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CASE NOTES

Bankruptcy Court Can Compel Defendants to Convey Trust Interest in Extraterritorial Realty

By Marcos A. Ramos

Kismet Acquisition, LLC v. Icenhower (In re Icenhower), 2014 WL 2978491 (9th Cir. July 3, 2014)

The United States Court of Appeals for the Ninth Circuit affirmed the order of the United States Bankruptcy Court for the Southern District of California that required the defendants-appellants to return their beneficial interest in Mexican realty to debtor's estate. The salient facts are as follows: The debtor filed its bankruptcy case on December 15, 2003. In March 2002—prior to its bankruptcy filing—the debtor transferred its interest in a fideicomiso trust (a trust under Mexican law commonly used by non-Mexican nationals to exercise ownership over real property in Mexico) to a newly formed entity that the Bankruptcy Court later determined was an alter ego of the debtor (the alter ego). At that time (in March 2002), debtor also was engaged in litigation in state court regarding the trust interest, and the Bankruptcy Court later determined that the debtor transferred its interest to the alter ego in part to shelter the trust interest.

After the debtor's bankruptcy filing, the alter ego sold its trust interest to the appellants. The sale was not disclosed in the debtor's bankruptcy case until after the transaction was consummated and the majority of the consideration paid for the alter ego's trust interest was not paid to alter ego but to other entities owned or controlled by the debtor. At the time of the sale, the appellants knew (or should have known) of the debtor's bankruptcy case and numerous "red flags" associated with the closing including the direction provided to the appellants by the debtor for payment of the consideration from the sale to entities other than the alter ego.

Ultimately, the Bankruptcy Court concluded that the alter ego was an alter ego of the debtor and that the beneficial interest in the fideicomiso trust was property of the estate as of the date of the debtor's bankruptcy filing. Accordingly, the Bankruptcy Court concluded that the sale of that interest to the appellants was an unauthorized post-petition transfer and ordered the appellants to cause the interest to be reconveyed to debtor (or its successor).

The appellants argued that the local action doctrine barred the Bankruptcy Court from exercising jurisdiction over the interest in Mexican realty. The local action doctrine bars district courts from exercising jurisdiction over actions directly affecting land in a different state. The court held, however, that the local action doctrine is preempted by 28 U.S.C. § 1334(e), which grants bankruptcy courts exclusive jurisdiction over all property, wherever located, in which the debtor has an interest. As the Bankruptcy Court ruled that the interest was the property of the estate and an unauthorized postpetition transfer had taken place, the Bankruptcy Court properly had exercised jurisdiction over the interest in the Mexican realty.

Appellants argued that the Bankruptcy Court should have honored the designation of Mexico under a forum selection clause. The court held that the public policy objective of centralizing disputes supported the Bankruptcy Court's decision to decline to enforce the forum selection clause including as the claims at issue were core proceedings not inextricably intertwined with non-core proceedings.

The appellants also challenged the Bankruptcy Court's exercise of jurisdiction as violating the comity doctrine. But that doctrine only applies where there is a "true conflict" between domestic and foreign law. Here, the court held that there was not a true conflict as the Bankruptcy Court ordered the transfer to take place consistent with the form of Mexican law and did not impose terms that purported to require recognition or enforcement of the Bankruptcy Court's order by Mexican authority.

The appellants similarly argued that the Bankruptcy Court's judgment should be vacated because Mexico was a necessary and indispensable party to the suit. The court held that the Bankruptcy Court's remedy was crafted to be consistent with existing Mexican law and therefore Mexico was not a necessary and indispensable party.

Finally, the appellants argued that Mexican law rather than U.S. law should have governed whether they were good-faith purchasers of the property. The court rejected this argument and also determined that the appellants were not good-faith purchasers including based on their knowledge of the debtor's bankruptcy filing and badges of fraud related to their purchase of interest from the alter ego.

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