

Two Recent Decisions Reinforce – and Refine – the Protective Scope of the Bankruptcy Code’s Safe Harbors

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Two courts – the U.S. Court of Appeals for the Second Circuit in *In re Fairfield Sentry Ltd.* (Aug. 5, 2025)¹ and the U.S. Bankruptcy Court for the District of Delaware in *Opioid Master Disbursement Trust II v. Covidien Unlimited Co. et al. (In re Mallinckrodt Plc, et al.)* (Aug. 20, 2025)² – have recently addressed the reach of the safe harbor for certain qualified financial contracts as set forth in Bankruptcy Code section 546(e),³ and its companion provision for Chapter 15 cases, section 561(d).

While the factual settings differ greatly between a British Virgin Islands “claw-back” claim in the *Fairfield* Chapter 15 case and a fraudulent-transfer action arising from a spinoff in the *Mallinckrodt* Chapter 11 cases, several common themes emerge that are worthy of note:

- **Courts continue to read the Bankruptcy Code’s safe harbor reach expansively** – but with careful attention to statutory text, defined terms and transaction structure.
- **“Transaction first, not component parts” remains the rule**, yet there must still be an identified qualifying “securities contract” or “settlement payment.”
- **A qualifying participant is indispensable**, and whether complex corporate families can satisfy the “financial institution / financial participant” prong continues to get scrutinized.
- **Alternative labels may not effectively evade the safe harbor**, even when claims are couched in foreign law.
- **Extraterritorial application is settled in Chapter 15 – at least in the Second Circuit – through Bankruptcy Code section 561(d)**, the safe harbor provision that protects the rights of financial market participants in cross-border cases.

***Fairfield Sentry*: Section 546(e) Applies Extraterritorially Through Section 561(d)**

Fairfield Sentry consisted of three British Virgin Island (BVI) feeder funds that invested billions with Madoff Investments Securities. Following Madoff’s collapse, liquidators of the BVI funds sought to recover approximately \$6 billion of pre-collapse redemption payments from hundreds of investors. After obtaining Chapter 15 recognition in the Southern District of New York,⁴ the liquidators moved forward with BVI statutory and common-law claims (unjust enrichment, constructive trust, unfair preferences under BVI insolvency law, undervalue transactions under BVI insolvency law, etc.) against the investors that had redeemed their shares. Defendants moved to dismiss the liquidators’ claims on various grounds, including that the securities transactions safe harbor in Bankruptcy Code section 546(e) should bar any claim. The Bankruptcy Court dismissed the liquidators’ claims except for claims based on non-U.S. (BVI) statutory law.⁵

The U.S. Court of Appeals for the Second Circuit issued a significant decision finding that the clear intent of Congress was that all of the liquidators’ claims should be barred by the section 546(e) safe harbor, which applied extraterritorially in Chapter 15 cases, as made applicable via section 561(d). Indeed, the Court of Appeals found that the only plausible reading of section 561(d) is that it applies

extraterritorially – the general rationale being that, in Chapter 15 cases, foreign representatives only possess the avoidance powers available under foreign law because Chapter 15 expressly prohibits a foreign representative from using the statutory avoidance powers of the Bankruptcy Code. As such, for section 561(d) to have any effect or application and not be illusory, it necessarily had to apply extraterritorially to claims under foreign law. The Court of Appeals rejected the liquidators’ attempts to draw distinctions or posit alternative arguments, narrowing the issue down to the question of whether the remedy being sought would negate or claw back a transaction that the safe harbors were intended to protect. The Court of Appeals observed that “the focus of § 546(e) is the transaction, not the specific legal authority that a domestic trustee would use to avoid that transaction”, rejecting the liquidators’ efforts to limit the focus of section 561(d) to foreign statutory avoidance powers only existing under bankruptcy law.⁶ The Court of Appeals concluded in broad, non-ambiguous terms that “the safe harbor operates in Chapter 15 to prohibit claims under foreign statutory or common law that seek to avoid the same category of covered transactions.”⁷ The Court of Appeals further noted that the liquidators cannot have it both ways—they cannot “benefit[ing] 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.”⁸

This decision is notable because, during the decades since the introduction of Chapter 15, courts have disagreed as to whether the Bankruptcy Code’s avoidance provisions apply extraterritorially to avoid the transfer and recover the transferred assets.⁹

The decision is also notable from another perspective: public policy. Recognizing that Congress explicitly provided in Section 1506 that “[n]othing in [Chapter 15] prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States,” the Court of Appeals concluded that extending the safe harbor to preempt state-law claims is necessary as a matter of public policy of the United States.¹⁰ The public policy position is an important one because it alone supports applying the safe harbor broadly regardless of the extraterritorial nature of Section 561(d). Put differently, U.S. public policy should protect the “same category of protected transaction” from a foreign representative’s attacks, as such policy would protect a domestic transaction – even if the foreign representative is attacking a transaction involving collateral located outside of the U.S. In other words, under Chapter 15, a foreign representative’s claims before a bankruptcy court must stop at the doors of the safe harbor, where U.S. public policy protecting the “same category of protected transaction” safeguards the transaction against the foreign representative’s attacks, including where the transaction involves the exercise of rights to collateral located abroad.¹¹ Reliance on the public policy defense may also avoid the practical problems that could arise if one were to rely exclusively on extraterritoriality in the case, including where a U.S. court may lack personal jurisdiction over a party.

The decision cements the broad reach of the safe harbors, even in cross-border insolvencies, and prohibits foreign liquidators from trying to repackage avoidance claims under foreign statutes to skirt the Bankruptcy Code’s safe harbors. While Chapter 15 proceedings encourage comity, the decision shows an inclination for U.S. courts (at least within the Second Circuit) to enforce policy choices embedded in the Bankruptcy Code when it comes to evaluating transactions that are meant to be afforded protection under U.S. bankruptcy law.

***Mallinckrodt/Covidien*: Safe Harbor Bars Some, But Not All, Spinoff-Related Claims**

Within weeks of the *Fairfield Sentry* decision, a separate decision out of the Delaware Bankruptcy Court also addressed the application of section 546(e), this time in the context of assessing *what*

constitutes a qualifying safe harbor transaction and, further, *who* qualifies as a financial participant entitled to invoke the safe harbor's shield. In *Mallinckrodt/Covidien*, a post-emergence trust that was formed to benefit opioid liability claimants sought to avoid and recover approximately \$1.6 billion of value in transfers made in connection with the 2013 spinoff of Mallinckrodt from Covidien. Various defendants (including Covidien entities) asserted that these transfers were protected by the section 546(e) safe harbor. At issue in Covidien's motion for summary judgment was whether the court would treat the entire 231-step spinoff as one transaction "in connection with" a single securities agreement as required under section 546(e). Ultimately, the bankruptcy court indeed ruled that all 231 transaction steps of the spinoff were deemed to be transfers made "in connection with" a single securities contract, even if not every individual step itself was a settlement payment. The court rejected arguments that only isolated steps could be protected, emphasizing that the safe harbor applies to the overarching transaction subject to avoidance.

On the issue of whether there was a "qualifying participant" as required for the application of the safe harbor to the transfers, the court was split. The court found that certain defendants met the definition of "financial participant" due to their substantial currency forward and swap contracts with unaffiliated counterparties. However, other defendants did not qualify as financial participants because the court determined that the indentures pursuant to which the defendants had issued various series of notes to third parties were not themselves "securities contracts" for purposes of section 546(e). To reach this outcome, the court referred to Delaware Bankruptcy Judge Walrath's decision in *Qimonda*¹² and New York Bankruptcy Judge Drain's decision in *MPM Silicones*¹³ where they, too, were not persuaded that indentures, standing alone, are contracts for the purchase, sale or loan of a security, as opposed to contracts that set forth the governing terms for underlying notes.¹⁴

Conclusion

While the section 546(e) safe harbor is not absolute, these decisions serve as a reminder to market participants that courts remain committed to giving the Bankruptcy Code's safe harbors vigorous effect while also adhering to the statute's textual boundaries. Parties structuring complex transactions, as well as litigants asserting or contesting avoidance claims, must closely analyze both prongs of section 546(e), remain mindful of section 561(d) in cross-border contexts and recognize that re-branding an avoidance claim under foreign law may not successfully bypass the safe harbor's reach with respect to transactions that fall within its scope (regardless of the law under which the claims are asserted). Moreover, courts may look to the substance and structure of a transaction as opposed to isolating individual steps. The ruling also underscores the importance of establishing qualifying participant status with appropriate evidence of qualifying financial contracts in order to invoke the safe harbor as a shield.

¹ 147 F.4th 136 (2nd Cir. 2025).

² Adv. Proc. No. 22-50433 (BLS) Docket No. 9275, 2025 WL 2416807 (D. Del. Aug. 20, 2025).

³ Bankruptcy Code section 546(e) provides a "safe harbor" that protects against avoidance of a transfer that is "a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or

securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.” 11 U.S.C. §546(e).

⁴ Chapter 15 of the Bankruptcy Code is the U.S. adoption of the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law (“UNCITRAL”). It provides a mechanism by which a proceeding commenced in another country may be recognized by the U.S. Bankruptcy Court.

⁵ The Bankruptcy Court held that some claims, such as the constructive trust claims, were not barred because those claims were based on BVI common law as opposed to BVI statutory law, reasoning that section 546 “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.” *In re Fairfield Sentry Ltd. (Fairfield III)*, No. 10-13164, 2020 WL 7345988, at *7 (Bankr. S.D.N.Y. Dec. 14, 2020) (Op. at 11). Ultimately, however, 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.” 11 U.S.C. § 546(e) (Op. at 43).

⁶ 147 F3d. at 169 (citation omitted, emphasis provided).

⁷ *Id.*

⁸ *Id.* 170 (quoting *Fairfield Sentry Ltd. v. Citibank, N.A. London (Fairfield V)*, 630 F. Supp. 3d 463, 490 (S.D.N.Y. 2022) (internal quotation marks and citation omitted)). The Court of Appeals also found that the transactions at issue were “settlement payments” made to “financial institution[s]...in connection with a securities contract”, and that such covered transactions did not escape the safe harbor because no carve-outs (such as that for intentional fraudulent transfer claims) were applicable to rescue the claims against the defendants. *Id.* at 161-65.

⁹ In certain areas, U.S. bankruptcy law has been explicitly stated to apply extraterritorially for more than 70 years. For example, in 1952, due to confusion about the scope of a debtor’s property to be administered by a bankruptcy trustee under the Bankruptcy Act of 1898, Congress inserted the phrase “wherever located” into section 70a of the act “to make clear that a trustee in bankruptcy is vested with the title of the bankrupt in property which is located without, as well as within, the United States.” H.R. Rep. No. 82-2320, at 15 (1952), reprinted in 1952 U.S.C.C.A.N. 1960, 1976; see also Pub. L. No. 82-456, 66 Stat. 420 (July 7, 1952). This language was preserved in Section 541(a) of the Bankruptcy Code (enacted in 1978), which states that the bankruptcy estate includes the debtor’s property “wherever located and by whomever held.” Section 541(a) provides further that such property includes various “interests” of the debtor in property. However, the provisions of the Bankruptcy Code permitting avoidance and recovery of preferential or fraudulent transfers (i.e., Sections 544, 547, 548, and 550) do not expressly refer to “property of the estate” as that term is defined in Section 541. The different language has created confusion among bankruptcy courts as to whether the avoidance provisions were intended to apply to property outside the U.S.

¹⁰ 147 F.4th at 168, fn. 14.

¹¹ Citing approvingly the Bankruptcy Court's decision, the Court of Appeal noted that "a chapter 15 foreign representative (and the bankruptcy court) cannot prevent the enforcement of Close-Out Rights, even if the exercise of those rights involves the transfer of collateral located abroad[,] and cannot invoke non-U.S. law to avoid and recover those transfers if they have already occurred." 147 F.4th at 160.

¹² *In re: Qimonda Richmond, LLC*, 467 B.R. 318 (Bankr. Del.2012).

¹³ *In re MPM Silicones, LLC et al.*, No. 14-22503-rdd, 2014 WL 4436335 (Bankr. S.D.N.Y. September 9, 2014).

¹⁴ The *Mallinckrodt* court granted summary judgment in part for certain defendants and denied it for others, thus allowing some claims to proceed to further discovery.