Avoidance of Pre-Bankruptcy Transactions in Multinational Bankruptcy Cases

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From the perspective of planning commercial transactions, the application of the avoiding powers may be the single most important aspect of multinational insolvency/bankruptcy cases. Yet there have been remarkably few reported cases dealing with those issues. The present author was guilty of an article on the subject

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1. Although I use the United States term “bankruptcy” throughout, the analysis is meant to apply primarily to corporate insolvency proceedings.
some fifteen years ago. Very few cases have been reported since that time, until the three fraudulent conveyance cases I discuss in this article. The French case is a Court of Appeals case that applies United States law to avoid a pre-bankruptcy transfer of real estate in Bermuda. In the Midland Euro Exchange case, the Los Angeles bankruptcy court comes to the opposite conclusion about a transnational payment in the context of a Ponzi scheme. In the third case, Al Sabah, the Privy Council applied Cayman Islands law to permit a Bahamian trustee in bankruptcy to undo two Cayman Islands trusts. Relatively speaking, our cup runneth over.

I. BACKGROUND

As I have noted in a prior paper for the Academy, many issues in a multinational bankruptcy case require two distinct choice-of-law analyses: one to determine the proper nonbankruptcy law and the other to choose the applicable bankruptcy law. Thus, for example, nonbankruptcy law might determine if a party has a valid contract claim against the debtor in bankruptcy, while bankruptcy law would determine the priority, if any, that claim would receive in a bankruptcy distribution. The contract law would be chosen by “the proper law of the contract” in most cases, while the choice of applicable bankruptcy law would depend on whether the jurisdiction followed a more territorial or a more universalist approach in multinational bankruptcy cases.

II. FRAMING THE PROBLEM

A. Choice of Bankruptcy Law

The ancient law review article I mentioned above was devoted exclusively to the second determination, the choice of bankruptcy law. In that article, I surveyed the few existing cases concerning choice of law for avoidance actions and performed

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7. Westbrook, Universalism, supra note 6, at 634.
a detailed analysis as to the choice of the proper avoidance law in multinational cases. I refer the reader to that article for a more elaborate discussion.

Because all three of the recent cases have involved what Americans would call a “fraudulent conveyance,” I will focus on that aspect of the problem. We start with the fact that a court following a traditional territorial approach to multinational bankruptcies will have difficulty fashioning a defensible choice-of-law rule for avoidance of multinational transactions. Territorialists grab what local assets are available and apply local law to them. They then distribute any proceeds of an avoiding action under the local priority system. They would normally not seek to recover assets located in foreign jurisdictions, but they may control assets that have arguably been transferred in fraud of creditors. The literature does not reveal any coherent approach to the application of foreign avoidance law under a territorialist system.

However, courts in the United States and a number of other countries are moving in the direction of a modified universalism in multinational bankruptcies, seeking to cooperate with other courts in achieving a pragmatic result as close as possible to the ideal of a single worldwide proceeding. Those courts are forced to consider which country’s bankruptcy laws should be applied to a particular issue in a multinational bankruptcy system. For example, if a creditor subject to personal jurisdiction in two countries, such as a multinational bank, engages in behavior that violates the moratorium (stay) of the country where a bankruptcy proceeding is pending, yet the behavior takes place entirely in the second country where there is no proceeding, which law should apply to the creditor’s conduct?

The most difficult choice-of-law issue is determining which avoidance law to apply to a given pre-bankruptcy transaction. The first step in fashioning a sound approach is to understand that the avoidance provisions in every country reflect a balance between two conflicting values:

a) the need to return to the estate certain property transferred prior to bankruptcy for redistribution according to the statutory scheme of priority;

b) the need to avoid imposing too much uncertainty in the marketplace with regard to transactions that are normally unobjectionable.

Countries draw the balance quite differently at the margins. Almost all bankruptcy laws would permit avoidance of a gift given with the intent to evade creditors at a time when the transferor was insolvent and the transferee had the

10. Id. at 2219.
12. ALI Principles, supra note 8, Principle 5 and Illus., at 49-50.
intent to cooperate in the evasion.\textsuperscript{14} However, jurisdictions are sharply divided as to the relevance of the transferee’s state of mind—some regarding it as a crucial element or defense, while others are prepared to avoid the transfer regardless of the transferee’s knowledge or intent.\textsuperscript{15} Where there is some consideration for a transfer by an insolvent, but what the transferor gets falls well short of equaling the value of the property, some laws would make avoidance dependent upon the state of mind and knowledge of the transferor, the transferee, or both.\textsuperscript{16} Other laws (for example, the Bankruptcy Code in the United States\textsuperscript{17}) would for the most part ignore the state of mind of either party in determining avoidability.

The case for avoidance is often compelling. A pre-bankruptcy transfer by an insolvent debtor for little or no consideration may well impact the rights of creditors in a serious way and often will be ill-motivated in fact. On the other hand, fraudulent conveyance laws often reach far back in time, and avoidance of a transfer made to an innocent party years before bankruptcy may impose a serious and costly uncertainty on the market and be seen as quite unfair to the transferee.\textsuperscript{18}

It will fairly often be true that one country with significant contacts with a payment or other transaction would hold it avoidable while a second relevant country would not. In this common situation, which law should be applied? I have argued that those courts following the approach of modified universalism should apply the avoidance law of the debtor’s home country.\textsuperscript{19} In broad and brutal summary of a complex analysis, there are two key reasons for this conclusion. The first reason is that no other rule can be predictable and transparent in its application.\textsuperscript{20} The modern conflicts literature has long since demonstrated that a rule depending on the “place” in which the transaction occurred is manipulable and unpredictable.\textsuperscript{21} In every difficult case, the transaction has elements in more than one jurisdiction; therefore, it is easy to choose either place as the relevant location and apply its law.

In reaction to this defect, modern conflicts analysis looks at significant conflicts and the interests of the states involved.\textsuperscript{22} However, modern analysis applied on a case by case basis can also raise serious problems of predictability,\textsuperscript{23} making it hard for parties to know if their transactions might run afoul of bankruptcy laws in

\textsuperscript{14} See generally J. H. DALHUISEN, DALHUISEN ON INTERNATIONAL INSOLVENCY AND BANKRUPTCY, Vol 1, Part II, § 1.01 (1986). I deliberately write a bit loosely, because the various laws are endlessly nuanced as to intent and knowledge.
\textsuperscript{15} Id. at § 1.04.
\textsuperscript{16} Id.
\textsuperscript{18} One might think of the debtor’s children being asked to return their bicycles, dolls, and action figures—but, then again, one might think of the debtor’s spouse being allowed to keep a chateau in the south of France.
\textsuperscript{19} See Westbrook, Global, supra note 2, at 500.
\textsuperscript{20} Id. at 530.
\textsuperscript{21} RUSSELL WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS § 1.5 (2001); LUTHER L. MCDOUGAL, III, ROBERT L. FELIX, RALPH U. WHITTEN, AMERICAN CONFLICTS LAW § 2 (2001).
\textsuperscript{22} See BRAINERD CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS 180 (1963).
another country. A home-country rule provides the best result we can currently hope to achieve in that it is relatively difficult to manipulate and produces reasonably predictable outcomes.  

The second reason for applying home-country law turns on the fact that the whole purpose of avoiding powers in a bankruptcy proceeding is to redistribute the debtor’s assets according to certain statutory priorities. Because of the link between avoidance and priority, an interests analysis supports a home-country rule. Let’s take the example of a transfer of personal property made by X, a citizen and resident of Country A, to Y, a citizen and resident of Country B. At all times the property is located in Country B. Shortly after the transfer, X files for bankruptcy in Country A. There is no bankruptcy filed as to X in Country B. The bankruptcy law of Country A provides that all bankruptcy distributions will go to Creditor Group 1, including all proceeds of avoidance actions. Country B’s bankruptcy law gives all such distributions to Creditor Group 2. The transfer is not avoidable under the laws of Country A, but is avoidable under the laws of Country B. We may also assume that there are creditors from each creditor group in each of the two countries.

In this situation, it seems obvious that the Country A court should refuse a request by X’s trustee in bankruptcy to avoid the transaction. It cannot be avoided under the local law in Country A. If the Country A bankruptcy court avoids the transfer by applying the law of Country B, the result would be a windfall for Creditor Group 1, even though neither country would avoid the transaction for the benefit of Group 1. Nothing would go to Creditor Group 2 because of the priority

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24. Professor LoPucki would disagree, because he regards the home-country court determination as inherently unpredictable. Lynn M. LoPucki, Universalism Unravels, 79 AM. BANKR. L.J. 143, 158-59 (2005). I have suggested that modified universalism increases the predictability of the forum that will be chosen, and therefore the law that will be applied, even though it falls well short of the universalist ideal. Jay Lawrence Westbrook, Multinational Financial Distress: The Last Hurrah Of Territorialism, 41 TEX. INT’L L.J. 321, 327 (2006); Jay Lawrence Westbrook, Locating the Eye of the Financial Storm, 32 BROOK. INT’L L.J. (forthcoming 2007) (copy on file with the author) [hereinafter Westbrook, Multinat. Fin. Distress].

25. It must be conceded that a fairly predictable result might be obtainable by adopting the unfortunate rule in the European Insolvency Regulation, but only at a considerable cost. Commission Regulation 1346/2000, art. 13, 2000 O.J. (L 160) 1. The effect of the rule is that the transaction will often escape avoidance unless it would be avoidable under the laws of both the home country and the country whose laws otherwise govern the transaction. (The actual language is opaque, but the foregoing is a reasonable interpretation). See Miguel Virgos & Etienne Schmidt, Report on the Convention on Insolvency Proceedings, paras. 35-39. The effect of such a rule must be to narrow greatly the applicability of the avoiding powers and thus weaken the policies of fairness and priority that underlie them. Westbrook, Global, supra note 2, at 519, n.82; Four Models, supra note 8, at 586.

26. Professors Duggan and Telfer, discussing Canadian law, draw a sharp distinction between preference and fraudulent conveyance law. Canadian Preference Law Reform, 42 TEX. J. INT’L L.J. 661 (2007). They view the former as having the purpose stated in the text, but understand fraudulent conveyance law to be directed at protecting each individual creditor against debtor wrongdoing. While I agree with them with regard to fraudulent conveyance laws operative outside of bankruptcy. See DALHUISEN, supra note 14. I think the purpose of fraudulent conveyance avoidance in bankruptcy necessarily becomes collective and focused on the publicly determined priority system. Our views may differ in part because in the United States preference recovery is also available outside of bankruptcy as against insiders, removing one of the distinctions that influences their views. Univ. Fraudulent Transfer Act § 5(b), 7 A.U.L.A. 2 (2006). In addition, the seminal fraudulent conveyance case, Twyne’s Case, 3 Coke 806, 76 Eng. Rep. 809 (1601), involved a preferential payment, as did the famous (or infamous) case of Dean v. Davis in the United States Supreme Court, 242 U.S. 438 (1916). Those cases suggest the close association of the two doctrines, even though they have diverged in many ways.
system in Country A. The lawmakers in Country A expressly decided that avoidance in such a case as this would impose excessive costs on the commercial community, even though the result would benefit their favored Creditor Group 1. On the other hand, the lawmakers in Country B overcame any concerns about commercial effects because of the perceived importance of protecting Creditor Group 2. They seem to have no concern for Creditor Group 1. Country B lawmakers might even protest imposing costs on their commercial community to produce proceeds for Group 1. Neither country’s interests would be served by applying Country B’s avoidance law in this case. If we make Creditor Group 1 secured creditors and Group 2 employees or taxing authorities, the example is not unrealistic, albeit greatly simplified.

This example illustrates that the best rule for choice of avoiding powers is the law of the country that will distribute the proceeds of any avoidance recovery.\textsuperscript{27} In an ideal universalist system, that court would be the home-country court for all creditors throughout the world. Thus the powers would be used when the recoveries would benefit those who were given priority under the home-country’s laws. But universalism is currently only an ideal. A pragmatic court committed to modified universalism, such as we find in the United States, should try to come as close to the universalist result as it practically can.\textsuperscript{28} Thus, it should generally choose the avoiding power of the home-country court: the transaction is avoidable if, and only if, it is avoidable under home-country law. Neither of the three cases I discuss came to that result, although it has the most important precedential force under United States law.

\textbf{B. Nonbankruptcy Law}

Ordinarily, this part of the analysis follows the same path as in a nonbankruptcy context, using the choice-of-law rules generally applied in the jurisdiction to determine if local law or some other law should apply to the nonbankruptcy elements of the case. As noted above, in the instance of an ordinary contract claim filed in the bankruptcy case, the proper law of the contract determines the validity and amount of the claim, while bankruptcy law determines its priority.\textsuperscript{29} Occasionally, the problem becomes more complicated because the bankruptcy law reflects a policy different from nonbankruptcy law. For example, in a purely domestic case within the United States, nonbankruptcy law may give landlords a much bigger claim than United States bankruptcy law will permit.\textsuperscript{30} The bankruptcy law simply overrides the nonbankruptcy law in that case. But if the nonbankruptcy law is that of another country, the correct answer may not be so clear. The \textit{French} case does not appear to raise such an instance, but it suggests how the problem can arise. I will address that point later in this article.

\textsuperscript{27} This article does not address the particularly tricky problem that arises when the debtor’s COMI has allegedly changed since the transfer under attack. For a general discussion of COMI and its manipulation, see Westbrook, \textit{Storm}, supra note 24, at 24-25.

\textsuperscript{28} One example of a pragmatic exception would be a refusal to avoid a payment to a small local creditor in another jurisdiction, where local interests might be too gravely hurt by the threat of distant litigation. Westbrook, \textit{Global}, supra note 2, at 531.


\textsuperscript{30} United States Bankruptcy Code, 11 U.S.C. \textsection 502(b)(6) [hereinafter BC] (limiting the amount a lessor may claim in bankruptcy).
A second relevance of nonbankruptcy law is found in avoidance statutes that may be used without a pending bankruptcy proceeding. A well-known example is the Uniform Fraudulent Transfer Act in the United States. It is a uniform law adopted in most states that can be used by a single creditor to avoid a fraudulent conveyance and to reap the recovery for the payment of that creditor’s debt. I address that wrinkle in the discussion of Al Sabah below.

III. THE FRENCH CASE

The facts in French were simple. Mrs. French gave the deed to her Bermuda real estate to her children at a Christmas party in 1981. However, the children failed to record the deed at that time, apparently to avoid taxes. In mid-2000, the children became concerned about her declining financial situation and filed the deed. Mrs. French then became the subject of an involuntary Chapter 7 (liquidation) petition in October of that year. Her trustee in bankruptcy brought an action to avoid the transfer as a fraudulent conveyance. All the parties were citizens and residents of the United States at all times.

Because the United States Bankruptcy Code treats the transfer as having occurred on the date of recordation, the transfer fell within the one-year avoidance period for fraudulent conveyances under section 548 of the Code. The trustee in bankruptcy apparently did not claim an actual intent to defraud creditors, but rather “constructive fraud,” similar to the British idea of a “transaction at an undervalue.” Absent actual intent to defraud, the most commonly invoked avoidable conveyance attack in the United States contains two required elements: the debtor-transferor was insolvent at the time of the transfer and the transfer was for less than “reasonably equivalent value.” Here both elements were conceded. Thus if section 548 applied to this transaction, it was voidable and the transferees could be required to reconvey the property to the trustee in bankruptcy.

On the other hand, it was assumed that Bermuda law required an actual intent to defraud creditors as a condition of avoidance of a conveyance, so the transfer would not be avoidable if Bermuda law applied.

The Court of Appeals affirmed the actions of the lower courts by finding that United States law applied and the transaction should be avoided. In determining that the United States fraudulent conveyance provision applied to the transfer of the

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33. Id. at 148-49.
34. Id. at 150.
35. 11 U.S.C. § 548(a)(1) (one-year reachback when the French bankruptcy was filed; now two years). Section 548(d)(1) of the Bankruptcy Code provides that, for the purposes of section 548, a transfer takes place when it is so “perfected” that it cannot be attacked under non-bankruptcy law by a bona fide purchaser for value. It appears there was no dispute in French about the fact that this transfer would be held to be within a year of the October, 2000, petition, so presumably recordation is necessary under Bermuda law to prevent attack on a transfer by a bona fide purchaser. Thus Bermuda nonbankruptcy law was tacitly applied as to the perfection of a real estate transfer.
36. French, 440 F.3d at 148.
Bermuda property, the court focused on the applicability of the “presumption against extraterritorial effect” and on comity among courts. 39

A. The Presumption Against Extraterritoriality

It is worth noting that the court implicitly began with the assumption that section 548 applies in any United States bankruptcy case. It then had to determine if that assumption was inaccurate here because of the so-called presumption against extraterritoriality. The United States Supreme Court has said the presumption represents a “longstanding principle of American law ‘that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.’”40 The Court’s rule could be understood as requiring Congress to state explicitly that each provision it enacts applies to foreign transactions if it wishes that provision to have effect where any foreign element is found.41 However, the lower courts have generally interpreted the presumption more narrowly.42 They have done so in two ways. First, they have applied a choice-of-law analysis to determine if the conduct is “extraterritorial.” If not, the presumption does not apply.43 Second, they have held the presumption to be overcome where they find that Congress intended the provision to apply on the facts presented. They ascertain the Congressional intent from the language of the provision and from the policy behind the provision.44 The French court used both methods.

1. Significant Contacts

The court first counted and weighed contacts in classic American choice-of-law analysis.45 It found that the great majority of important contacts were in the United States, including the parties, the bankruptcy case, and all but one creditor.46 On that basis, it was inclined to find that the transfer was not extraterritorial; therefore, the presumption did not apply, leaving section 548 applicable as in any domestic case.47 However, it was troubled by the presence of one significant contact on the Bermuda side: the property in question was Bermuda real estate.48 For obvious and sensible

39. French, 440 F.3d at 149.
42. See Dodge, supra note 40, at 95-98.
45. Weintraub, supra note 21, § 1.5; McDougal, supra note 21, § 84. See also In Regus Business Centre Corp., 301 B.R. 122 (Bankr. S.D.N.Y. 2003).
46. French, 440 F.3d at 150.
47. Id.
48. Id.
reasons, all choice-of-law rules recognize that real estate is almost always governed by the law of its location. Yet it is also clear that this rule is not absolute. So, for example, decisions in domestic relations cases have applied the law of the domicile of the marriage to questions of ownership of real estate as between husband and wife. Nonetheless, the court was sufficiently concerned about the countervailing weight of the real estate rule that it turned to the second argument for finding the presumption inapplicable: the wording and policy of the Bankruptcy Code.

2. Congressional Intent

The discussion of the Code was largely a restatement of the contacts counting and weighing discussion that preceded it. That part of the court’s discussion was of limited analytical value. The interpretive ground for avoiding the presumption is not, after all, about choosing one law or the other; instead, it rests on whether the Congress intended this United States law to apply under these circumstances. If not, no choice of law is presented. The analysis should turn on whether a Congress anxious to undo fraudulent conveyances would want to permit them whenever the property involved was foreign real estate, but the court did not focus on that specific question.

On the other hand, a close examination of the statutory language was more fruitful. The court worked through section 541(a)(1) of the Bankruptcy Code, which defines property of the bankrupt estate in the broadest possible terms, and section 1334 of Title 28 of the United States Code, which gives the bankruptcy courts jurisdiction of “all property, wherever located, of the debtor.” The awkwardness of that phrase reflects the fact that “wherever located” was added to the bankruptcy law precisely to make it clear that the United States bankruptcy courts were to claim worldwide jurisdiction of the debtor’s property, without distinction between real and personal property (immovables and movables). The court reasonably concluded that the combination of these two provisions demonstrated Congress’ intent to include the debtor’s worldwide property in the estate, and therefore, that they likely intended to include foreign property transferred before bankruptcy within the reach of the bankruptcy avoidance powers. That conclusion was buttressed by a similar analysis by the Fifth Circuit Court of Appeals, albeit in a different context.

Oddly enough, neither the Fourth nor the Fifth Circuits cited or discussed section 541(a)(3) of the Bankruptcy Code which explicitly includes in the property of

49. WEINTRAUB, supra note 21, § 8.2; MCDOUGAL, supra note 21, § 153.
50. See WEINTRAUB, supra note 21, § 8.14.
56. Cullen Ctr. Bank & Trust v. Hensley (In re Criswell), 102 F.3d 1411, 1417 (5th Cir.1997).
the estate all property that the trustee in bankruptcy recovers under the avoiding powers. That provision strongly suggests that Congress intended the reach of those powers to be co-extensive with the broad, global embrace of its definition of estate property, although the bankruptcy court in *Midland* disagreed.57

3. Comity

Having determined that section 548 did apply to the transfer of the Bermuda property, the French court then turned to the defendants’ argument that “comity” required the court to defer to Bermuda law.58 The court’s rejection of the argument involved going back through the same contact-counting and weighing it had done twice before. 59

This sort of unhelpful comity analysis arises from a confusion of the roles of the comity doctrine and choice-of-law rules. A full treatment of that subject would be another article, but a brief discussion is warranted. Generally, comity is a doctrine of deferral to the actions of a foreign court while choice-of-law rules govern deferral to the laws of a foreign state. The confusion between deferring to judicial actions and deferring to statutes arose at the start in the classic formulation in *Hilton v. Guyot*.60 In that case, the United States Supreme Court defined comity broadly:

“Comity,” in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws. 61

Notwithstanding the formulation in *Hilton*, comity has been used primarily in the context of enforcement of judgments—the issue presented in *Hilton*—or other situations, like parallel litigation, in which the United States courts have decided to defer to the actions of foreign courts.62 That application is far preferable to using comity as a choice-of-law rule, because the comity doctrine has both the virtues and the deficiencies of a highly flexible, case-by-case doctrine. That flexibility is just what is needed for deference to foreign courts, while choice-of-law rules should strive for some level of generality and predictability. 63

58. *French*, 440 F.3d at 152.
59. *Id.* at 153-54.
61. *Id.* at 163-64 (emphasis added).
The confusion between these two uses of comity is sadly illustrated by the
decision in Maxwell,\(^\text{64}\) still the classic case for choice of avoidance law in the United
States courts.\(^\text{65}\) In that case, the debtor filed for bankruptcy in both the United
Kingdom and the United States, although de facto the two courts agreed to treat
the United Kingdom as the home-country court.\(^\text{66}\) The upshot of the case was a
worldwide liquidation plan, perhaps the first such plan ever achieved. But an
important legal issue remained unresolved even after the plan was adopted. The
debtor had made substantial payments to its lenders shortly prior to its twin
bankruptcy filings.\(^\text{67}\) It was conceded that the payments would be recoverable from
the lenders as avoidable preferences under United States bankruptcy law, but would
not be recoverable under United Kingdom law.\(^\text{68}\) The joint administrators brought
suit to recover the payments under United States law.\(^\text{69}\) The bankruptcy court found
that United Kingdom law applied and dismissed the suit.\(^\text{70}\) The district court and
court of appeals affirmed.\(^\text{71}\)

The two lower courts addressed the choice-of-law problem by counting and
weighing contacts to determine if the presumption against extraterritoriality applied
in that case; they found it did and dismissed.\(^\text{72}\) The court of appeals seemed to agree
with that approach, but then veered off sharply, resting its affirmance not on the
choice-of-law analysis, but on comity.\(^\text{73}\) It was persuaded that the overall good result
in the case, marked by wonderful cooperation between the courts of the two
countries, suggested that the United States should defer to the English courts (and
therefore the English law) as a matter of comity.\(^\text{74}\) The result was to aggravate the
confusion between choice of law and comity as a ground for applying foreign law.

There was no similar element in the French case. There was apparently no
proceeding of any kind in Bermuda with which to cooperate or to which to defer.
Thus, the comity discussion in French was simply off the point. The succinct and
well-reasoned opinion in another recent international preference case, Florsheim,\(^\text{75}\)
noted that no parallel proceeding was pending in another country, but still discussed
choice-of-law policies a second time in the context of comity. The only effect of this
approach is to create a risk of confusion and error.

\(^{64}\) In re Maxwell Commc'ncs Corp., 93 F.3d 1036 (1996). See generally Jay Lawrence Westbrook,
The Lessons of Maxwell Communications, 64 FORDHAM L. REV. 2531 (1996); Paul L. Lee, Ancillary Proceedings Under Section 304
Reform of Choice of Avoidance Law in the Context of International Bankruptcies from a U.S. Perspective, 10 AM. BANKR. INST. L.

\(^{65}\) For this confusion, see also In re PSINet Inc., 268 B.R. 358 (2001) (choice-of-law issue discussed as
comity question per Maxwell).

\(^{66}\) The company’s headquarters were in England but its largest subsidiaries were in the United
States, so either country could make a claim to be its home country. See Westbrook, Maxwell, supra note 64, at 2541, n.44; Westbrook,
Universalism, supra note 6, at 635, n.42.

\(^{67}\) Maxwell, 93 F.3d at 1041.

\(^{68}\) Id. at 1043.

\(^{69}\) Id.

\(^{70}\) Id. at 1044.

\(^{71}\) Id. at 1044, 1054-55.

\(^{72}\) Maxwell, 93 F.3d at 1044.

\(^{73}\) Id. at 1046-50.

\(^{74}\) Id. at 1053.

\(^{75}\) In re Florsheim Group, Inc., 336 B.R. 126, 133 (Bankr. N.D. Ill. 2005)
IV. **Midland**

In *Midland*, the United States debtor ran a Ponzi scheme, which meant that all its transfers were presumptively made with fraudulent intent under United States law. The trustee in bankruptcy sought to avoid about $900,000 in transfers to “SFC,” an English company based in London. The transfers were made from the London account of the debtor’s Barbados subsidiary to the New York account of SFC, although the money ended up back in London. It was agreed that if section 548 of the Bankruptcy Code applied, the transfer was likely avoidable, but that it was unlikely to be avoidable under English law, which required that the trustee show that SFC, as transferee, had a guilty state of mind. The analysis of the case was (or should have been) complicated by the fact that the corporate group was substantively consolidated in the United States bankruptcy proceeding.

For some reason the trustee in bankruptcy conceded that avoidance would require extraterritorial application of section 548. Thus, the court had only to mention in passing the English contacts with the transaction. With the trustee’s concession, the court had no difficulty in determining that the presumption against extraterritoriality applied, and United States avoidance law could not be used; hence the transfer was not avoidable. As the earlier analysis suggested, it seems to me that the so-called presumption is really code for a choice-of-law analysis, so conceding that point dictates the conclusion: if the challenged transaction was so predominantly connected with England that English law should be applied, one can feel comfortable that Congress would not have intended to apply United States law. If it were much more connected with the United States, as in *French*, then the court should reasonably conclude Congress likely intended to apply United States law.

The merit of that analysis is illustrated by the *Midland* court’s note that the result was bad policy, vindicating dishonest conduct by debtors. Why ascribe bad policy to Congress by saying United States avoidance law does not apply? If good policy would be application of United States law, then it should be applied as Congress would wish. If, on the other hand, a choice-of-law analysis leads to the conclusion that English law and policy should apply, then that jurisdiction’s balancing of fraud recovery versus transactional stability should rightly prevail. The result is good United States policy in that we properly vindicated our ally’s commercial policy in a circumstance where it had more at stake than we did. Thus, we come back always to choice of law.

From my perspective, the key point is the identity of the debtor. If we ignore substantive consolidation in this case, and take the debtor’s home country (“center...
of main interest") to be in Barbados, I would apply Barbados law. On the other hand, if we take substantive consolidation as representing a finding that the subsidiaries in this case were not independent corporations but merely divisions of the United States debtor, then the transferor was the debtor, its home country was the United States, and section 548 should apply. There would be no theory under which English insolvency law would apply in a universalist court on these facts.

V. *Al Sabah*

A Kuwaiti sheikh was found liable in an English court for massive frauds. He was a resident of the Bahamas and entered bankruptcy in that jurisdiction. He had created two trusts that, at the time of bankruptcy, were governed by Cayman Islands law. His trustee in bankruptcy sought to avoid the creation of these trusts as "settlements," that is, gratuitous transfers that in the United States would be attacked as fraudulent conveyances. Bahamian law provided for avoidance of such settlements, but only if they were created by traders. Being reluctant to litigate the question of the debtor’s status as a “trader,” the trustee wanted to use Cayman avoidance law which applied whether the debtor was a trader or not. The Bahamian court in the “main proceeding” duly requested that the Cayman court permit the trustee to use the Cayman avoiding power to avoid the settlements. The Cayman court agreed to apply Cayman law. The case was then appealed to the Privy Council, which affirmed the application of Cayman law.

Most of the opinion was devoted to a close analysis of statutory provisions which need not detain us. The ultimate question was whether a particular provision was applicable in Cayman bankruptcy law and whether it operated in substance like section 426 of the British Insolvency Act, giving a court broad authority to apply local bankruptcy law in favor of a foreign trustee in bankruptcy as if it were being

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86. I have not researched Barbados law on this point. It is likely to be, although not necessarily, similar to English law.


89. Al Sabah v. Grupo Torras S.A. [2005] UKPC 1, [2005] 2 W.L.R. 904., at 907. It is not clear when the debtor became a Bahamian resident and I ignore that point for purposes of this discussion, interesting as it is.

90. There might have been other grounds for attack, but they are not addressed here.

91. Id. at 908.

92. Id.


94. Id. at 922.
applied in a local bankruptcy proceeding. Thus, it permitted the Bahamian trustee to appear in the Cayman court and invoke the relevant Cayman avoidance power. The statutory framework necessarily focused the Privy Council’s attention on questions of jurisdiction and forum rather than choice of law as such, although the effect of the decision was to apply a Cayman avoiding power to obtain a recovery for distribution in a Bahamian bankruptcy.

The choice-of-law question was not an important part of the result. Lord Walker’s judgment concluded with a brief reference to the admonition in section 426(5) that the “requested” (Cayman) court take into consideration private international law in deciding whether to grant the foreign trustee the use of local avoidance powers, but the reference was passing and in the context of an exercise of discretion in choice of forum. Thus the choice-of-law result was incidental to those other elements.

The result of the statutory structure was the merging of choice of forum with choice of law and a lack of a place for analysis of the policies at stake in the latter choice. Of course, I would argue that Bahamian law should have been applied, and thus the trusts would not be avoidable. My argument would rest on the disconnect between the Cayman avoidance policy and the Bahamian priority and distribution policy. The priority rules in the two jurisdictions might differ in ways important in this case, just as their avoidance rules do. Bahamian rules might benefit Creditor Groups A-D, while Cayman rules might distribute the recovery to Groups C-H.

With regard to avoidance of settlements, the legislators for the two jurisdictions may have come to different conclusions in balancing the risk of fraud on creditors versus disruption of ordinary expectations. The legislators for the Bahamas might have thought that persons in business (traders) were more likely to be slippery rogues, so for their transactions, the risk of fraud outweighed the costs of market disruption. If they saw nontraders as less likely to engage in such manipulations, they might conclude the balance swings the other way with them. By contrast, the legislators for the Cayman Islands may have thought all debtors were inclined to trickery in evading creditors. In making their decisions, the Bahamas policy maker may have concluded that benefiting the A-D groups of creditors was not worth a broad disruption of transactions, while the Cayman Island’s policymakers may have been anxious to protect the vulnerable C-H groups of creditors entitled to priority under Cayman law. Yet the recovery in Al Sabah might flow to Creditor Groups A and B, disrupting Cayman transactions for the benefit of creditors whom neither policymaker thought important enough to justify that disruption.

In Al Sabah, the configuration of rules was such that the law applied was that of the place of transacting. In another case, the place of transacting might have the

96. Id. at 918-20.
97. Id. at 923.
99. Something similar seems to have happened in a 2001 Florida bankruptcy case involving German and Florida fraudulent conveyance law, although the opinion is too elliptical to be sure of the exact holding. In re Wachsmuth, 272 B.R. 766 (Bankr. M.D. Fla. 2001).
100. I assume for this purpose that the Bahaman Islands were the debtor’s center of main interest, as the judgment suggests.
101. More precisely, it was the law under which the trusts were created and the law chosen in the
weaker avoidance rule and might have been chosen for trust creation for just that reason. Specifically, the next case might involve a Bahamian bankruptcy under circumstances where the Bahamian avoidance rule was stronger than the avoidance rule in the Cayman Islands where the trusts were created. Of course, the Bahamian trustee would not seek help from the Cayman courts in that situation, having the stronger rule at home. Would the trustee be permitted to apply the stronger Bahamian rule in this new case? If so, then the rule of law would be that a transaction will be avoided if it is avoidable under the law of any state with reasonable contacts to the transaction or the bankruptcy. Such a general rule strikes me as almost as bad as the rule under the European Insolvency Regulation, which appears to provide that the transaction is not avoidable unless it would be avoidable under both relevant laws.\footnote{Commission Regulation 1346/2000, \textit{supra} note 25.}

VI. ONE STEP FARThER

Two special situations concerning the role of nonbankruptcy law are worthy of further discussion, even though they did not arise in any of these cases. In one situation, the nonbankruptcy law represents a strong local policy squarely inconsistent with the home-country bankruptcy policy, creating a “true” conflict. In the second, the nonbankruptcy law is itself an avoidance law, but one that can be applied outside of a bankruptcy proceeding.

A. \textit{Conflict Between Avoidance Law and Other Law Governing the Challenged Transaction}

There was no indication in \textit{French} that Bermuda real estate law had any special policy against avoidance of a fraudulent conveyance as against a duly recorded deed. Indeed, it appeared that Bermuda would avoid such a conveyance if made with actual intent to defraud, so any imposition on Bermuda nonbankruptcy law and policy by the avoidance of the transfer in \textit{French} would seem relatively minor. It is instructive, however, to consider what might have happened had the case presented a substantial conflict of policies between Bermuda real estate law and United States bankruptcy law.

Suppose that Bermuda had a strong rule that record title for real estate was controlling: no attack by way of fraudulent conveyance or constructive trust or other similar action could undo the effect of a recorded deed. Bermuda might have adopted such a rule because much of its property is owned by people in other countries, and it might deplore having many foreign avoidance laws, unknown to its judges and real estate experts, threaten the integrity of its real estate recordation system. Thus it might adopt a nondiscriminatory rule that no avoidance power, domestic or foreign, can undo or contravene a deed. Under those circumstances, should a United States court on the facts in \textit{French} avoid the transfer? If it did, would its judgment be enforceable?
This circumstance would present what the modern choice-of-law literature calls a “true” conflict. The interests of the two countries are squarely contrary. The United States has a substantial interest in protecting the American creditors of this American debtor from this fraudulent conveyance. Yet we have supposed that Bermuda might also have a powerful and defensible policy reason for its rule. When such a conflict is presented, it is most difficult to develop a principled basis for its resolution.

The universality of bankruptcy should be the trumping principle, a view that appears to have been shared by the French court. It underlies the general rule I have suggested, that the avoidance law of the home country should generally be the law applied. Where the policies of the two jurisdictions are in equipoise, it would seem a strong ground for tipping the balance in favor of the home-country rule.

However, we must also consider the enforceability of the avoidance judgment in French. It is well-settled that courts do not ordinarily enter judgments they know will be unenforceable. In our hypothetical situation, it seems likely that the Bermuda court would refuse to enforce a United States court order transferring the deed to the United States trustee in bankruptcy. However, it is quite possible that the United States court could achieve its desired result without the intervention of the Bermuda court. The United States court could order the United States defendants, the record owners of the Bermuda property, to transfer the deed themselves. They would presumably be within the personal jurisdiction of the United States court and subject to contempt sanctions if they failed to comply. This remedy has been used in Europe in similar cases.

B. Nonbankruptcy Avoidance Law

Many jurisdictions have avoidance laws that may be used without depending upon the existence of a bankruptcy proceeding. These nonbankruptcy avoidance laws require a somewhat different analysis. These laws are intended for the benefit of a particular creditor rather than being part of collective enforcement in bankruptcy. The key question there is whether a trustee in bankruptcy is authorized


104. Note that it was a concealed conveyance, not recorded until almost twenty years after it was made. We do not know if the French couple carried it on their financial statements or not.

105. WEINTRAUB, supra note 21, §§ 3.1, 3.6; McDougal, supra note 21, § 85. One could argue that there is no true conflict on the particular facts presented, because there was only one Bermuda creditor of the debtor and it would actually benefit from avoidance. Conversely, it appears there were no Bermuda creditors of the children/transferees who would have been prejudiced by the re-transfer of the property to the debtor’s trustee in bankruptcy. On the other hand, the hypothetical Bermuda rule rests on a policy relating to real estate deeds generally and that hypothetical policy would have been weakened by the result in French, so it seems to me to be a real conflict.


107. See generally DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES 855-72 (3d ed. 2002)


to use such a law by both the bankruptcy laws of the home country and the local avoidance law. In the United States, for example, the trustee in bankruptcy is authorized to use such statutes enacted under state nonbankruptcy law.\textsuperscript{110} Thus in \textit{Al Sabah}, if the Cayman Islands settlement-avoidance law was not part of its bankruptcy law, and if the Cayman courts had interpreted their law to permit its use by a trustee in bankruptcy, a United States trustee could avoid the settlement under Cayman law and distribute the proceeds in the United States proceeding without the policy anomalies I have asserted above. The analysis is different from the earlier one because the Cayman nonbankruptcy avoidance law would be intended to benefit any creditor, not to protect the creditors specified in a bankruptcy distribution scheme. Thus, there may be no policy anomaly in distributing the proceeds to creditors generally under whatever priority scheme may exist in the home-country.

\section*{VII. Conclusion}

The three cases discussed here present interesting factual settings for thinking about choice of law for the avoiding powers, although only \textit{French} really provides a rule. It adopts the home-country rule, but without a general theory. \textit{Midland} turns on a trustee’s concession and ignores the effect of substantive consolidation, while \textit{Al Sabah} applies a very broad avoidance rule based on a statute that may not have been drafted with that result in mind. Thus we still await a case that will give us predictable results.

The power of avoidance actions and the importance of the policies they serve make it essential that we move toward a more predictable choice-of-law rule for such actions. As things stand, a creditor or other transferee of a cross-border transfer faces a risk of action under a law with seemingly little contact with the transaction or the debtor. It also faces the risk of liability for the transfer in multiple courts. On the other hand, the lack of effective actions to avoid cross-border transfers, including enforcement of avoidance judgments in other jurisdictions, offers an opportunity for parties to maneuver around the avoidance laws of all the interested jurisdictions, defeating their bankruptcy policy goals.

The home-country rule suggested here is far from perfect and only moderately predictable. Anything better must await international agreements that are likely to be a long time coming. In the meantime, this choice-of-law rule will bring some coherence and a greater possibility of coordination to multinational insolvencies. It is a pragmatic goal and an achievable one.

\textsuperscript{110} ALAN N. RESNICK ET AL, \textsc{Collier on Bankruptcy}, paras. 502.03(2)(a), 502.03(2)(b)(ii).