ALERT MEMORANDUM

Second Circuit Applies Bankruptcy Code's Securities Safe Harbor To Bar Billions of Dollars of Madoff-Related Claims

August 11, 2025

On August 5, 2025, the U.S. Court of Appeals for the Second Circuit held that over $6 billion in claims brought by the largest investment funds invested in Madoff's Ponzi scheme were barred by the Bankruptcy Code's securities safe harbor. Cleary Gottlieb Steen & Hamilton LLP successfully led and argued the appeal on behalf of a group of hundreds of defendants.

In answering the question of whether section 546(e) applies to claims brought under foreign statutes or common law, the Second Circuit held that section 546(e) bars all claims that seek to avoid covered securities transactions, regardless of whether the underlying transactions are entirely foreign transactions, and irrespective of whether the resulting claims are brought pursuant to U.S. statutes, U.S. common law, foreign statutes, or foreign common law.

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Background and Procedural History

Three British Virgin Islands ("BVI") based investment funds (the "Funds") had invested heavily in Bernard L. Madoff Investment Securities prior to the collapse of Bernie Madoff's infamous Ponzi scheme. In 2009, soon after BLMIS's fraud was revealed, the Funds entered into liquidation proceedings in the BVI. Shortly thereafter, the liquidators of the Funds (the "Liquidators") set out on a years-long crusade to claw back redemption payments made to the Funds' own shareholders prior to BLMIS's collapse under BVI contract, unjust enrichment, constructive trust and insolvency act theories.

In a series of decisions, the U.S. Bankruptcy Court for the Southern District of New York dismissed all of the Liquidators' claims except for the constructive trust claim. The Bankruptcy Court reasoned that section 546(e) "did not apply directly to the constructive trust claims and did not impliedly preempt those claims because '[c]ourts do not assume that otherwise applicable foreign law is preempted absent express statutory language to that effect.'"[1]

Following an appeal by the Liquidators and a certified interlocutory appeal by the defendants, the U.S. District Court for the Southern District of New York affirmed the judgment of the Bankruptcy Court that dismissed all claims except the constructive trust claims.[2] The Liquidators and defendants subsequently appealed to the Second Circuit.

Extraterritoriality of Section 546(e)

On the merits, the Second Circuit began by rejecting the Liquidators' argument that the defendants' position applied the safe harbor "in violation of the presumption against extraterritoriality."[3] The Second Circuit concluded that the presumption against extraterritoriality was overcome because section 561(d) of the Bankruptcy Code, which extends the section 546(e) safe harbor to cases under Chapter 15 of the Bankruptcy Code, "manifests an unmistakable congressional intent to apply extraterritorially."[4]

Indeed, the Second Circuit found it "implausible that Congress intended to allow a foreign debtor…to take advantage of U.S. bankruptcy law to bring avoidance actions unconstrained by the safe harbor that applies to the avoidance actions of a domestic trustee."[5] Moreover, foreign representatives in Chapter 15 cases, like the Liquidators, only have avoidance powers under foreign law, meaning section 561(d) "must apply extraterritorially if it is to have any effect at all."[6]

Scope of the Safe Harbor

The Second Circuit next turned to the question of whether the Liquidators' claims fell within the safe harbor's scope. The Second Circuit rejected all three of the Liquidators' arguments, holding that the safe harbor barred all of the Liquidators' claims.

First, the Liquidators argued that section 546(e) did not apply because their claims fell within the carve-out for avoidance claims brought under section 548(a)(1)(A), which allows a Chapter 11 debtor-in-possession to avoid transfers made "with actual intent to hinder, delay, or defraud" a creditor.[7] Although the Liquidators did not (and indeed, could not) bring section 548(a)(1)(A) claims directly, the Liquidators argued that their claims nevertheless fell within the carveout because they claimed that the administrator of the Funds acted with actual intent to hinder, delay, or defraud creditors.[8]

The Second Circuit rejected this argument, holding that, at most, the Liquidators' allegations established that the administrators of the Funds acted negligently or recklessly in failing to verify suspicions that BLMIS

[1] *See* Opinion at 11-12, *In re Fairfield Ltd.* Case Nos. 22-2101-bk(L) and 23-965(L) (2d Cir. Aug. 5, 2025) (ECF No. 705) ("Opinion") (citing *Fairfield III*, 2020 WL 7345988, at *10).
[2] *Fairfield Sentry Ltd. v. Citibank, N.A. London*, 630 F. Supp. 3d 463, 473 (S.D.N.Y. 2022) ("*Fairfield V*").
[3] Opinion at 21.
[4] *Id.* at 24 (citing *RJR Nabisco*, 579 U.S. at 339).
[5] *Id.* at 32.
[6] *Id.* at 24.
[7] *Id.* at 34-35 (citing § 548(a)(1)(A)).
[8] *Id.* at 35.

was engaging in fraud.[9] The Second Circuit also held that the Liquidators did not plausibly allege that the Funds' administrators' intent was attributable to the Funds. To the contrary, the Liquidators "consistently maintained that the Funds were victims of a fraud that [the administrator] perpetrated," and principles of agency law clearly establish that acts of an agent are not imputed to the principal if the agent acts adversely to the principal.[10]

Second, the Liquidators argued that the safe harbor did not bar their claims because it only applies to claims brought pursuant to the Bankruptcy Code's statutory avoidance powers.[11] Consequently, according to the Liquidators, the safe harbor does not apply to foreign statutory avoidance claims or common-law claims that a litigant could bring outside of bankruptcy, such as constructive trust.[12]

The Second Circuit rejected this argument too, noting that it contradicted the statutory text. The Second Circuit explained that section 546(e) does not say that it bars only avoidance actions that utilize the Bankruptcy Code's statutory avoidance powers, but rather says that a trustee "may not avoid" transactions that fall within the safe harbor's scope, regardless of the source of law under which the claims are brought.[13]

Third, the Liquidators attempted to "rescue" their constructive trust claims by arguing that they were not avoidance claims because they "proceed on different theories and different proof" and, therefore, did not fall within the safe harbor.[14]

The Second Circuit, however, held that whether "a claim is an avoidance claim for purposes of the safe harbor depends on the remedy sought—that is, whether it would avoid a covered transaction—rather than the legal elements of the claim."[15] The Second Circuit thus found it "dispositive" that the constructive trust claims sought a "similar remedy" as an avoidance action under the Bankruptcy Code.[16] Accordingly, the Second Circuit held that the safe harbor applied to bar the Liquidators' constructive trust claims as well.

Key Takeaways

The Second Circuit's decision has important implications for debtors and creditors, particularly in cases involving foreign debtors who have sought recognition of proceedings outside the U.S.

First, the Second Circuit's holding that section 561(d), which extends section 546(e) to Chapter 15 bankruptcy cases, "must apply extraterritorially" to claims brought under foreign law by foreign representatives in Chapter 15 ensures there is no loophole that would have allowed foreign representatives to bring claims to avoid transactions that a domestic trustee (or debtor) in a U.S. Chapter 11 proceeding could not.[17] The result is that foreign representatives cannot both benefit from the domestic forum Chapter 15 has created for foreign law claims as a "matter of comity while trying to avoid the limitations that Chapter 15 imposes on their power to bring these claims."[18]

Second, the Second Circuit clarified the requisite intent necessary to qualify for the safe harbor's carve-out for avoidance claims brought under section 548(a)(1)(A). The Second Circuit held that a foreign-law claim "need not include fraud as an element in order to fall within the carve-out" if the allegations include an actual intent to hinder, delay, or defraud creditors. However, the Second Circuit held that the "requisite actual intent" requires something more than just an intent to prefer one creditor over another. Indeed, in order to adequately plead actual intent, litigants must allege that the debtor (or its agents) had an intent to interfere with creditors' rights or collection processes. The exception therefore covers many

[9] *Id.* at 35, 36 (citing Restatement (Second) of Torts § 8A (1965)).
[10] *Id.* at 40.
[11] *Id.* at 42.
[12] *Id.*
[13] *Id*. at 43 (citing 11 U.S.C. § 546(e)).
[14] *Id.* at 49 (citations omitted).
[15] *Id.* at 50.
[16] *See id.*
[17] *Id.* at 29.
[18] *Id.* at 32 (citing *Fairfield V*, 630 F. Supp. 3d at 490).

foreign law claims that are analogous to state law claims where the allegations fall short of the actual intent to defraud required by section 548(a)(1)(A).

Third, the Second Circuit reiterated its holding in *In re Tribune* that the focus of the safe harbor is (and Congress' intent in enacting it was) to prevent "settled securities transactions" from being unwound in a way that would "seriously undermine markets in which certainty, speed, finality, and stability are necessary to attract capital."[19] The Second Circuit's decision emphasized the broad scope of the safe harbor, determining that section 546(e) bars all claims in Chapter 15 proceedings[20] that seek to avoid transactions that fall within the safe harbor's scope, regardless of whether those claims are brought pursuant to foreign or domestic statutory or common law. Moreover, the Second Circuit held that "[w]hether a claim is an avoidance claim for purposes of the safe harbor *depends on the remedy sought* . . . rather than the legal elements of the claim."[21] In so holding, the Second Circuit made clear that litigants will not be able to escape the safe harbor's reach by artfully recasting claims to avoid covered transactions under different sources of law.

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[19] *See id.* at 51 (citing *In re Tribune Co. Fraudulent Conveyance Litig.*, 946 F.3d 66, 90-92 (2d Cir. 2019)).
[20] Although this case was in the Chapter 15 context, the Second Circuit's reasoning has potential implications for Chapter 11 cases as well, insofar as the Second Circuit further clarified that the safe harbor applies to all claims, however pled and under any source of law, that seek the same or a similar remedy as avoidance claims brought under the Bankruptcy Code.
[21] *Id.* at 50 (emphasis added).