

FEBRUARY 26, 2020 | PUBLICATION

Client Alert: The Long Arm of the Law: Avoidance Actions Without Borders

A June 2018 Bankruptcy Court decision in the Southern District of New York (SDNY) held that foreign companies with no presence in the U.S. were subject to default judgments.

Foreign-based companies doing business in the U.S., and foreign affiliates of U.S. companies, are routinely counter-parties to a variety of commercial contracts in the U.S. Given the vicissitudes of financial and economic conditions, it is inevitable that such companies will occasionally encounter the insolvency of their counter-party. The insolvency could be pursuant to a Chapter 11 filing in the U.S. Increasingly, insolvencies are pursuant to foreign insolvency proceedings. A foreign insolvency proceeding may precipitate the filing of a Chapter 15 (of the U.S. Bankruptcy Code), which is an ancillary proceeding to assist the foreign insolvency estate regarding U.S. assets, claims and related issues.

Unfortunately, Chapter 11 cases often result in the pursuit of preference claims against parties who received payments from the debtor-counterparties prior to the Chapter 11 filing. Also, Chapter 11 estates may seek to recover payments as “fraudulent conveyances”. In Chapter 15 cases, the foreign insolvency estate may not pursue avoidance actions under the U.S. Bankruptcy Code. However, U.S. courts have ruled that the foreign insolvency estates may recover on avoidance actions based on the laws of the foreign jurisdiction, and based on state law avoidance statutes, such as the Uniform Fraudulent Transfer Act, as adopted by U.S. states.

In the Chapter 11 case of *Advance Watch Company, Ltd.*, the Bankruptcy Court for the SDNY ruled that default judgments on preference claims against Hong Kong based companies were valid and enforceable. In *Advance Watch*, the Advance Watch trustee filed adversary proceedings in the SDNY to recover payments made to the defendants. In each of the lawsuits, the Bankruptcy Court determined that the Hong Kong companies had been properly served with process under Rule 4(f) of the Federal Rules of Civil Procedure regarding service on foreign defendants. Rule 4(f) requires compliance with the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters (1965) (the “Hague Service Convention”). The Hague Service Convention in turn requires that service complies with the laws of Hong Kong.

The Hong Kong companies ignored the complaints. In response, the trustee filed motions for default

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judgments against the foreign companies. The *Advance Watch* Court noted that the Hague Service Convention is NOT applicable to service of pleadings other than the summons and complaint. Rather, FRCP 5(b)(2)(c) requires the motions for default be mailed to the defendants' last known addresses. The trustee need only submit an affidavit to that effect with no requirement of proof of actual service.

As a consequence of the Court's ruling, the Hong Kong companies are now subject to the U.S. judgments against them. Though it is not ideal to have a U.S. judgment outstanding, it is unclear of the actual impact of the judgments against the foreign defendants. Certainly, the trustee could enforce the judgments against assets located in the U.S., including the attachment of funds owed to the companies by U.S. affiliates or by third parties. Identifying assets to attach could be difficult and expensive, if the foreign entity does not maintain operations in the U.S.

Exporting a U.S. judgment abroad can be nearly impossible, since the U.S. is not a party to any bilateral or multilateral treaty among countries regarding the reciprocal enforcement of judgments. Rather Many foreign countries perceive U.S. money judgments as excessive and generally bristle at the extraterritorial exercise of jurisdiction by U.S. courts. However, some countries will enforce U.S. judgments based on such countries' internal laws and international comity. In this case, the trustee would be required to initiate a lawsuit in Hong Kong seeking enforcement of the U.S. judgment. It is unlikely a Hong Kong court would recognize a U.S. judgment against a Hong Kong company. Moreover, it is unlikely the trustee could initiate avoidance actions based on the U.S. Bankruptcy Code against the companies in Hong Kong, courts. Accordingly, it is possible that a foreign company and its assets outside the U.S. are practically insulated from a U.S. Bankruptcy Court judgment for a preference recovery.

Nevertheless, the *Advance Watch* decision illustrates the long-arm of the U.S. Bankruptcy Code, particularly preference recovery claims. If a foreign-based entity has or will have material assets or operations in the U.S., it may be advisable to defend the preference claims, particularly since such claims are usually subject to substantial defenses.

We hope you found this useful and informative. Please contact us if you have any questions about this or any other matter.

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