Is the United States a 'Safe Harbor' for Financial Institutions in Non-US Insolvency Proceedings?

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Foreign representatives and their counsel should take note of recent US Bankruptcy Court decisions in Fairfield that, if upheld on appeal, could significantly impair their ability to pursue avoidance claims in US Chapter 15 proceedings.

The court in Fairfield held that the US Bankruptcy Code's safe-harbor provisions apply to foreign avoidance claims brought by foreign representatives in Chapter 15 proceedings, including foreign avoidance claims pertaining to foreign transfers between foreign parties. That said, the court also found that foreign representatives have the ability to bring foreign common law claims—such as unjust enrichment and constructive trust—affording foreign representatives another path to recovery.

Offshore practitioners would be well served to review and scrutinize these rulings and the Bankruptcy Code's safe-harbor provisions before employing any strategy to pursue clawback claims in the US, according to James Leda, the managing director of offshore liquidation firm of Krys Global, and litigators Ester Murdukhayeva and Evan Bianchi of Selendy & Gay in New York.

The United States Bankruptcy Code gives trustees the authority to rescind—or "avoid"—certain preferential or fraudulent transfers made by a debtor (i.e. the bankrupt entity). The purpose of avoidance powers is to maximize the size of the bankruptcy estate and facilitate an equitable distribution to creditors. Although avoidance powers are among the most important tools available to bankruptcy trustees, these powers are subject to certain restrictions including various statutory provisions referred to as "safe harbors." One of these provisions, section 546(e) bars the avoidance of a range of transfers associated with securities contracts, including "settlement payments" made by or to statutorily specified entities including "financial institutions." Although Congress first enacted this provision to protect a limited subset of commodities-related transactions, statutory amendments and judicial interpretations have expanded the reach of this particular safe harbor to offshore payments.

On the face of the Bankruptcy Code, section 546(e) and related safe-harbor provisions apply only to avoidance claims brought under United States law in domestic bankruptcies. Nevertheless, a federal bankruptcy court recently held that, when it passed the law, Congress intended to extend the section 546(e) safe harbor to apply to foreign avoidance claims brought by foreign representatives (who often operate from the offshore world) in Chapter 15 proceedings filed in a United States bankruptcy court in support of a foreign main insolvency proceeding. The court ruled that the safe harbor applied even to foreign avoidance claims pertaining to foreign transfers between foreign parties. 'Foreign representative' is a term in Chapter 15 which is not mentioned in section 546(e).

The expansion of the code's safe harbors to foreign avoidance claims has (barring successful appeals) created unprecedented protections for financial institutions involved in non-US insolvency proceedings.

Click here to read the full article, which explores the scope of section 546(e) and related safe harbors and discusses the possible implications of judicial rulings that extend section 546(e)'s reach to foreign avoidance claims.

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