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New York Bankruptcy Courts Grapple with Territorial Limits of U.S. Bankruptcy Code

By Rick Antonoff, Michael B. Schaedle, Bryan J. Hall, and Matthew E. Kaslow*

Two bankruptcy court judges have taken different approaches to the issues of their ability to assert personal jurisdiction over foreign defendants, and application of U.S. laws to transactions that occur, at least in part, outside of the United States. The authors of this article discuss the decisions and the implications.

In a pair of opinions from the U.S. Bankruptcy Court for the Southern District of New York, two judges took varying approaches to the issues of (1) their ability to assert personal jurisdiction over foreign defendants, and (2) application of U.S. laws to transactions that occur, at least in part, outside of the United States.

The first opinion, from Judge Sean H. Lane, denied the defendants' motion to dismiss a lawsuit seeking to avoid and recover money initially transferred to correspondent bank accounts in New York designated by the defendants, before being further transferred outside of the United States to complete transactions under investment agreement executed outside of the United States and governed by foreign law. On remand after a district judge ruled that the defendants' use of correspondent banks in the United States was sufficient for the bankruptcy court to have personal jurisdiction over them, Judge Lane held that the doctrine of international comity and the presumption against extraterritoriality did not prevent application of U.S. law to avoid transfers under the Bankruptcy Code. The second opinion, from Judge James L. Garrity, Jr., dismissed a bankruptcy trustee's claims to avoid and recover transfers under U.S. bankruptcy law that occurred entirely outside the territory of the United States.

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OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF ARCAPITA BANK B.S.C.(C) v. BAHRAIN ISLAMIC BANK (IN RE ARCAPITA BANK B.S.C.(C))[1]

Judge Lane's opinion was issued in connection with the Chapter 11 bankruptcy case of Arcapita Bank B.S.C.(c) ("Arcapita"), a Bahraini entity licensed by the Central Bank of Bahrain as an Islamic wholesale bank. In March 2012, Arcapita entered into separate placement agreements (the "Placement Agreements") with Bahrain Islamic Bank ("BisB") and Tadhamon Capital B.S.C. ("Tadhamon"), also Bahraini entities.

Pursuant to the Placement Agreements, Arcapita made investments through BisB and Tadhamon on the following terms:

(1) Arcapita transferred money to correspondent bank accounts in New York selected by the defendants before being further transferred to bank accounts in Bahrain or to a broker in London;

(2) the defendants used the funds to make investments on behalf of Arcapita; and

(3) the defendants were required to return to Arcapita on a specified date the amount of its initial investment plus a predetermined rate of return (the "Placement Proceeds").

The Placement Agreements were negotiated and signed in Bahrain and governed by Bahraini and Shari'ah law.

Arcapita filed its Chapter 11 bankruptcy petition shortly after transferring money to the correspondent bank accounts and the defendants making the investments. The defendants failed to return the Placement Proceeds on the specified date and instead stated their intention, pursuant to Bahraini law, to set off the proceeds against antecedent debts owed to them by Arcapita.

The official committee of unsecured creditors (the "Committee") appointed in Arcapita's bankruptcy case sued BisB and Tadhamon seeking, among other things, to avoid and recover the Placement Proceeds under various sections of the U.S. Bankruptcy Code.

The defendants moved to dismiss the adversary proceedings, arguing that:

(1) the bankruptcy court lacked personal jurisdiction over them;

(2) the claims were barred by the doctrine of international comity; and

[1] 575 B.R. 229, 233 (Bankr. S.D.N.Y. 2017).

(3) the claims were barred by the presumption against extraterritorial application of U.S. laws.

Although the bankruptcy court initially granted the defendants' motions based on a lack of personal jurisdiction,[2] the district court reversed on appeal,[3] and on remand the bankruptcy court ruled in the Committee's favor on the remaining issues of international comity and extraterritoriality.

PERSONAL JURISDICTION

Reversing Judge Lane's ruling that the court did not have personal jurisdiction over the defendants, the district judge focused on the defendants' receipt of the allegedly avoidable transfer in New York, noting that in a lawsuit arising out of that transfer, "the defendant can hardly claim that it could not have foreseen being haled into court" in the location where the transfer occurred. The district court judge remanded the case back to Judge Lane after ruling that the bankruptcy court did have personal jurisdiction based on several grounds.

First, as noted, the district court determined that the defendants' use of the correspondent bank accounts alone constitutes the requisite minimum contacts with the United States for personal jurisdiction, because the defendants' use "was purposeful and not coincidental or adventitious." The minimum contacts would not have existed if Arcapita had selected the correspondent bank accounts instead of the defendants. However, "both banks deliberately chose to receive Arcapita's funds in U.S. dollars and designated correspondent bank accounts in New York to receive the funds, even though they presumably could have performed the Placement transactions without ever directing the funds through New York or anywhere else in the United States."

Second, the district court determined that the Committee's avoidance claims arose out of and related to the defendants' contacts. Because the Committee sought to avoid the transfers Arcapita made to the correspondent bank accounts in New York, the defendants' contacts were "at the heart of" the Committee's claims and there was "an articulable nexus" between the contacts and the claims. Therefore, the district court concluded, "[i]t should hardly be unforeseeable to a bank that selects and makes use of a particular forum's banking system that it might be subject to the burden of a lawsuit in that forum for wrongs related to, and arising from, that use."

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[2] *Official Comm. of Unsecured Creditors of Arcapita Bank B.S.C.(c) v. Bahrain Islamic Bank (In re Arcapita Bank B.S.C.(c))*, 529 B.R. 57, 67 (Bankr. S.D.N.Y. 2015).

[3] *Official Comm. of Unsecured Creditors of Arcapita, Bank B.S.C. (c) v. Bahrain Islamic Bank*, 549 B.R. 56 (S.D.N.Y. 2016).

Finally, the district court determined that the exercise of personal jurisdiction would not offend traditional notions of fair play and substantial justice because:

(1) the burden imposed on a defendant forced to litigate in a distant forum is mitigated by modern communication and transportation;

(2) in respect of the interest of the United States in providing relief to creditors and debtors under the Bankruptcy Code, it was not "prudential" to give foreign creditors priority over domestic creditors based solely on their foreign status; and

(3) it was uncertain whether similar relief would be available to the Committee in a non-U.S. forum.

The district court concluded that the bankruptcy court had personal jurisdiction over the defendants and vacated the order dismissing the adversary proceedings. On remand to the bankruptcy court, Judge Lane considered BisB's and Tadhamon's remaining arguments for dismissal based on international comity and the presumption against extraterritoriality.

INTERNATIONAL COMITY AND THE PRESUMPTION AGAINST EXTRATERRITORIALITY

Following the district court's lead, Judge Lane focused on the defendants' use of the correspondent bank accounts in New York as a basis to apply U.S. law under both the doctrine of international comity and the presumption against extraterritoriality.

He noted that analysis of international comity in the Second Circuit comprises two distinct doctrines: prescriptive and adjudicative. Prescriptive comity limits the reach of U.S. law and adjudicative comity refers to a judge's discretion to decline to act in deference to a foreign proceeding. Judge Lane discussed only prescriptive comity because there was no parallel foreign proceeding to which deference could be given. Pursuant to prescriptive comity, one country refrains from prescribing laws that unreasonably govern activities connected to another country. In applying prescriptive comity, courts rely on a variety of factors to determine if the exercise of jurisdiction is reasonable.

In *Arcapita*, Judge Lane found that prescriptive comity did not prevent his exercise of jurisdiction. The use of correspondent bank accounts in New York established a link between the parties' transactions and the United States, even though the parties were all Bahraini entities and the defendants made the investments outside of the United States. Judge Lane adopted the district court's reasoning that the use of the correspondent bank accounts defeated the defendants' alleged "justified expectations" of litigating in Bahrain. He further noted that the Bahraini choice-of-law provisions in the Placement Agreements did not limit his jurisdiction because the bankruptcy court was "competent" to apply Bahraini law. Finally, Judge Lane observed the Committee's avoidance and turnover claims form the "bedrock" of the protections available to creditors under the Bankruptcy Code and expressed a "grave concern" that, in the absence of a parallel foreign insolvency proceeding, parties might make transfers overseas to "shield[]" them from U.S. law and the debtor's creditors.

Judge Lane also concluded that his jurisdiction was not constrained by the presumption against extraterritoriality. He explained that the presumption reflects the principle that the reach of U.S. legislation is meant to apply only domestically, unless a contrary congressional intent is apparent. Courts use a two-part inquiry to determine if the presumption is rebutted, so that a U.S. law can be applied extraterritorially. A party seeking to apply U.S. law extraterritorially must demonstrate either that Congress intended it to apply outside of the United States or that the conduct the statute is meant to regulate occurred at least in part within the United States.

As to the Committee's avoidance claims, Judge Lane rejected the defendants' argument that factors such as the parties' nationalities, where the antecedent debt originated, and where the underlying agreement was negotiated and executed, determine whether a claim involves the extraterritorial application of U.S. law. Rather, "the focus of congressional concern" (i.e., the "transactions that the statute seeks to regulate") was dispositive, and in *Arcapita*, the focus of the Bankruptcy Code provisions at issue was the initial transfer of property of the estate from Arcapita to the correspondent bank accounts in New York. Therefore, the Committee's avoidance claims did not involve the extraterritorial application of the Bankruptcy Code at all. As to the Committee's claims for violations of the automatic stay and turnover of the Placement Proceeds, Judge Lane concluded that Congress intended such provisions to apply extraterritorially, because they refer to property of the estate that includes Arcapita's property "wherever located and by whomever held."

Accordingly, Judge Lane concluded that the doctrines of international comity and the presumption against extraterritoriality did not require dismissing the case and denied the defendants' motion.

LAMONICA v. CEVA GROUP PLC (IN RE CIL LIMITED)[4]

More recently, another New York bankruptcy court judge held that the avoidance provisions of the U.S. Bankruptcy Code did not apply to transactions

[4] Adv. Proc. No. 14-2242-JLG, Case No. 13-11272-JLG (Bankr. S.D.N.Y. Jan. 5, 2018).

that occurred entirely outside of the United States.

Judge Garrity's opinion was issued in connection with the bankruptcy case of CIL Limited (f/k/a CEVA Logistics Limited, "CIL"), a Cayman Islands holding company owned and controlled by affiliates of Apollo Global Management, LLC ("Apollo"). CIL and its subsidiaries operated a global logistics and freight management business. CIL's sole asset was its ownership of its subsidiary and operating company, CEVA Group PLC ("CEVA Group"), a U.K. entity. In April 2013, CIL and its affiliates undertook to restructure and deleverage the enterprise, particularly by transferring 99.99 percent of CIL's equity interest in CEVA Group to CEVA Holdings, a newly formed Marshall Islands affiliate of Apollo.

Three holders of payment-in-kind ("PIK") notes issued by CIL filed an involuntary Chapter 7 petition against CIL in New York. The bankruptcy trustee appointed in CIL's bankruptcy case sued CIL's two former directors and CEVA Group, alleging that CIL's transfer of its equity interests in CEVA Group stripped CIL of its interests with no consideration, to the detriment of the PIK noteholders. The trustee sought to recover the value of CIL's equity interest in CEVA Group. The trustee alleged that the restructuring transaction was a fraudulent transfer subject to avoidance under Bankruptcy Code Section 548 and under "applicable law" pursuant to Bankruptcy Code Section 544(b), including New York state law, U.K. law, and Cayman Islands law. The defendants sought to dismiss the trustee's claims arguing, among other things, that the Bankruptcy Code avoidance powers on which the trustee's claims relied do not apply extraterritorially.

Applying the same two-part inquiry as Judge Lane in *Arcapita*, Judge Garrity reached a different conclusion in *CIL Limited*.

First, Judge Garrity concluded that Congress did not intend for Bankruptcy Code Section 548 to apply to international transfers. Judge Garrity distinguished other Bankruptcy Code provisions, such as Section 541(a), which as explained above defines property of the estate, because Section 548(a) speaks of "an interest of the debtor in property," but without the broader reference found in Section 541(a). While noting judges in the Southern District of New York, and in other districts, are divided on the question of whether the Bankruptcy Code's avoidance provisions apply extraterritorially, Judge Garrity concluded that they do not.

Second, Judge Garrity observed that the trustee sought to avoid "the authorization by CIL, a Cayman Islands company, of the issuance of stock in CEVA Group, an England and Wales company, to CEVA Holdings, a Marshall Islands company." Judge Garrity found the conduct "allegedly harmed foreign creditors" and was "accomplished outside the United States" by non-U.S.

entities. On these facts, Judge Garrity concluded that the conduct that was the focus of the statute occurred "plainly outside the United States." Because he concluded that Section 548 does not apply extraterritorially and because the conduct at issue occurred outside of the United States, Judge Garrity dismissed the trustee's claims under Section 548.

The trustee also sought to avoid the transfer of the CEVA Group equity under applicable non-bankruptcy law pursuant to Bankruptcy Code Section 544(b). The trustee argued non-U.S. law, in particular U.K. law, constituted "applicable law." Judge Garrity rejected the trustee's argument that inclusion of the phrase "applicable law" in Section 544(b) gives the section extraterritorial application. Because the challenged transaction was not a "domestic transfer," the trustee could not avoid the transfer of the CEVA Group equity under Section 544(b).

IMPLICATIONS

As the *Arcapita* decision highlights, non-U.S. parties potentially may be subject to liability in U.S. courts under U.S. laws if the court determines either 1) that the statute under which the suit is brought applies outside of the U.S. territorial jurisdiction or 2) that the specific challenged transaction was domestic rather than foreign. Application of the U.S. Bankruptcy Code, including its avoidance provisions, to non-U.S. transactions raises significant implications for international financial transactions, maritime practice, and other areas of global commerce.

The holding in *CIL Limited* provides non-U.S. parties with a thorough analysis and arguments as to why a court should not apply the U.S. Bankruptcy Code avoidance provisions to transactions involving a non-U.S. transferor and a non-U.S. transferee. But courts remain strongly divided on this issue. Parties involved in international transactions should give careful consideration, and may wish to seek advice from counsel, regarding any transaction that potentially may implicate U.S. law, including Bankruptcy Code avoidance provisions.