Benchnotes

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Sovereign Immunity Shields Tribe from Fraudulent Transfer Liability

In *In re Greektown Holdings LLC*,[1] the Sixth Circuit Court of Appeals applied the doctrine of sovereign immunity to protect a Native American tribe from claims seeking to avoid and recover $177 million in fraudulent transfers. Prior to its filing, the debtor was owned and managed by the Sault Ste. Marie Tribe of Chippewa Indians. From the start, the casino was in financial distress. Nevertheless, the casino made $177 million in transfers to or for the benefit of the tribe in 2005. In 2008, the tribe sought chapter 11 relief. The post-confirmation trustee sought to recover the payments as fraudulent transfers.

The tribe filed a motion to dismiss the complaint, asserting that it possessed sovereign immunity from the trustee's claims. The trustee disputed this assertion, claiming that Congress abrogated tribal sovereign immunity when it enacted the Bankruptcy Code. The bankruptcy court denied the tribe's motion to dismiss. The district court reversed, and the trustee appealed.

Affirming the district court, the Sixth Circuit first noted that "Indian tribes have long been recognized as 'separate sovereigns pre-existing the Constitution,'" and as such, "they possess the 'common law immunity from suit traditionally enjoyed by sovereign powers.'"[2] Yet, the court noted, this immunity is limited because Congress has the ability to abrogate sovereign immunity. The court continued, "To do so, Congress must 'unequivocally' express that purpose."[3] At issue, then, was whether Congress unequivocally expressed such an intent in § 106 of the Bankruptcy Code, which provides that "sovereign immunity is abrogated as to a *governmental unit*." The term "governmental unit" is defined in § 101(27) to include, among other things, any "foreign or domestic government."

Relying on basic principles of statutory interpretation, the court held that the abrogation of sovereign immunity for a "foreign or domestic government" did not unequivocally waive immunity for Indian tribes. "In order to abrogate tribal sovereign immunity," the court stated, "Congress must leave *no doubt* about its intent."[4] The court stated that the existence of doubt with respect to whether Congress unequivocally intended to abrogate tribal sovereign immunity in bankruptcy was evidenced by a circuit split on the issue between the Ninth and Seventh Circuits.[5]

The court conceded that Indian tribes are domestic entities that possess attributes of a government. However, the real inquiry here was "whether Congress — when it employed the phrase 'other foreign or domestic government' — unequivocally expressed an intent to abrogate tribal sovereign immunity."[6] Concluding that the answer to this question is "no," the court reasoned that "there is not one example in all of history where the [U.S.] Supreme Court has found that Congress intended to abrogate tribal sovereign immunity *without* expressly mentioning Indian tribes somewhere in the statute."[7] While Congress did not need to expressly reference Indian tribes in all instances in order to abrogate tribal sovereign immunity, the court stated that the Bankruptcy Code lacks the requisite clarity of intent.

The dissent also relied on traditional tools of statutory construction, stating that "[b]ecause the statute contains clear language that 'sovereign immunity is abrogated' and that language applies to domestic governments, the sole remaining question is one [that] the majority ignores: Is an Indian tribe a domestic government?"[8] The dissent had little trouble concluding that the tribe was a domestic government, relying on Supreme Court precedent and various nonbankruptcy statutory provisions that treat tribes as such. Finally, the dissent urged that its interpretation furthered the purposes of the Bankruptcy Code by ensuring a fair and equitable distribution of estate assets among all creditors.

Second Circuit: Fraudulent Transfer Statutes Applied Extraterritorially

In *In re Picard*,[9] the Second Circuit Court of Appeals held that §§ 548 and 550 can be applied extraterritorially to recover fraudulent transfers from foreign subsequent transferees. The case involved 88 consolidated appeals from the dismissal of fraudulent-transfer claims brought by the Madoff trustee, **Irving H. Picard**, to recover billions of dollars that were paid to so-called feeder funds that were located abroad.

The feeder funds, the initial transferees of the payments, subsequently transferred the funds to

1 *Buchwald Capital Advisors LLC v. Sault Ste. Marie Tribe of Chippewa Indians (In re Greektown Holdings LLC)*, 2019 WL 922658 (6th Cir. Feb. 26, 2019).
2 *Id.* at *3.
3 *Id.*
4 *Id.* at *4.
5 *Id.* at *4-6 (discussing *Krystal Energy Co. v. Navajo Nation*, 537 F.3d 1055 (9th Cir. 2004); *Meyers v. Oneida Tribe of Indians of Wis.*, 836 F.3d 818 (7th Cir. 2016)).
6 *Id.* at *6.
7 *Id.* at *7.
8 *Id.* at *13.
9 *In re Irving H. Picard, Trustee for the Liquidation of Bernard L. Madoff Inv. Sec. LLC*, 2019 WL 903978 (2d Cir. Feb. 25, 2019).

their foreign investors. Since the feeder funds had commenced their own liquidation proceedings, the trustee sought to recover the payments directly from the investors as subsequent transferees under § 550(a)(2). Reasoning that U.S. statutes do not apply extraterritorially absent a contrary statement by Congress, and relying on principles of international comity, the lower courts dismissed the suits. The trustee appealed.

The Second Circuit reversed, thereby reviving the fraudulent-transfer lawsuits. The court first noted that the presumption against extraterritoriality contemplates that "[a]bsent clearly expressed congressional intent to the contrary, federal laws will be construed to have only domestic application."[10] This canon, the court explained, helps avoid the international discord that can result when U.S. law is applied to conduct in foreign countries. The court found that an action may only proceed internationally if either the statute indicates its extraterritorial reach or the case involves a domestic application of the statute.

Despite the fact that the subsequent transferee investors had no real connections to the U.S., the court held that the case involved a domestic application of the Bankruptcy Code. The court concluded that the lower courts had erroneously focused on § 550, not § 548, when conducting its extraterritoriality analysis. The harm to the estate, the court reasoned, began with the initial transfer, which is governed by § 548, not § 550. The court continued that § 550 is "merely the means by which the statute achieves its end" of recovering the fraudulent transfer.[11]

As such, the court held that the extraterritoriality analysis should focus on the initial transfers to the feeder funds. Here, such transfers were domestic transactions made by a domestic debtor from U.S. bank accounts. Thus, the court held, the presumption against extraterritoriality did not prohibit the debtor's trustee from recovering such property using § 550(a), "regardless of where any initial or subsequent transferee is located."[12] The relevant conduct, the court reiterated, is the debtor's fraudulent transfer of property, not the transferee's receipt of property.

The court also addressed principles of international comity. Comity, the court stated, might "be viewed as a discretionary act of deference by a national court to decline to exercise jurisdiction in a case properly adjudicated in a foreign state."[13] Comity only comes into play when there is a true conflict between U.S. law and that of a foreign jurisdiction. Assuming without deciding that such a conflict existed, the court held that the U.S.'s interest in allowing domestic estates to recover fraudulently transferred property far outweighed any interests of the foreign countries where the feeder funds were located. As such, notions of international comity likewise did not preclude pursuit of the foreign subsequent transferees under § 550(a)(2).

Miscellaneous

• *Aurelius Investment LLC v. Commonwealth of Puerto Rico*, 915 F.3d 838 (1st Cir. 2019) (municipal bond insurers sought to dismiss debt-adjustment proceedings commenced by Puerto Rico's Financial Oversight and Management Board on grounds that board lacked authority to initiate such proceedings because its members were appointed in contravention of U.S. Constitution's Appointments clause; First Circuit agreed, holding that appointment of board members was unconstitutional because members were U.S. officers who should have been appointed by president; nevertheless, court denied insurer's motion to dismiss PROMESA proceedings; court set 90-day period to allow president and Senate to constitutionally validate appointments or reconstitute board);

• *In re 1111 Myrtle Avenue Group LLC*, 2019 WL 642843 (Bankr. S.D.N.Y. Feb. 14, 2019) (oversecured lender sought post-petition interest at default rate, which was seven percentage points above contract rate, in a chapter 11 case where all creditors were paid in full and debtor emerged from bankruptcy with substantial equity; while acknowledging that courts are permitted to reduce default interest based on equitable principles, bankruptcy court nevertheless allowed more than $1 million in default interest on lender's $6 million claim; court reasoned that seven-percentage-point differential was "not so egregious or inequitable that the Court must rewrite the Debtor and Lender's contract and apply a lower default rate of interest");

• *In re Energy Future Holdings Corp.*, 2019 WL 366216 (D. Del. Jan. 30, 2019) (district court held that bankruptcy court did not err in denying "substantial contribution" administrative expense; bankruptcy court correctly rejected argument that mere extensive participation in chapter 11 case, without more, warrants substantial contribution administrative expense; "actual and demonstrable" benefit to estate is required and, in present case, claimant merely duplicated role already being performed by court-appointed committee);

• *In re Paragon Offshore PLC*, 2019 WL 1112298 (Bankr. D. Del. March 11, 2019) (after surveying Supreme Court case law, Delaware bankruptcy court narrowly interpreted *Stern v. Marshall* and its progeny, and held that bankruptcy courts have constitutional authority to enter final judgment in fraudulent-transfer suit; "Bankruptcy courts, having been granted the authority to do so by Congress, may enter final judgments in *all* core fraudulent transfer claims");

• *In re Skymark Properties II LLC*, 2019 WL 922654 (Bankr. E.D. Mich. Feb. 21, 2019) (single-asset real estate debtor executed assignment of rents in favor of its lender prior to petition date; post-petition, debtor filed motion to use rental income derived from leases in office building as cash collateral; lender objected, arguing that under Michigan assignment-of-rents statute, acts of (1) execution of assignment of rents, (2) recording of assignment of rents, and (3) default under mortgage were sufficient to transfer ownership of rents to lender, notwithstanding its failure to record notice of default and serve such notice on tenants pre-petition; noting split in case law, bankruptcy court ruled in lender's favor, finding that absolute assignment of rents occurs upon default under state law; therefore, debtor's cash-collateral motion was denied and case was dismissed);

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10 *Id.* at *14.
11 *Id.* at *22.
12 *Id.* at *25-26.
13 *Id.* at *28.

• *Keystone Gas Gathering LLC v. Ad Hoc Committee of Unsecured Creditors (In re Ultra Resources Inc.)*, 913 F.3d 533 (5th Cir. 2019) (joining Third Circuit, Fifth Circuit held that creditor is not "impaired" by reorganization plan simply because it incorporated Bankruptcy Code's disallowance provisions in § 502(b); accordingly, creditors who received payment in full other than their contractual make-whole claims that were disallowed under § 502(b)(2) were unimpaired for purposes of voting on plan; "A creditor is impaired under § 1124(1) only if '*the plan*' itself alters a claimant's legal, equitable or contractual rights");

• *Klein v. ODS Technologies LP (In re J&J Chemical Inc.)*, 2019 WL 183516 (Bankr. D. Idaho Jan. 11, 2019) (recipient of fraudulent transfers, who resided out of district, moved to dismiss suit for improper venue based on BAPCPA small-dollar-venue provision in 28 U.S.C. § 1409(b), which requires that small-dollar claims "arising in" or "related to" bankruptcy case must be brought in district where defendant resides; noting "knotty legal issue" and split in authority, court held that even if Congress inadvertently omitted "arising under" claims from the statute, court was required to follow its plain meaning; thus, venue for small-dollar arising-under fraudulent-transfer claim was proper);

• *Simon v. Short (In re Oakland Physicians Medical Center LLC)*, 2019 WL 442296 (Bankr. E.D. Mich. Feb. 1, 2019) (insider "loaned" $1.6 million to hospital during six years before its bankruptcy filing and received $572,000 in repayments during same period; sole issue was whether pre-petition loans were true loans or equity-capital contributions; if capital contributions, then payments to defendant were arguably fraudulent transfers, not payments on account of an antecedent debt; in 52-page opinion, court applied *Roth Steel* factors for recharacterizing debt to equity to determine that large portion of advances were capital contributions, not loans; as such, for fraudulent-transfer purposes, repayments were not made on account of an antecedent debt); and

• *Wohleber v. Skurko (In re Wohleber)*, 2019 WL 1008555 (B.A.P. 6th Cir. March 4, 2019) (debtor sought damages against creditor and its lawyer under § 362(k) for willfully violating the automatic stay by allowing post-petition sentencing portion of pre-petition contempt proceeding to continue despite their knowledge that automatic stay was in effect; reversing bankruptcy court, appellate panel held that upon debtor's bankruptcy filing, it was incumbent on creditor and its counsel to stop nonbankruptcy court from continuing collection proceedings against debtor; "A creditor cannot sit idly by, appear at a collection proceeding, and allow the debtor to be jailed because he did not pay the creditor's dischargeable debt"). abi