
9 *See Maxwell I*, 170 B.R. at 810.
10 *See id.* at 810-11 (citing *Kollias*, 29 F.3d at 73).
11 *See Kollias*, 29 F.3d at 73.

holding.[12] Moreover, the Second Circuit stated that if only the express words of a statute were permitted to be analyzed in making an extraterritoriality determination, the Supreme Court would have expressly prohibited other means of interpretation.[13] Therefore, following the guidance of *Kollias*, in Maxwell I Judge Tina Brozman examined the language and legislative history of § 547 and stated that there was no expressed intent for the preference laws to apply extraterritorially.[14]

Next, the bankruptcy court stated that, aside from legislative intent that the statute applies extraterritorially, there are two other exceptions to the presumption against extraterritoriality: where the overseas transaction (1) has an effect within the United States[15] and (2) involves conduct occurring in the United States that Congress seeks to regulate.[16] The court determined that neither exception applied to the transactions at issue. Therefore, the court held that the presumption against the extraterritorial reach of the law applied in *Maxwell* where the parties to the transfer were foreign and the exchange took place overseas.[17]

Fallback

While Judge Brozman based her decision in *Maxwell I* on her extraterritoriality analysis because it was a case of first impression, she also examined whether applying U.S. preference laws to international or foreign transfers would violate the principles of comity. Her inquiry was based on a second tenet of statutory construction, unaffiliated with her extraterritoriality analysis.[18]

Judge Brozman reasoned that Congress is presumed to have enacted our laws with the principles of comity in mind. Therefore, where two countries have overlapping claims to jurisdiction, our courts are required to examine both the domestic and foreign interests in retaining jurisdiction in the matter. The U.S. court should yield jurisdiction to a foreign court if the foreign court plainly has a greater interest in the matter. In *Maxwell I*, Judge Brozman held that, in addition to the transfer at issue being beyond the reach of the U.S. preference laws, under the principles of comity jurisdiction over the preference actions did not belong in the U.S.[19]

Maxwell II *and* III*: Validation*

On appeal, the U.S. District Court for the Southern District of New York affirmed the bankruptcy court's decision.[20] Judge Shira Scheindlin stated that to determine whether the presumption against extraterritoriality applies in a specific factual setting, the court must conduct a two-part inquiry: (1) Did the offensive conduct occur outside the U.S.?, and (2) if so, did Congress intend for its statutory scheme to apply extraterritorially? The district court broke down the transfers into component parts, noting that all parties involved were foreign entities, with a relationship centered abroad. The relevant antecedent debts arose from accounts maintained abroad and governed by foreign laws, and the debts were paid by transferring funds from a foreign account of MCC. The only U.S. connections the transfers had were that the transfers were paid from the proceeds of the sale of U.S. assets and the sale depleted the assets available to satisfy the claims of all creditors. However, the court found that these U.S. connections to the transfers were merely preparatory steps that were insufficient to characterize the transfers as domestic in nature.[21]

As for part two of the district court's inquiry, Judge Scheindlin stated that unless Congress unequivocally expressed its intent either within the language of the statute or in the legislative history for a statutory scheme to apply extraterritorially, all acts of Congress will be presumed to have only a domestic application. Further, any uncertainty will be construed in favor of the presumption against extraterritorial application. As applied to the Code's preference law, the term "any transfer" in § 547 is not sufficient to overcome the presumption against extraterritoriality. Moreover, while the Code provides protections to foreign debtors, that does not mean that Code provisions apply to all of the foreign debtor's dealings.[22] Following the appeal to the district court, *Maxwell* was once again appealed, this time to the U.S. Court of Appeals for the Second Circuit, which affirmed the lower court decisions based on the secondary comity holding and did not reach the lower courts' holdings regarding the extraterritoriality of § 547.[23]

Post-Maxwell

Since the *Maxwell* cases were decided, only a few courts have examined transnational avoidance issues, but each has deemed it unnecessary to decide the issue of whether the relevant Bankruptcy Code provisions were intended to apply extraterritorially. For instance, Judge Brozman reviewed her earlier decision and the other *Maxwell* cases in *In re Interbulk*.[24] While she stuck to her *Maxwell I* holding, she distinguished *Maxwell* and *Interbulk* on their facts, emphasizing the parallel proceedings and international cooperation present in *Maxwell* but absent in *Interbulk*. In addition, she noted that the transaction at issue in *Interbulk* had multiple connections to the U.S., such as domestic accounts and negotiations, in addition to a defendant who filed a proof of claim in the main bankruptcy case. Thus, this time Judge Brozman held that the transfer in question was not extraterritorial.

The Take-Away

The crux of the *Maxwell* extraterritoriality analysis is the center of gravity of the transactions. In today's global economy, transfers between multinational entities are increasing, and often quite complex, making the factual scenario in *Maxwell* likely to repeat itself. U.S. courts will likely not and should not seek to apply § 547 to these transactions where the transactions were intended to be, and essentially were, primarily foreign.

The take-away message for creditors who are preference defendants seeking to prevent the application of U.S. preference laws to a foreign transaction is that where the potentially preferential transaction mainly took place outside the United States between foreign entities, involved foreign banks and assets, and did not have a direct or substantial impact in the United States, these defendants should argue that *Maxwell*'s basic holding that the preference laws were not intended to apply extraterritorially was correct and that the center of gravity of the transaction was abroad and therefore extraterritorial.

In addition, since *Maxwell*, courts analyzing these issues have focused on whether parallel foreign insolvency proceedings are pending where a foreign court could plausibly possess jurisdiction with which a debtor may use to redress pre-bankruptcy wrongs.

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12 *See id.*
13 *See id.*
14 *See Maxwell I*, 170 B.R. at 811.
15 "Two prime examples of this exception are the Sherman Anti-Trust Act, 15 U.S.C. §§ 1-7 (1976), and the Lanham Trade-Mark Act, 15 U.S.C. § 1051 *et seq.* (1976), which have both been applied extraterritorially where the failure to extend the statute's reach would have negative economic consequences within the United States." *Environmental Defense Fund v. Massey*, 986 F.2d 528, 531 (D.C. Cir. 1993) (citing numerous cases).
16 This exception applies "when the conduct regulated by the government occurs within the United States... Even where the significant effects of the regulated conduct are felt outside U.S. borders, the statute itself does not present a problem of extraterritoriality, so long as the conduct which Congress seeks to regulate occurs largely within the United States." *Massey*, 986 F.2d at 531.
17 *See Maxwell I*, 170 B.R. at 813.
18 *See id.* at 814.
19 *See id.*
20 *See Maxwell II*, 186 B.R. at 824.
21 *See id.* at 815-16.
22 *See id.* at 818-20.
23 *See Maxwell III*, 93 F.3d at 1054-55.
24 240 B.R. at 198-99.

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Absent an ongoing foreign proceeding, which brings with it the availability of alternative relief, courts may hesitate to deny relief in the U.S. Further, if a foreign insolvency proceeding concerning the debtor is already pending, the preference defendant should consider arguing that under the principles of comity, the U.S. court should refrain from hearing the matter and allow the foreign court to make decisions concerning the foreign transaction.

Debtors seeking to avoid a transfer under U.S. laws must make every attempt to demonstrate that U.S. interests and entities were involved in and affected by the transfer. If possible, debtors should maintain that the transfer had an effect within the United States or that the transfer, while having an effect abroad, involved conduct occurring in the United States that Congress seeks to regulate. In addition, debtors should be cognizant of the impact a foreign filing may have on any preference actions they may bring. A debtor who anticipates that avoiding pre-petition transfers will be significant to the success of its insolvency proceeding should examine domestic and foreign preferential-transfer-avoidance laws prior to filing. ■