U.S. Supreme Court Denies Review in Madoff Bankruptcy Proceedings

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The U.S. Supreme Court announced today that it has declined to review a case involving the 2008 collapse of Bernard L. Madoff Investment Securities, LLC (BLMIS), allowing its SIPA trustee, Irving H. Picard, to move forward with efforts to obtain recovery on behalf of Madoff's victims. [1]

Petitioners challenged a decision by the U.S. Court of Appeals for the Second Circuit [2] that authorized recovery of property under Section 550(a) of the Bankruptcy Code from so-called "foreign subsequent transferees" who invested with Madoff through offshore feeder funds. [3]

The Second Circuit rejected arguments—revived in Petitioners' Supreme Court cert briefs—that either the presumption against extraterritoriality or principles of international comity should bar Picard's efforts.

The long-awaited announcement adopts the U.S. government's recommendation to decline review, departing from a trend in recent years to take up cases involving questions of extraterritorial application of U.S. law.

As a result, Picard can now resume efforts to recover nearly $2.1 billion in foreign subsequent transfers (on top of $14.3 billion in initial transfers already recovered) for equitable distribution among Madoff's victims through the U.S. bankruptcy courts. These cases should now move forward into discovery and may lead to additional settlements, adding to the recoveries already achieved by Picard and his team.

Background

Petitioners in the case are foreign individuals and entities who invested with Madoff through offshore "feeder funds"—intermediary vehicles designed to pool money from investors.

Madoff represented that each of these funds had a brokerage account established at BLMIS through which Madoff bought and sold securities as part of his "split-strike conversion strategy." As the world would later learn, however, the money was never actually invested. Instead, it was deposited into a U.S. bank account, from which new contributions were used to enrich Madoff and his associates, while servicing older redemptions as part of a massive Ponzi scheme.

The feeder funds in question here were all foreign entities—two of which were organized under the laws of the British Virgin Islands (the Fairfield and Kingate Funds) and one under the laws of the Cayman Islands (Harley International (Cayman) Limited Funds). Likewise, the funds' investors (including Petitioners) were predominantly foreign. Each of these feeder funds placed all or substantially all their assets with BLMIS and have since entered foreign liquidation proceedings of their own.

In practice, every redemption to Petitioners required two foreign transfers—from Madoff to the feeder fund, and then from the feeder fund to the foreign investor—and each of those subsequent transfers are alleged to have taken place entirely outside the United States.

Second Circuit Decision

The Second Circuit decision dealt with the narrow question of whether the trustee of a U.S. estate (here, Picard) could recover property transferred from one foreign entity to another in transactions that took place wholly outside the United States.

Ultimately, the court held that it could, overruling contrary decisions by the district and bankruptcy courts, and rejecting two arguments raised by Petitioners in the proceedings below.

First, the Second Circuit held that the presumption against extraterritoriality—a canon of statutory construction that construes federal laws as having "only domestic application" "[a]bsent clearly expressed congressional intent to the contrary"—did not preclude Picard's claims against foreign subsequent transferees, because those claims involved a permissible domestic application of U.S. law.

The court explained that, under Supreme Court precedent, it was necessary to determine the statute's "focus" or "'the object of its solicitude,' which can include the conduct it 'seeks to regulate,' as well as the parties and interests it 'seeks to protect' or vindicate." However, a court need not do so in a vacuum. Where, as here, "the statutory provision at issue works in tandem with other provisions, it must be assessed in concert with those other provisions."

Accordingly, the Second Circuit concluded that the district and bankruptcy courts took too narrow a view when determining that Section 550(a) was focused on "the property transferred" and "the fact of its transfer." Instead, the court was required to also look to Section 548(a)(1)(A), which is principally concerned with remedying the initial fraudulent depletion of the estate by the debtor.

Because "[o]nly the initial transfer involves fraudulent conduct, or any conduct, by the debtor," regulating that conduct clearly involves a domestic application of U.S. law. As such, the Second Circuit determined that it was not required to address the broader question whether Section 550(a) applies extraterritorially in all cases.

Second, the Second Circuit held that principles of international comity did not bar Picard from suing foreign subsequent transferees because the interests of the United States in applying domestic bankruptcy law outweighed the countervailing interests of foreign states.

Among other factors the court deemed compelling, it noted that the United States had interests in maximizing the likelihood of recovery for creditors and former investors in the Madoff estate, as well as in eliminating a loophole for would-be fraudsters looking to shield assets from the purview of U.S. courts. In addition, consolidating Picard's claims in a single unified proceeding would be "more 'equitable and orderly' than forcing him to litigate different claims in different countries."

By contrast, the court found that foreign states had significantly lower interests in regulating the transfers. Although foreign courts are actively overseeing liquidations of the very feeder funds involved in this case, those liquidations have different means and goals from the Madoff liquidation. Moreover, because Picard is not a creditor in those proceedings, he would not be entitled to any recovery by the feeder funds' estates.

That allowing Picard's claims to proceed against foreign subsequent transferees "might frustrate the efforts of [feeder funds'] trustees to recover the same property in a foreign court" was of no consequence.

Cert Briefing In the U.S. Supreme Court

In seeking a writ of certiorari, Petitioners revived their arguments on extraterritoriality and international comity. On the first point, Petitioners principally argued that the Second Circuit's decision violates recent Supreme Court precedent in *WesternGeco* [4]—a patent case allowing foreign damages from defendant's domestic infringement—because the Second Circuit wrongly focused on the domestic activity of the *plaintiff* rather than the *defendant*. In so doing, it "develop[s] a legal fiction that 'recovering' the proceeds of a *foreign* transaction between *foreign* parties is a 'domestic application' of the Bankruptcy Code."

On the second point, Petitioners argued that the Second Circuit's decision improperly supplants its own *de novo* judgment for that of the district and bankruptcy courts on the question of whether international comity bars Picard's claims.

Picard pushed back on Petitioners' narrow reading of *WesternGeco* in opposition, writing that "[w]hat th[e] [Supreme] Court said matters is the conduct Congress sought to regulate and the persons it sought to protect"—both factors that weigh in Picard's favor.

Picard also rejected the argument that the Second Circuit inappropriately exercised *de novo* review, because the question here—one of so-called "prescriptive comity" involves statutory interpretation—a task that appellate courts are equally equipped to handle.

Invited by the Supreme Court to provide the views of the United States, the Solicitor General filed a brief recommending against the grant of certiorari, concluding that the Second Circuit's decision was "correct" and "does not conflict with any decision of this Court or another court of appeals."

Key Takeaways

The Supreme Court's announcement that it has declined to review the merits of the Second Circuit decision in *HSBC Holdings PLC v. Picard* closes an important chapter in the more than decade-old Madoff saga that will have significant implications for the parties in those actions.

- First, the announcement increases the likelihood that stakeholders in the Madoff estate will share in the recovery of some or all of the $2.1 billion in foreign subsequent transfers made through foreign feeder funds;
- Second, it reduces the likelihood that Picard would have to initiate parallel litigation in foreign courts under foreign law to recover those subsequent transfers, preserving the very efficiencies Congress sought to achieve through consolidated bankruptcy proceedings in a single court; and
- Third, and most importantly, it will create significant settlement pressure for defendants who may wish to avoid costly and potentially risky discovery.

Even with this development, we note that several key questions will remain unresolved:

- First, defendants in this (and future actions) could still seek dismissal on other grounds, including that they lack sufficient contacts with the forum to subject them to its personal jurisdiction;
- Second, even if the New York bankruptcy court has jurisdiction and Picard is able to obtain a judgment, he may need to pursue recoveries against any non-U.S. based assets through actions in foreign courts—particularly for non-financial institutions without correspondent bank accounts in the United States; and
- Third, the Supreme Court's announcement does not resolve the question left unanswered by the Second Circuit—namely whether Section 550(a)(2) applies extraterritorially. New York courts remain split on that question. As such, we would expect that defendants in future actions will continue to invoke extraterritoriality and comity-based defenses in factually distinct circumstances.

We will continue to follow developments on the case and update our clients accordingly. Should you have any questions in the meantime, or wish to speak with us directly, please contact any of the attorneys listed above.

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[1] *HSBC Holdings PLC v. Picard*, No. 19-277.

[2] *In re Picard, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC*, 917 F.3d 85 (2d Cir. 2019).

[3] 11 U.S.C. §§ 548(a)(1), 550(a).

[4] *WesternGeco LLC v. ION Geophysical Corp.*, 138 S. Ct. 2129 (2018).

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