SECTIONS 548 AND 550—DEVELOPMENTS IN THE LAW OF FRAUDULENT TRANSFERS AND RECOVERIES IN 2012

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I. INTRODUCTION

Fraudulent transfer law "imposes a substantive prohibition: the debtor may not dispose of his property with the intent or effect of placing it beyond the reach of his creditor."[1] Under the Bankruptcy Code,[2] fraudulent transfer avoidance and recovery are principally governed by two independent sections—sections 548 and 550, respectively. This Article provides an introductory discussion of these two provisions,[3] and examines particular cases decided in 2012 that clarified or otherwise relied on these or related provisions.

Fraudulent transfer law was the subject of many reported decisions in 2012. One of the most awaited rulings of 2012 was the decision rendered by the Eleventh Circuit Court of Appeals in *In re TOUSA, Inc.*, a decision discussed at length in last year's edition of this Article.[4] Also, as expected, the liquidation of the notorious Ponzi scheme operated through Bernard L. Madoff

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[1]Countryman, Cases and Materials on Debtor and Creditor 127 (2d ed. 1974).

[2]Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C.A. §§ 101 to 1532 (2011) (the "Bankruptcy Code")).

[3]Though this Article addresses recent developments in §§ 548 and 550, out of necessity it also discusses § 544, and other major bankruptcy provisions addressing fraudulent transfers, including § 546, a Bankruptcy Code section that places certain limits on a trustee's or debtor-in-possession's avoidance powers. See 11 U.S.C.A. §§ 544 and 546.

[4]The trio of decisions arising from the bankruptcy proceedings of TOUSA, Inc. ("TOUSA"), including the Eleventh Circuit Court of Appeal's decision issued in early 2012, were discussed at length in a previous edition of this Article.

Investment Securities continued to produce decisions of note in

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See Maryann Gallagher, Section 548 and 550—Developments in the Law on Fraudulent Transfers and Recoveries, Annual Survey of Bankruptcy Law (2012). The TOUSA bankruptcy cases arose out of a failed joint venture that left TOUSA, and certain of its subsidiaries, facing costly litigation against lenders to the joint venture ("Transeastern Lenders"). TOUSA's principles settled this litigation for approximately $421 million (the "Settlement"). To finance the Settlement, TOUSA and its subsidiaries (the "Conveying Subsidiaries") borrowed approximately $500 million in new secured debt (the "New Loan"), even though the subsidiaries were not liable for the joint venture indebtedness, were not party to the ensuing litigation, and received none of the proceeds of the New Loan, as the proceeds were earmarked specifically to fund the Settlement. Although TOUSA's management intended for the Settlement to save the enterprise from bankruptcy, the sharp decline of the real estate market, among other factors, led TOUSA and most of its subsidiaries to file for bankruptcy protection in January of 2008. Soon after the bankruptcy filing, the official committee of unsecured creditors appointed in the bankruptcy cases (the "Committee") commenced an adversary proceeding to avoid as constructively fraudulent transfers the liens and guaranties conveyed under the terms of the New Loan, and to recover the proceeds of the New Loan transferred to the Transeastern Lenders.

In *In re TOUSA, Inc.*, 422 B.R. 783 (Bankr. S.D. Fla. 2009), quashed in part, 444 B.R. 613 (S.D. Fla. 2011), aff'd in part, rev'd in part, 680 F.3d 1298, 56 Bankr. Ct. Dec. (CRR) 135, 67 Collier Bankr. Cas. 2d (MB) 1035, Bankr. L. Rep. (CCH) P 82276 (11th Cir. 2012) ("*TOUSA I*"), the bankruptcy court ruled in favor of the Committee, ordering the avoidance of the liens and obligations granted under the New Loan as constructively fraudulent transfers, pursuant to section 548(a)(1)(B) of the Bankruptcy Code and recovery from the Transeastern Lenders of the proceeds of the New Loan they received in the Settlement. The bankruptcy court stressed its finding that the Conveying Subsidiaries received "no direct value" and, if they received "any value at all, it was minimal and did not come anywhere near the millions of dollars of obligations they incurred." TOUSA I, 422 B.R. at 844. The bankruptcy court found that the lenders under the New Loan (the "New Lenders") and the Transeastern Lenders were grossly negligent when they funded the New Loan and accepted the proceeds of the New Loan, because at the time of the transfers there existed "overwhelming evidence that TOUSA was financially distressed." TOUSA I, 422 B.R. at 850–55.

On appeal by the New Lenders and the Transeastern Lenders, the district court reversed the bankruptcy court's decision holding that the transfers were not avoidable and the Settlement proceeds where not recoverable. See *In re TOUSA, Inc.*, 444 B.R. 613 (S.D. Fla. 2011), aff'd in part, rev'd in part, 680 F.3d 1298, 56 Bankr. Ct. Dec. (CRR) 135, 67 Collier Bankr. Cas. 2d (MB) 1035, Bankr. L. Rep. (CCH) P 82276 (11th Cir. 2012) ("*TOUSA II*"). The district court held that (i) the payment of the Settlement with proceeds from the New Loan to the Transeastern Lenders were not fraudulent transfers because (A) the Settlement proceeds were not property of the subsidiaries and (B) even if the proceeds were property of the subsidiaries, the subsidiaries received reasonably equivalent value in exchange for granting liens on their assets; and (ii) even if the transaction qualified as a fraudulent transfer, the Transeastern Lenders were not entities from whom a fraudulent transfer could be recovered under section

the Southern District of New York, including a landmark decision on recoverability from subsequent transferees, discussed herein.[5] Notable cases in 2012 also examined the Supreme Court's

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550 of the Bankruptcy Code because the transfers at issue were not made for the benefit of the Transeastern Lenders. Thereafter, the Committee appealed to the Eleventh Circuit Court of Appeals. The Eleventh Circuit vacated the district court's ruling and held that the Conveying Subsidiaries did not receive reasonably equivalent value in exchange for their liens and that the Transeastern Lenders were entities for whose benefit the liens were transferred. See *In re TOUSA, Inc.*, 680 F.3d 1298, 56 Bankr. Ct. Dec. (CRR) 135, 67 Collier Bankr. Cas. 2d (MB) 1035, Bankr. L. Rep. (CCH) P 82276 (11th Cir. 2012) ("*TOUSA III*"). Of particular note, the Eleventh Circuit held that the plain language of Section 550(a)(1) of the Bankruptcy Code, combined with the language of the documents governing the New Loan, supported the conclusion that the Transeastern Lenders were entities "for whose benefit" the Conveying Subsidiaries transferred the liens, and therefore recovery of the Settlement proceeds was proper. The Eleventh Circuit's decision highlights the importance of investigating a borrower's financial condition when seeking repayment perhaps more stringently than they would when underwriting a new loan.

[5] *Securities Investor Protection Corporation v. Bernard L. Madoff Inv. Securities LLC*, 480 B.R. 501, 57 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2012). On the topic of Ponzi schemes, last year's edition of this Article contained a fulsome discussion of the 2011 cases addressing the "Ponzi Scheme Presumption," and this area of law continued to develop in 2012. The "Ponzi Scheme Presumption" is a general rule that provides that where a Ponzi scheme exists, all of the transfers made in furtherance of the scheme are presumed to have been made with the actual intent to hinder, delay and defraud creditors. See *In re Bernard L. Madoff Inv. Securities LLC*, 2011 WL 3897970, *4 (S.D. N.Y. 2011); see also *In re Bayou Group, LLC*, 439 B.R. 284, 294 (S.D. N.Y. 2010) ("*Bayou IV*"); *In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 8 (S.D. N.Y. 2007); *Drenis v. Haligiannis*, 452 F. Supp. 2d 418, 429 (S.D. N.Y. 2006). See generally *In re AFI Holding, Inc.*, 525 F.3d 700, 704, 49 Bankr. Ct. Dec. (CRR) 243, Bankr. L. Rep. (CCH) P 81218 (9th Cir. 2008) (noting that the existence of a Ponzi scheme is sufficient to establish actual intent to defraud under § 548(a)(1)); *Armstrong v. Collins*, 2010 WL 1141158, *20 (S.D. N.Y. 2010) (Ponzi scheme operators necessarily act with "actual intent to defraud creditors due to the nature of their schemes" (quoting *Terry v. June*, 432 F. Supp. 2d 635, 639 (W.D. Va. 2006))); *Quilling v. Stark*, 2006 WL 1683442, *6 (N.D. Tex. 2006) (the existence of a Ponzi scheme makes the transfer of funds fraudulent as a matter of law); *In re Bernard L. Madoff Inv. Securities, LLC*, 440 B.R. 243, 255, 53 Bankr. Ct. Dec. (CRR) 268, 64 Collier Bankr. Cas. 2d (MB) 957 (Bankr. S.D. N.Y. 2010), leave to appeal denied, 2011 WL 3897970 (S.D. N.Y. 2011) ("It is now well recognized that the existence of a Ponzi scheme establishes that transfers were made with the intent to hinder, delay and defraud creditors."); *In re 1031 Tax Group, LLC*, 439 B.R. 47, 72, 53 Bankr. Ct. Dec. (CRR) 180 (Bankr. S.D. N.Y. 2010), subsequent determination, 439 B.R. 84, 53 Bankr. Ct. Dec. (CRR) 247 (Bankr. S.D. N.Y. 2010) and opinion supplemented, 439 B.R. 78, 53 Bankr. Ct. Dec. (CRR) 246 (Bankr. S.D. N.Y. 2010) (noting that if the Ponzi scheme presumption applies, "actual intent for purposes of section 548(a)(1)(A) is established 'as a matter of law.' " (quoting *In re Manhattan Inv. Fund Ltd.*,

ubiquitous *Stern v. Marshall* decision and its effect on bank-

397 B.R. at 14)); *In re Rothstein Rosenfeldt Adler, P.A.*, 2010 WL 5173796, *5 (Bankr. S.D. Fla. 2010) ("[B]ankruptcy courts nationwide have recognized that establishing the existence of a Ponzi scheme is sufficient to prove a Debtor's actual intent to defraud." (quoting *In re McCarn's Allstate Finance, Inc.*, 326 B.R. 843, 850, 44 Bankr. Ct. Dec. (CRR) 275 (Bankr. M.D. Fla. 2005))); *In re Christou*, 2010 WL 4008167 (Bankr. N.D. Ga. 2010) (stating that transfers made during the course of a Ponzi scheme are "presumptively made with intent to defraud").

Courts in the 3rd, 5th, 6th, 7th, and 11th Circuits examined the application of the Ponzi Scheme Presumption to Ponzi-like schemes and pleading standards in 2012. In *American Cancer Society v. Cook*, the Fifth Circuit examined whether the Ponzi Scheme Presumption applied in a state law fraudulent transfer context brought in an SEC receivership, to a scheme in which money raised by a securities offering was improperly utilized. *American Cancer Soc. v. Cook*, 675 F.3d 524 (5th Cir. 2012). While the relevant offering memorandum stated that 20% of the money raised would be used for management costs, the SEC discovered that a large percentage of cash was funneled to pay an insider's personal expenses. Am. Cancer Soc., 675 F.3d at 526. The court found that the assertion that the misuse of funds was part of a "Ponzi-like" scheme did not relieve the receiver's burden to prove fraudulent intent. Am. Cancer Soc., 675 F.3d at 528–29. The 7th Circuit held similarly in *In re Sentinel Management Group, Inc.*, where it declined to apply a "modified version" of the Ponzi Scheme Presumption to a case where the debtor investment manager failed to segregate customer assets and instead used customer funds to secure a loan to fund the company's operations. *In re Sentinel Management Group, Inc.*, 689 F.3d 855, 864, 56 Bankr. Ct. Dec. (CRR) 234, 68 Collier Bankr. Cas. 2d (MB) 441 (7th Cir. 2012), opinion withdrawn and vacated, 704 F.3d 1009 (7th Cir. 2012). In so holding, the court noted that the trustee failed to provide authority for the application of the modified presumption, but instead asserted simply that the debtor must have known when it perpetuated the illegal act that it would prevent its customers from recovering the principle of their investments. Sentinel, 689 F.3d at 863–64.

In the Eleventh Circuit, the district court for the Middle District of Florida went the opposite way, holding, in a motion to dismiss context, that the Ponzi Scheme Presumption may apply outside of a traditional Ponzi scheme and to parties not involved in the scheme, provided the plaintiff can prove that transfers were made in furtherance of a Ponzi scheme. *In re Pearlman*, 478 B.R. 448 (M.D. Fla. 2012). In *Pearlman,* the debtor operated several fraudulent schemes, one of which was not structured as a traditional Ponzi scheme. Pearlman, 478 B.R. at 451. The defendant bank received transfers as the result of the non-Ponzi fraud and contended that the Ponzi Scheme Presumption could not apply to those transfers. Pearlman, 478 B.R. at 453. The court declined to dismiss, instead holding that it was plausible that the transfers were indeed made in furtherance of the Ponzi scheme, a determination to be made in later proceedings. Pearlman, 478 B.R. at 454.

In the case of *DBSI, Inc.*, the bankruptcy court for the District of Delaware examined the applicability of the Ponzi Scheme Presumption to pleading standards, holding, in a motion to dismiss context, that, in addition to demonstrating the existence of a Ponzi scheme, the plaintiff in a fraudulent transfer action must also plead sufficient facts to show that the disputed transfers were

ruptcy courts' ability to enter final judgments in actions alleging fraudulent transfer.[6] In addition, the Chapter 11 case of *Idearc, Inc.*, which arose out of a 2006 spin-off by Verizon, generated three related decisions that, in the aggregate, address many of the most interesting and complex issues in fraudulent transfer law, including the recoverability of obligations, the safe harbor contained in Section 546(e) of the Bankruptcy Code, and the requirements for a "triggering creditor" under Section 544 of the Bankruptcy Code.[7] Finally, the application of the "collapsing" doctrine for imposing fraudulent transfer liability on transferees in related leveraged transactions was the focus of decisions highlighting the issues inherent in bankruptcies that occur after a leveraged buyout.[8] Many of the most important and novel 2012 fraudulent transfer decisions are addressed in Section III below.

II. BACKGROUND

Sections 548 and 550 of the Bankruptcy Code respectively set forth a trustee's or debtor-in-possession's power to avoid prepetition fraudulent transfers and obligations and rights to recover with respect to avoided transfers. Enacted as part of the original 1978 Bankruptcy Reform Act, Sections 548 and 550 of the Bankruptcy Code remained largely unchanged in their first 20 years. However, section 548, which addresses the avoidance of certain prepetition fraudulent transfers and obligations, underwent significant structural changes in 1998 as a result of the enactment of the Religious Liberty and Charitable Donation Protection Act of 1998 (the "Charitable Donation Act"),[9] and again in 2005 as a

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made in furtherance of the scheme. *In re DBSI, Inc.*, 476 B.R. 413, 56 Bankr. Ct. Dec. (CRR) 240 (Bankr. D. Del. 2012); see also *In re DBSI, Inc.*, 477 B.R. 504 (Bankr. D. Del. 2012).

[6] *Kirschner v. Agoglia*, 476 B.R. 75 (S.D. N.Y. 2012); *In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 57 Bankr. Ct. Dec. (CRR) 89, 68 Collier Bankr. Cas. 2d (MB) 1429, Bankr. L. Rep. (CCH) P 82404 (9th Cir. 2012), cert. granted, 2013 WL 3155257 (U.S. 2013); *In re G & S Livestock Co.*, 478 B.R. 906, Bankr. L. Rep. (CCH) P 82370 (S.D. Ind. 2012).

[7] *U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 2012 WL 3100778, *1 (N.D. Tex. 2012); *U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 479 B.R. 405 (N.D. Tex. 2012); *U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 892 F. Supp. 2d 805, 822-27 (N.D. Tex. 2012).

[8] *In re Bachrach Clothing, Inc.*, 480 B.R. 820, 866–67 (Bankr. N.D. Ill. 2012).

[9] Pub. L. No. 105-183, 112 Stat. 517 (1998), codified at 11 U.S.C.A. § 548(a)(2). For an in-depth discussion of the Charitable Donation Act, see

result of the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").[10]

As further discussed below, section 550, which sets forth the trustee's or debtor-in-possession's power to recover the value of avoided transfers, was also significantly amended under the Bankruptcy Amendments and Federal Judgeship Act of 1984 (the "1984 Amendments"),[11] the Bankruptcy Reform Act of 1994 (the "1994 Reform Act")[12] and BAPCPA.

A. *History and Construction of Section 548*

Section 548 is derived in large part from Section 67(d) of the Bankruptcy Act of 1898, although its history dates from the Statute of Elizabeth passed by Parliament in 1571.[13] The Statute of Elizabeth was aimed at a practice by which debtors conveyed their assets to friendly parties, thereby frustrating creditors' attempts to satisfy their claims.[14] After creditors abandoned their efforts to recover on their claims, the friendly parties would reconvey the debtor's property to the debtor, thus disadvantaging the debtor's creditors.[15]

Similar to the Statute of Elizabeth, the purpose of section 548 is to thwart such a practice by vesting in the trustee (or debtor-

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Hiren Patel, Section 548—Recent Developments in the Law of Fraudulent Transfers, Norton Annual Survey of Bankruptcy Law at 527 (1998).

[10] Pub. L. No. 109-8 (2005). BAPCPA was signed into law on April 20, 2005. While BAPCPA was largely effective on October 17, 2005, BAPCPA §§ 1501(a) and 1406(a) were effective only with respect to cases commenced on or after that date. Changes made to Bankruptcy Code § 548 and BAPCPA § 1501(b)(1) were generally effective immediately.

[11] Pub. L. No. 98-353, 98 Stat. 333 (1984).

[12] Pub. L. No. 103-394, 108 Stat. 4106, 4121 (1994) (an attempt to expressly overrule the Seventh Circuit's decision in *Levit v. Ingersoll Rand Financial Corp.*, 874 F.2d 1186, 19 Bankr. Ct. Dec. (CRR) 574, 22 Collier Bankr. Cas. 2d (MB) 36, 11 Employee Benefits Cas. (BNA) 1323, Bankr. L. Rep. (CCH) P 72910 (7th Cir. 1989) (disapproved of by, *In re Arundel Housing Components, Inc.*, 126 B.R. 216, 21 Bankr. Ct. Dec. (CRR) 959, Bankr. L. Rep. (CCH) P 73922 (Bankr. D. Md. 1991))).

[13] 30 Stat. 544 (July 1, 1898) (as amended and as subsequently repealed by the Bankruptcy Code, the "Bankruptcy Act"); see S. Rep. No. 989, 95th Cong., 2nd Sess. (1978), as reprinted in 1978 U.S.C.C.A.N. 5787.

[14] *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 644–45, 22 Bankr. Ct. Dec. (CRR) 251, 25 Collier Bankr. Cas. 2d (MB) 1064, Bankr. L. Rep. (CCH) P 74288, 15 U.C.C. Rep. Serv. 2d 1119 (3d Cir. 1991), as amended, (Oct. 28, 1991). Section 67(d) was codified at section 107(d) of old Title 11, prior to the enactment of the Bankruptcy Code.

[15] Mellon Bank, 945 F.2d at 644–45.

in-possession) the power to avoid transfers that improperly deplete the debtor's estate, the assets of which should be available to all creditors. Section 548 allows the trustee to avoid two types of transfers: those made with the intent to hinder, delay or defraud creditors ("actually fraudulent" transfers), and those made in exchange for less than reasonably equivalent value at a time when the debtor was insolvent ("constructively fraudulent" transfers). Section 548(a)(1)[16] states as follows:

> The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily:
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> (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
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> (B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
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> (ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;[17]
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> (II) was engaged in business or a transaction, or was about

[16]Due to the renumbering of § 548 that took place with the incorporation of the Charitable Donation Act, care should be taken when researching earlier cases. For example, the "reasonably equivalent value" provision in the present § 548(a)(1)(B)(i) was contained in § 548(a)(2)(A) prior to the revisions.

[17]"Insolvent" is defined by the Bankruptcy Code as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property at a fair valuation." 11 U.S.C.A. § 101(32)(A). There is no single standard that is applicable to establish an entity's solvency at the time of the transfers at issue. Courts determine solvency using a variety of methods and the issue is decided on a case-by-case basis. See, e.g., *Covey v. Commercial Nat. Bank of Peoria*, 960 F.2d 657, 661–62, 22 Bankr. Ct. Dec. (CRR) 1316, 26 Collier Bankr. Cas. 2d (MB) 1046, Bankr. L. Rep. (CCH) P 74530 (7th Cir. 1992) ("The Bankruptcy Code requires [courts] to assess things from the debtor's perspective . . . to decide whether a firm is insolvent within the meaning of [section] 548(a)(2)(B)(i) [and] a court should ask: what would a buyer be willing to pay for the debtor's entire package of assets and liabilities? If the price is positive, the firm is solvent; if negative, insolvent."); *Bayou IV*, 439 B.R. 284, 336–37 (S.D.N.Y. 2010) (establishing debtor's solvency via expert reports and testimony based on otherwise non-admissible evidence); *In re EBC I, Inc.*, 380 B.R. 348, 356, 49 Bankr. Ct. Dec. (CRR) 92, 59 Collier Bankr. Cas. 2d (MB) 203 (Bankr. D. Del. 2008), order aff'd, 400 B.R. 13 (D. Del. 2009), judgment aff'd, 382 Fed. Appx. 135 (3d Cir. 2010) ("in determining solvency under [section] 548(a)(2)(B)(i), it is appropriate to take into account intangible assets not carried on the debtor's balance sheet"); *In re Bachrach Clothing, Inc.*, 480 B.R. 820, 866–67 (Bankr.

to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

1. *Changes to Section 548 Under BAPCPA*

The prefatory paragraph of section 548(a)(1) generally gets less attention from the courts than the subtest provisions of section 548(a)(1)(A) and (B). BAPCPA, however, made two significant changes to the prefatory paragraph.[18]

The first change, discussed in detail below, relates to employ-

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N.D. Ill. 2012) (applying the "discounted cash flow" method to arrive at a corporate debtor's enterprise value, for purposes of assessing debtor's solvency in the fraudulent transfer context by analyzing present value of expected cash flows, taking into account appropriate risk); *In re Iridium Operating LLC*, 373 B.R. 283, 348 (Bankr. S.D. N.Y. 2007) ("Without a firm basis to replace management's cost projections' with those developed for litigation, the starting point for a solvency analysis should be management's projections."). The question as to who bears the burden of solvency versus insolvency has been addressed by one court under unusual circumstances. In *Eerie World*, a defendant moved for summary judgment on this issue in a trial that lasted for years. *Eerie World Entertainment, L.L.C. v. Bergrin*, 2004 WL 2712197, *2–3 (S.D. N.Y. 2004). The plaintiff's response was to rest on the allegations in the pleadings, arguing that solvency was a question of fact, not law. The court in *Eerie World* found that while solvency was a question of fact ordinarily reserved for a jury, as a response to a summary judgment motion in such a case, resting on the pleadings was entirely inappropriate and warranted judgment in the defendant's favor. See also *In re Worldcom, Inc.*, 357 B.R. 223, 230 (S.D. N.Y. 2006) (grant of debtors' summary judgment motion upheld where evidence of insolvency was so great that insolvency was decided as a matter of law).

[18] In addition to these direct changes, BAPCPA changed other Bankruptcy and United States Code provisions governing actions under § 548. One significant change relates to the venue of avoidance actions. See 28 U.S.C.A. § 1409(a). Generally, unless *de minimus*, all such actions may be brought where the bankruptcy case is venued. For *de minimus* actions, however, 28 U.S.C.A. § 1409(a) dictates that such cases may be brought only in the district in which the defendant resides. BAPCPA also adjusted the thresholds for such *de minimus* actions. Post-BAPCPA and after several annual adjustments, the current threshold for property or money judgments is $1,250, the threshold for consumer debts is $18,675 and the threshold, added by BAPCPA, for debts (excluding consumer debts) against non-insiders is $12,475. Actions seeking to avoid smaller amounts as fraudulent transfers must be brought in the district where the defendant resides. 28 U.S.C.A. § 1409(b).

ment contracts as a fourth subtest for reasonably equivalent exchange. As "transfer" is already broadly defined in the Bankruptcy Code,[19] the addition of the language: "including any transfer to or for the benefit of an insider under an employment contract" after the word "transfer" in section 548(a)(1) arguably does nothing other than communicate that Congress understands there is a perceived problem in this realm (something that could have been easily communicated in the legislative history to BAPCPA).

BAPCPA also altered the look-back period in section 548 from one to two years.[20] This change to the look-back period was applicable "only with respect to cases commenced . . . more than one year after the date of the enactment of [BAPCPA]."[21] The two-year limitation in this section is augmented by the operation of Section 546(a) of the Bankruptcy Code[22] and Section 544(b)(1)

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[19] 11 U.S.C.A. § 101(54); see *In re Bernard*, 96 F.3d 1279, 1282, 36 Collier Bankr. Cas. 2d (MB) 1585 (9th Cir. 1996) (" '[A] transfer is a disposition of an interest in property. The definition is as broad as possible . . . Under this definition, any transfer of an interest in property is a transfer, including a transfer of possession, custody or control even if there is no transfer to title, because possession, custody and control are interests in property.' " (quoting S. Rep. No. 95-989 (1978))). See generally 2 Collier on Bankruptcy ¶ 101.54 (Alan N. Resnick and Henry J. Sommer eds., 16th ed. 2012).

[20] See 11 U.S.C.A. § 548(a)(1), (b).

[21] BAPCPA § 1406(b)(2). For a case that affirms the timing element, and also considers a number of other statute of limitations, relation back, and related principles, see *In re Circle Y of Yoakum, Texas*, 354 B.R. 349, 47 Bankr. Ct. Dec. (CRR) 117 (Bankr. D. Del. 2006). The change to the look-back period is applicable to cases commenced on or after April 20, 2006.

[22] Section 546(a) provides in relevant part as follows:

> (a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of-
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> (1) the later of-
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> (A) 2 years after the entry of the order for relief; or
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> (B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A) . . .

11 U.S.C.A. § 546(a)(1). The United States Court of Appeals for the Eighth Circuit has examined the two-year look-back period of § 546(a) and held that "the plain language of § 546(a) provides that a complaint filed on the two-year anniversary of the entry of the order for relief . . . is not time barred." See *In re Raynor*, 617 F.3d 1065, 1071, 53 Bankr. Ct. Dec. (CRR) 144, 63 Collier Bankr. Cas. 2d (MB) 1765, Bankr. L. Rep. (CCH) P 81836 (8th Cir. 2010), cert. denied, 131 S. Ct. 945, 178 L. Ed. 2d 756 (2011).

of the Bankruptcy Code,[23] the latter of which allows the trustee to pursue causes of action arising under state fraudulent transfer law, which in turn can offer a look-back period of four or more years.[24]

The majority of the attention paid by the courts to section 548(a) is focused on the subtests in section 548(a)(1)(A) and section 548(a)(1)(B)—the "actual" and "constructive" fraud tests.[25]

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[23]Section 544(b)(1) provides as follows:

> Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

11 U.S.C.A. § 544(b)(1). See generally *In re Adelphia Recovery Trust*, 634 F.3d 678, 692 n.6, 54 Bankr. Ct. Dec. (CRR) 89 (2d Cir. 2011); *In re Moore*, 608 F.3d 253, 259–61, 53 Bankr. Ct. Dec. (CRR) 68, Bankr. L. Rep. (CCH) P 81781 (5th Cir. 2010). In a 2009 bankruptcy court decision, the court concluded that the federal look-back period under § 548(a)(1)(A) does not preempt the applicable state fraudulent transfer look-back period. *In re Supplement Spot, LLC*, 409 B.R. 187, 197–99 (Bankr. S.D. Tex. 2009).

[24]All but a handful of states have adopted the Uniform Fraudulent Transfers Act ("UFTA"), which provides that, for fraudulent transfers made with actual intent, the look-back period is either four years, or one year after the transfer or obligation was or could have reasonably been discovered by the claimant, whichever is greater. See UFTA § 9(a); accord *In re Maine Poly, Inc.*, 317 B.R. 1, 7-12 (Bankr. D. Me. 2004) (the court examined both Maine's UFTA and § 548 of the Bankruptcy Code to determine that the parent corporation's receipt of debt cancellation as part of an asset sale was affected with no actual intent to hinder, delay, or defraud creditors). Alaska, Kentucky, Louisiana, Maryland, New York, South Carolina and Virginia have not adopted the UFTA. See Legislative Fact Sheet—Fraudulent Transfer Act of the National Conference of Commissioners on Uniform State Laws, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Fraudulent Transfer Act (last visited on March 27, 2013).

[25]See *In re Hannover Corp.*, 310 F.3d 796, 799, 40 Bankr. Ct. Dec. (CRR) 116, 49 Collier Bankr. Cas. 2d (MB) 1061, Bankr. L. Rep. (CCH) P 78741 (5th Cir. 2002); *Frierdich v. Mottaz*, 294 F.3d 864, 869–70, 39 Bankr. Ct. Dec. (CRR) 210, Bankr. L. Rep. (CCH) P 78674, 47 U.C.C. Rep. Serv. 2d 1451 (7th Cir. 2002) (trustee can prove actual intent to defraud by circumstantial evidence, such as whether the debtor retained control of the property after the transfer, whether he had a close relationship with the transferee, whether he received consideration for the transfer and whether he made the transfer before or after being threatened with suit by his creditors); cf. *In re Erlewine*, 349 F.3d 205, 211–13, 42 Bankr. Ct. Dec. (CRR) 12, Bankr. L. Rep. (CCH) P 78938 (5th Cir. 2003) (despite description of division of property contained therein as "disproportionate," court required a showing of actual fraud before failing to give comity to state divorce decree). As discussed in more detail below, the distinction between the actual and constructive fraud sections becomes a determinative factor with respect to a number of rights and remedies (e.g., with

With respect to the actual fraud test, several cases discuss the so-called "badges of fraud" that parties may present as circumstantial evidence to establish fraudulent intent because of the difficulty in proving actual fraud.[26]

Additionally, numerous cases discuss what does or does not constitute "reasonably equivalent value" for purposes of constructive fraud under section 548(a)(1)(B)(i) and the standards or proof for establishing such value.[27]

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respect to the limitations on avoidance contained in §§ 546 and 548(c) of the Bankruptcy Code).

[26]See, e.g., *Bayou IV*, 439 B.R. 439 B.R. 284, 307 (S.D.N.Y. 2010) (payments to investors in the fund operated as a Ponzi scheme were accompanied by numerous "badges of fraud" sufficient to imply actual intent to defraud on the part of the fund's principals) (*Bayou IV* was discussed at length in a previous edition of this Article, see Maryann Gallagher, Section 548 and 550—Developments in the Law on Fraudulent Transfers and Recoveries, Norton Annual Survey of Bankruptcy Law (2011)); see also *Adelphia Recovery Trust v. Bank of America, N.A.*, 624 F. Supp. 2d 292, 334–35 (S.D. N.Y. 2009) (margin lenders had reason to believe debtor was insolvent but continued to accept loan payments in order to keep margin lending facilities open, thus prolonging fraud); *In re Frierdich*, 294 F.3d at 870; *ASARCO LLC v. Americas Mining Corp.*, 396 B.R. 278 (S.D. Tex. 2008) (court found actual intent to hinder, delay and defraud creditors by a preponderance of the evidence after examining "badges of fraud" and other circumstantial evidence that demonstrated knowledge that the transaction as structured would hinder, delay and defraud some creditors despite the legitimate business purpose of payment of a security interest); *In re Bernard L. Madoff Inv. Securities, LLC*, 440 B.R. 243, 259 n.18, 53 Bankr. Ct. Dec. (CRR) 268, 64 Collier Bankr. Cas. 2d (MB) 957 (Bankr. S.D. N.Y. 2010), leave to appeal denied, 2011 WL 3897970 (S.D. N.Y. 2011) (noting that many courts examine "badges of fraud" as a means of determining fraudulent intent based on circumstantial evidence); *In re Phillips*, 379 B.R. 765, 778 (Bankr. N.D. Ill. 2007) (cumulative effect of the presence of numerous "badges of fraud" together with trustee's direct evidence was probative of actual intent); *In re MarketXT Holdings Corp.*, 376 B.R. 390, 405 (Bankr. S.D. N.Y. 2007) ("[b]adges of fraud are 'circumstances so commonly associated with fraudulent transfers that their presence gives rise to an inference of intent,' and they are allowed as proof 'due to the difficulty of proving actual intent to hinder, delay or defraud creditors.' " (citations omitted)); *In re Knippen*, 355 B.R. 710, 721–22 (Bankr. N.D. Ill. 2006), judgment aff'd, 2007 WL 1498906 (N.D. Ill. 2007) ("Because there is rarely direct evidence of the intent underlying a transfer of property, courts look to circumstantial evidence, referred to as the badges of fraud, in determining whether a transfer was intended to hinder, delay, or defraud creditors.").

[27]See, e.g., *TOUSA II*, 444 B.R. 613, 660 (S.D. Fla. 2011), aff'd in part, rev'd in part, *TOUSA III*, 680 F.3d 1298 (11th Cir. 2012); see also *In re Southeast Waffles, LLC*, 460 B.R. 132, 139–40, 55 Bankr. Ct. Dec. (CRR) 233, Bankr. L. Rep. (CCH) P 82115, 2011-2 U.S. Tax Cas. (CCH) P 50740, 108 A.F.T.R.2d 2011-7337 (B.A.P. 6th Cir. 2011), aff'd, 702 F.3d 850, 57 Bankr. Ct. Dec. (CRR) 80, Bankr. L. Rep. (CCH) P 82389, 2012-2 U.S. Tax Cas. (CCH) P 50708, 110 A.F.T.R.2d 2012-6953 (6th Cir. 2012), aff'd, 2012 WL 6050348 (6th Cir. Dec. 6,

As noted above, however, BAPCPA added a subtest for constructive fraud—one specifically targeted at employment contracts. This additional subtest is the second change to section 548 with respect to insiders under employment contracts. This change may result in a lessening of the preventive nature of sec-

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2012) (although reasonably equivalent value typically is a question of fact, payment prior to bankruptcy of tax penalty that reduced debtor's tax liability on a dollar for dollar basis was made for reasonably equivalent value); *In re Kendall*, 440 B.R. 526, 532–33, 64 Collier Bankr. Cas. 2d (MB) 1404, Bankr. L. Rep. (CCH) P 81898 (B.A.P. 8th Cir. 2010) (the question of receipt of reasonably equivalent value is a factual determination and finding that, with respect to indirect benefits, value is conferred "so long as there is some chance that a contemplated investment will generate a positive return at the time of the disputed transfer"); *In re TriGem America Corp.*, 431 B.R. 855, 867, 53 Bankr. Ct. Dec. (CRR) 110 (Bankr. C.D. Cal. 2010) (indirect benefits can suffice as reasonably equivalent value "if they are 'fairly concrete and identifiable.' " (citing *TOUSA I*, 422 B.R. 783, 846–50 (Bankr. S.D. Fla. 2009))); *In re Goldstein*, 428 B.R. 733, 736, 64 Collier Bankr. Cas. 2d (MB) 202 (Bankr. W.D. Mich. 2010) (holding the same); *Grochocinski v. Schlossberg*, 402 B.R. 825, 835 n.7 (N.D. Ill. 2009) (issue of reasonably equivalent value is an element of the prima facie case to prove fraud in law) (citing *General Elec. Capital Corp. v. Lease Resolution Corp.*, 128 F.3d 1074, 1079, 47 Fed. R. Evid. Serv. 1074 (7th Cir. 1997)); *In re EBC I, Inc.*, 356 B.R. 631, 642, 47 Bankr. Ct. Dec. (CRR) 131 (Bankr. D. Del. 2006) (to the extent debtor paid more to defendant than the value of the services received, the termination of the contract eliminated that value, and thus the debtor received less than reasonably equivalent value); *In re Knippen*, 355 B.R. at 710 (the determination of "reasonably equivalent value" under § 548(a)(1)(B) is a two-step process where the court must first determine whether the debtor received value, and then examine whether the value is reasonably equivalent to what the debtor gave up); *In re Terry Mfg. Co., Inc.*, 358 B.R. 429, 434, 47 Bankr. Ct. Dec. (CRR) 110 (Bankr. M.D. Ala. 2006) ("reasonably equivalent value" is a fact-intensive question, not generally appropriate for summary judgment); see also *In re Northern Merchandise, Inc.*, 371 F.3d 1056, 1058–59, 43 Bankr. Ct. Dec. (CRR) 49, Bankr. L. Rep. (CCH) P 80112 (9th Cir. 2004) (finding reasonably equivalent value in return for security interests granted by debtor to secure loan to shareholders, when debtor actually benefited from the loan); *Pension Transfer Corp. v. Beneficiaries Under Third Amendment To Fruehauf Trailer Corporation Retirement Plan No. 003*, 319 B.R. 76, 86, 34 Employee Benefits Cas. (BNA) 1361 (D. Del. 2005), aff'd, 444 F.3d 203, 46 Bankr. Ct. Dec. (CRR) 100, 37 Employee Benefits Cas. (BNA) 1796, Bankr. L. Rep. (CCH) P 80483 (3d Cir. 2006) (the opportunity to receive economic benefit in the future is "value" under the Bankruptcy Code); *In re Denison*, 292 B.R. 150, 154–55 (E.D. Mich. 2003) (contractual rights to future consideration can provide reasonably equivalent value); *In re Solomon*, 300 B.R. 57, 64–67 (Bankr. N.D. Okla. 2003), order aff'd, 299 B.R. 626 (B.A.P. 10th Cir. 2003) (concluding that, securing antecedent debt provides value to the debtor, but that such value was not reasonably equivalent because, even if the lender did "provide some small measure of forbearance in exchange for the mortgages," the deprivation of property from the debtors' other creditors made the transaction overall lack reasonably equivalent value).

tion 548 in this regard because the inclusion of a subtest specifically addressing transfers under employment contracts with respect to insiders[28] may actually act to bar recovery in such instances. By including such a provision in the constructive fraud section, Congress first requires such transfers to be for less than reasonably equivalent value, a subject of much debate and often the cause of costly litigation. Further, the "not in the ordinary course" language included in the subtest may prove difficult to satisfy.[29]

2. *Section 548(a)(2): The Charitable Donation Act*

Section 548 contains a number of provisions *other than* the actual and constructive fraud provisions in section 548(a)(1). Section 548(a)(2), for example, codifies the Charitable Donation Act, as follows:

> (a) (2) A transfer of a charitable contribution to a qualified religious or charitable entity or organization shall not be considered to be a transfer covered under paragraph (1)(B) in any case in which-
>
> (A) the amount of that contribution does not exceed 15 percent of the gross annual income of the debtor for the year in which the transfer of the contribution is made;[30] or
>
> (B) the contribution made by a debtor exceeded the percentage amount of gross annual income specified in

[28]11 U.S.C.A. § 548(a)(1)(B)(ii)(IV) (deeming constructively fraudulent and avoidable transfers made or obligations incurred for less than reasonably equivalent value "to or for the benefit of an insider, under an employment contract and not in the ordinary course of business").

[29]Two decisions have held that severance payments to former insiders were constructively fraudulent under § 548(a)(1)(B) because even though the executives were not insiders when the payments were made, they were insiders at the time the payments were arranged. See *In re TransTexas Gas Corp.*, 597 F.3d 298, 52 Bankr. Ct. Dec. (CRR) 199, Bankr. L. Rep. (CCH) P 81684 (5th Cir. 2010); *In re TSIC, Inc.*, 428 B.R. 103 (Bankr. D. Del. 2010). The defense asserting that executives were not insiders when the severance was paid failed because insider status is determined when the obligation to pay severance is incurred. The argument that prior services provided the reasonably equivalent value required to defeat an action seeking to avoid severance as a constructively fraudulent transfer under § 548(a)(1)(B)(ii)(IV) was not successful. *In re TSIC, Inc.*, 428 B.R. 103 (Bankr. D. Del. 2010).

[30]One court determined that where a debtor's business is a sole proprietorship, the debtor's "gross income" for purposes of calculating charitable contributions under § 548(a)(2) shall be the debtor's gross receipts, without subtracting the cost of goods or operating expenses. *In re Lewis*, 401 B.R. 431, 445, 61 Collier Bankr. Cas. 2d (MB) 1051, Bankr. L. Rep. (CCH) P 81452 (Bankr. C.D. Cal. 2009).

> subparagraph (A), if the transfer was consistent with the practices of the debtor in making charitable contributions.

The Charitable Donation Act also amended section 544(b), preempting any attempt to use that section to avoid a charitable donation otherwise protected under section 548(a)(2).[31]

Bankruptcy courts have reviewed the plain meaning of the section, concluding that the 15 percent limitation in section 548(a)(2)(A) is, in essence, a qualifying criterion for a transfer, not a measuring device for propriety.[32] Thus, if a transfer exceeds the 15 percent mark, even by a penny, the entire transfer will not be afforded the protections of section 548(a)(2)(A).[33] Another problem with section 548(a)(2) is that, as drafted, the provision applies to single transfers.[34] Thus, while a single transfer in and of itself may not exceed the limitation, aggregated transfers within a single year may do so and the language of this section calls into question whether they would still be afforded protection. A court that considered what was required for a transfer to be "consistent with the practices of the debtor" determined that a $20,000 donation was inconsistent with practices when the largest previous donation was $2,000, and exceeded annual cumulative donations in past years.[35] One should also note that in order

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[31] Section 544(b)(2) now provides:

> Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3)) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

11 U.S.C.A. § 544(b)(2). As stated by the Ninth Circuit Bankruptcy Appellate Panel, "with the 1998 [Charitable Donation] Act, Congress unequivocally established the priority of charitable contributions. The clear and unmistakable message is that the interests of creditors are subordinate to the interests of charitable organizations, and we must follow this mandate." *In re Cavanagh*, 250 B.R. 107, 113, 36 Bankr. Ct. Dec. (CRR) 100, Bankr. L. Rep. (CCH) P 78233 (B.A.P. 9th Cir. 2000) (using § 548(a)(2) to provide guidance for a Chapter 13 plan).

[32] *In re Zohdi*, 234 B.R. 371, 374–84, 34 Bankr. Ct. Dec. (CRR) 609, 42 Collier Bankr. Cas. 2d (MB) 453 (Bankr. M.D. La. 1999); see also *In re Witt*, 231 B.R. 92, 97–100, 34 Bankr. Ct. Dec. (CRR) 22 (Bankr. N.D. Okla. 1999) (finding § 548(a)(2) to be constitutional).

[33] Such a transfer still may be afforded protection under § 548(a)(2)(B), if applicable. See In re Zohdi, 234 B.R. at 374–85.

[34] Zohdi, 234 B.R. at 380 n.20.

[35] *In re Jackson*, 249 B.R. 373, 377 (Bankr. D. N.J. 2000).

to invoke the protections of the Charitable Donation Act in this regard, the debtor must be a "natural person."[36]

3. *Section 548(b): Avoidance of Transfers to Partners*

Section 548(b) sets out the avoidance powers by the trustee of a partnership debtor of transfers to general partners of the debtor,[37] and is rarely litigated.[38]

4. *Section 548(c): The Savings Clause*

Section 548(c) contains a "savings clause" that protects transferees who would otherwise be subject to section 548 avoidance if they took "for value and in good faith" by granting such transferees lien rights, retained interests or enforcement rights, as the case may be, with respect to the interest transferred or obligation incurred to the extent that the transferees gave value to the debtor in exchange for such transfer or obligation.[39] Unless

[36] 11 U.S.C.A. § 548(d)(3)(A); *Universal Church v. Geltzer*, 463 F.3d 218, Bankr. L. Rep. (CCH) P 80725, 36 A.L.R. Fed. 2d 649 (2d Cir. 2006); *In re C.F. Foods, L.P.*, 280 B.R. 103, 111 n.17 (Bankr. E.D. Pa. 2002).

[37] Section 548(b) provides:

> The trustee of a partnership debtor may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, to a general partner in the debtor, if the debtor was insolvent on the date such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

11 U.S.C.A. § 548(b).

[38] See *In re Labrum & Doak, LLP*, 227 B.R. 383, 386–87, 33 Bankr. Ct. Dec. (CRR) 598 (Bankr. E.D. Pa. 1998) (dissolved law firm's general partners who received payments otherwise in violation of § 548(b) may retain the payments if the criteria of § 548(c) savings clause are met); *In re 1634 Associates*, 157 B.R. 231, 233–34, 24 Bankr. Ct. Dec. (CRR) 957 (Bankr. S.D. N.Y. 1993) (holding that § 548(b) applies to indirect transfers made for the benefit of general partners); see also *In re Prime Realty, Inc.*, 380 B.R. 529, 537 n.2, 49 Bankr. Ct. Dec. (CRR) 71 (B.A.P. 8th Cir. 2007) (finding that the debtor's long-term obligations to its limited partners pursuant to purchase contracts were not considered liabilities on its balance sheet in its insolvency analysis).

[39] Section 548(c) provides:

> Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

11 U.S.C.A. § 548(c).

the transferee demonstrates good faith and value[40] to the debtor,[41] the trustee will prevail.[42] Section 548(c) has been the topic of much litigation.[43]

5. *Section 548(d): Definitions*

Section 548(d) is a subsection containing definitions used in the section, and is too lengthy to set forth herein in its entirety.[44] Except for the safe harbor provision contained in section

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[40]Value for purposes of § 548 is defined as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." 11 U.S.C.A. § 548(d)(2)(A).

[41]The defendant has the burden of showing good faith and value for purposes of § 548(c). See generally 5 Collier on Bankruptcy ¶¶ 548.09[2][c], 548.11[1][b][iii] (Alan J. Resnick and Henry J. Sommer eds., 16th ed. 2012).

[42]See *In re Rosen Auto Leasing, Inc.*, 346 B.R. 798, 805–06, 46 Bankr. Ct. Dec. (CRR) 235 (B.A.P. 8th Cir. 2006).

[43]See *In re Dreier LLP*, 462 B.R. 474, 487 (Bankr. S.D. N.Y. 2011) (holding, among other things, that where complaint does not establish defendant's affirmative good faith defense, defendant's motion to dismiss on that basis would be denied); *In re Bernard L. Madoff Inv. Securities LLC*, 458 B.R. 87, 105, 55 Bankr. Ct. Dec. (CRR) 139 (Bankr. S.D. N.Y. 2011), leave to appeal denied, 464 B.R. 578 (S.D. N.Y. 2011); *Bayou IV*, 439 B.R. 284, 308 (S.D.N.Y. 2011) (a transferee bears the burden of "proving that it took: (1) 'for value . . . to the extent that [it] gave value' to the debtor in exchange for such transfer and (2) 'in good faith.' "); see also *In re Northern Merchandise, Inc.*, 371 F.3d 1056, 1060, 43 Bankr. Ct. Dec. (CRR) 49, Bankr. L. Rep. (CCH) P 80112 (9th Cir. 2004) (finding good faith where a loan incurred by a debtor's shareholders for the benefit of the debtor was secured with corporate assets, as value given to the debtor's estate). It is not necessarily dispositive that a transaction be entered into at arm's length. See *In re e2 Communications, Inc.*, 320 B.R. 849, 858, 43 Bankr. Ct. Dec. (CRR) 277 (Bankr. N.D. Tex. 2004) ("[H]ow arm's-length negotiations leading up to the execution of the [agreement] is relevant to this avoidance action is not explained by the Defendant. The Court sees little, if any, relevance at this time. Rather, what is relevant to a fraudulent transfer claim is the Debtor's intent in entering into the transaction . . ."). But see *In re Jones*, 304 B.R. 462, 475–76, 51 Collier Bankr. Cas. 2d (MB) 874 (Bankr. N.D. Ala. 2003) (finding good faith in an arm's length pawn transaction even though the debtor received far less than reasonably equivalent value in the transaction).

[44]BAPCPA changed § 548(d) in a manner consistent with the changes to § 546 noted below, namely to include "financial participants" to the general protections contained in § 548(d)(2)(B) to (D) (creating statutory definitions of when a transfer is made "for value" with respect to certain securities transactions). Similarly, BAPCPA added a new § 548(d)(2)(E) which included, in parallel to the addition of § 546(j), "master netting agreements" to those transfers that are statutorily "for value."

548(d)(2),[45] which was litigated on several occasions in 2001,[46] section 548(d) is rarely the subject of litigation.[47]

6. *Section 548(e): Transfers to Self-Settled Trusts*

Section 548(e) addresses transfers to asset protection trusts.[48] Under section 548(e), a trustee can avoid a debtor's transfer of an interest in property made within 10 years of the filing if the transfer was made to a self-settled trust or similar device by the debtor for the benefit of the debtor and the transfer was made with the actual intent to hinder, delay or defraud any creditor. This section was added by BAPCPA and is targeted at persons

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[45]This provision shelters transfers involving a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency that receives 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. See 11 U.S.C.A. § 548(d)(2)(B).

[46]*In re Paramount Citrus, Inc.*, 268 B.R. 620, 624–26 (M.D. Fla. 2001) (§ 548(d)(2)(B) cannot be used to shelter a transfer unless the debtor itself had an account with the commodity broker); *In re Adler, Coleman Clearing Corp.*, 263 B.R. 406, 480–85, 44 U.C.C. Rep. Serv. 2d 1125 (S.D. N.Y. 2001).

[47]See *Frierdich v. Mottaz*, 294 F.3d 864, 867, 39 Bankr. Ct. Dec. (CRR) 210, Bankr. L. Rep. (CCH) P 78674, 47 U.C.C. Rep. Serv. 2d 1451 (7th Cir. 2002) (definition of "transfer" under § 548(d)(1)); see also *Anand v. National Republic Bank of Chicago*, 239 B.R. 511, 517, 42 Collier Bankr. Cas. 2d (MB) 1528 (N.D. Ill. 1999) (while collateralization of an antecedent debt may afford the debtor reasonably equivalent value under § 548(a)(l)(B)(i), reasonably equivalent value must be determined on a case-by-case basis).

[48]Section 548(e) provides:

> (e)(1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if:
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> (A) such transfer was made to a self-settled trust or similar device;
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> (B) such transfer was by the debtor;
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> (C) the debtor is a beneficiary of such trust or similar device; and
>
> (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.
>
> (2) For the purposes of this subsection, a transfer includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would be incurred by:
>
> (A) any violation of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws; or
>
> (B) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78l and 78o(d)) or under section 6 of the Securities Act of 1933 (15 U.S.C. 77f).

11 U.S.C.A. § 548(e).

who seek to use self-settled trusts to avoid paying creditors. A self-settled trust was commonly referred to as the "millionaire's loophole,"[49] and the provision added by section 548(e) was intended to curb the move by several states to exempt self-settled trusts from bankruptcy treatment.

The methodology of section 548(e) stems from the language of section 541 of the Bankruptcy Code (the statute defining property of a debtor's estate).[50] Under section 541(c)(2), restrictions on the transfer of beneficial interests in trusts that are "enforceable under applicable non-bankruptcy law" are made enforceable in a bankruptcy case (thereby causing such property to be excluded from the debtor's bankruptcy estate).[51] Rather than revise section 541, however, Congress chose instead to alter the application of section 548 by implementing section 548(e). The result is that a trustee can avoid a debtor's transfer of an interest in property made within 10 years of the filing if the transfer was made to a self-settled trust or similar device by the debtor for the benefit of the debtor and the transfer was made with the actual intent to hinder, delay or defraud any creditor.[52]

B. *Protections for Financial Contracts*

BAPCPA also made a number of significant changes affecting

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[49]The language in § 548(e) was chosen over competing changes introduced in the House of Representatives under the title of the "Billionaire's Loophole Elimination Act." H.R. 1278, 109th Cong., 1st Sess. (March 14, 2005).

[50]11 U.S.C.A. § 541(c)(2).

[51]Gretchen Morgenson, Proposed Law on Bankruptcy Has Loophole, N.Y. TIMES, March 2, 2005. Five states (Alaska, Delaware, Nevada, Rhode Island and Utah) enacted such laws between 1997 and the implementation of BAPCPA.

[52]Unlike the changes with respect to insider transfers, this provision is somewhat elegant in nature. By permitting the trustee to avoid the transfer to the trust (or similar device), Congress need not engage in tricky rulemaking with respect to § 541(c)(2). States remain free to protect such trusts but, if the transfers are fraudulent, the trust may be deemed to fail regardless. The impact of § 548(e) has been discussed in several cases. See *In re Mortensen*, 2011 WL 5025249 (Bankr. D. Alaska 2011) (transfers to a self-settled trust avoidable as fraudulent); see also *In re Porco, Inc.*, 447 B.R. 590, 594–97, 54 Bankr. Ct. Dec. (CRR) 153, Bankr. L. Rep. (CCH) P 81989 (Bankr. S.D. Ill. 2011) (constructive trust not a "similar device" to self-settled asset protection trust for avoidance under section 548(e)); *In re Mastro*, 465 B.R. 576 (Bankr. W.D. Wash. 2011), appeal dismissed, 2013 WL 623097 (W.D. Wash. 2013) (transfers to self-settled trusts were avoidable as fraudulent); *In re Potter*, 2008 WL 5157877, *8 (Bankr. D. N.M. 2008) (holding that § 548(e) applied to a trust even when the debtor was one of multiple beneficiaries and that transfers by a limited liability company to the trust were considered "by" the debtor when he was the sole member of the limited liability company).

the treatment of financial contracts in the context of actions under section 548 and related sections of the Bankruptcy Code, and section 546 in particular. With these changes, transfers that are margin or settlement payments made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant,[53] securities clearing agency,[54] or to a repurchase participant or financial participant in connection with a repurchase agreement[55] may only be avoided if actually fraudulent under section 548(a)(1)(A), but not if merely constructively fraudulent under section 548(a)(1)(B).[56] The same treatment applies to transfers made by or to a swap participant or financial participant under or in connection with any swap agreements[57] and transfers made by or to a master netting participant under or in connection with any master netting agreement or any individual contract covered thereby. As those changes relate to section 548, they include the addition of "financial participants" to the various financial contract parties who may be deemed to take for value under section 548(d)(2)[58] and the inclusion of "master

[53] 11 U.S.C.A. § 101(22A) (defining "financial participant").

[54] 11 U.S.C.A. § 546(e) (BAPCPA added "financial participant" to this group). Section 546(e) provides:

> Notwithstanding [s]ections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment as defined in [s]ection 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 [s]ection 741(7), commodity contract, as defined in [s]ection 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.A. § 546(e).

[55] 11 U.S.C.A. § 546(f) (BAPCPA added "financial participant" to this group).

[56] See *Picard v. Katz*, 462 B.R. 447, 451–52, 55 Bankr. Ct. Dec. (CRR) 133, Bankr. L. Rep. (CCH) P 82077 (S.D. N.Y. 2011), motion to certify appeal denied, 466 B.R. 208, 55 Bankr. Ct. Dec. (CRR) 266 (S.D. N.Y. 2012); *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 332, 55 Bankr. Ct. Dec. (CRR) 12, 65 Collier Bankr. Cas. 2d (MB) 1833 (2d Cir. 2011); *In re QSI Holdings, Inc.*, 571 F.3d 545, 548–49, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009).

[57] See 11 U.S.C.A. § 546(g) (BAPCPA added "financial participant" to this group and changed the wording of this provision);11 U.S.C.A. § 546(j) (added by BAPCPA).

[58] See 11 U.S.C.A. § 548(d)(2)(B) to (D) (each adding "financial participants" to those who may take "for value" under certain financial contracts); see also 11

netting agreements" to the various types of financial contracts that are afforded the same protection.[59]

The former change protects parties, defined as "financial participants," whose transactions total a gross dollar value of at least $1 billion in notional or actional principal amount or gross mark-to-market positions of at least $100 million (aggregated across counterparties) in one or more agreements or transactions, in any day during the previous 15-month period.[60] As noted by the FDIC, these changes aimed to "reduce systemic risk by providing greater clarity to the rights available to larger participants in markets."[61] The latter change, the addition of "master netting agreements," parallels the addition of section 561 of the Bankruptcy Code, clarifying the ability of counterparties to net payments across different categories of financial contracts[62] by making it clear that such netting may be for value under section 548(d)(2).

The treatment of financial contracts was further modified by the passage of the Financial Netting Improvement Act of 2006 (the "2006 Act")[63] which, among other things, clarified the types of transfers and payments that are subject to the statutory safe harbor from avoidance actions provided by section 546(e) of the Bankruptcy Code.[64] The updates and revisions to the descriptions of certain financial transactions were intended to better reflect current market and regulatory industry practice. Notably, in ad-

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U.S.C.A. § 101(22A) (defining "financial participant"); cf. 11 U.S.C.A. § 546(e) to (g).

[59]11 U.S.C.A. § 548(d)(2)(E) ("a master netting agreement participant that receives a transfer in connection with a master netting agreement or any individual contract covered thereby, takes for value to the extent of such transfer, except that, with respect to a transfer under any individual contract covered thereby, to the extent that such master netting participant otherwise did not take (or is otherwise not deemed to have taken) such transfer for value").

[60]11 U.S.C.A. § 101(22A)(A).

[61]See Michael H. Krimminger, Adjusting the Rules: What Bankruptcy Reform Will Mean for Financial Market Contracts, FYI: An Update on Emergency Issues on Banking, http://www.fdic.gov/bank/analytical/fyi/2005/101105fyi.html (last visited March 27, 2013).

[62]See 11 U.S.C.A. § 561; see also 11 U.S.C.A. § 101(38A) (defining "master netting agreement"); 11 U.S.C.A. § 101(38B) (defining "master netting agreement participant").

[63]See Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5 (2006).

[64]Pub. L. 109-390 (2006). The Financial Netting Improvement Act of 2006 also amends provisions of the Bankruptcy Code to conform with parallel provisions in the Federal Deposit Insurance Act and the Federal Credit Union Act.

dition to margin and settlement payments, which were already protected under section 546(e), the 2006 Act expanded this provision to encompass transfers made to or for the benefit of a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant or securities clearing agency in connection with any securities, commodities or forward contracts. The 2006 Act also expanded the section 546(e) safe harbor to include swap and repurchase agreement participants by virtue of amending certain definitional provisions of the Bankruptcy Code.[65]

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[65]Section 546(e) of the Bankruptcy Code insulates "margin payments" and "settlement payments" made to or by a broker or financial institution from challenge as fraudulent transfers, absent a showing of actual fraudulent intent. "Settlement payments" are defined by § 741(8) of the Bankruptcy Code, in substance, as settlement payments or similar payments commonly used in the securities trade. For the language of § 546(e), see supra note 54. Recent decisions addressing the safe harbor provided by § 546(e) include: *U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 892 F. Supp. 2d 805 (N.D. Tex. 2012); *AP Services LLP v. Silva*, 483 B.R. 63, Bankr. L. Rep. (CCH) P 82377 (S.D. N.Y. 2012) (the term "settlement payment" should be construed broadly); *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 55 Bankr. Ct. Dec. (CRR) 12, 65 Collier Bankr. Cas. 2d (MB) 1833 (2d Cir. 2011) (safe harbor protected from avoidance early redemption payments of commercial paper as "settlement payments" within the meaning of § 741(8)); *Picard v. Katz*, 462 B.R. 447, 55 Bankr. Ct. Dec. (CRR) 133, Bankr. L. Rep. (CCH) P 82077 (S.D. N.Y. 2011), motion to certify appeal denied, 466 B.R. 208, 55 Bankr. Ct. Dec. (CRR) 266 (S.D. N.Y. 2012); *In re Magnesium Corp. of America*, 460 B.R. 360 (Bankr. S.D. N.Y. 2011); *In re Renew Energy LLC*, 463 B.R. 475, 55 Bankr. Ct. Dec. (CRR) 106, 66 Collier Bankr. Cas. 2d (MB) 636, Bankr. L. Rep. (CCH) P 82061 (Bankr. W.D. Wis. 2011); *In re Qimonda Richmond, LLC*, 467 B.R. 318, 322–23, 56 Bankr. Ct. Dec. (CRR) 70 (Bankr. D. Del. 2012); *In re Quebecor World (USA) Inc.*, 453 B.R. 201, 55 Bankr. Ct. Dec. (CRR) 60 (Bankr. S.D. N.Y. 2011), aff'd, 480 B.R. 468, Bankr. L. Rep. (CCH) P 82355 (S.D. N.Y. 2012), judgment aff'd, 58 Bankr. Ct. Dec. (CRR) 12, 2013 WL 2460726 (2d Cir. 2013); *In re MacMenamin's Grill Ltd.*, 450 B.R. 414 (Bankr. S.D. N.Y. 2011); *In re D.E.I. Systems, Inc.*, 2011 WL 1261603 (Bankr. D. Utah 2011); *In re Mervyn's Holdings, LLC*, 426 B.R. 488 (Bankr. D. Del. 2010). Several decisions, discussed in the 2010 edition of this Article, address the avoidance of payments and transfers made in connection with leveraged buyouts as fraudulent transfers and whether such payments fall within the safe harbor of § 546(e). Lara R. Sheikh, Section 548 and 550—Developments in the Law on Fraudulent Transfers and Recoveries, Norton Annual Survey of Bankruptcy Law, Part III.C. (2010); see, e.g., *In re Plassein Intern. Corp.*, 590 F.3d 252, 52 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 81653 (3d Cir. 2009); *In re QSI Holdings, Inc.*, 571 F.3d 545, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009); *Contemporary Industries Corp. v. Frost*, 564 F.3d 981, 51 Bankr. Ct. Dec. (CRR) 157, Bankr. L. Rep. (CCH) P 81473 (8th Cir. 2009).

C. *The Power of Foreign Representatives*

BAPCPA also granted specific and limited powers to foreign representatives under Chapter 15 of the Bankruptcy Code to invoke and utilize the power to avoid fraudulent transfers under Section 548 through the inclusion of Sections 1521(a)(7) and 1523(a) of the Bankruptcy Code.[66] Though a detailed discussion regarding these provisions of the Bankruptcy Code is outside the scope of this Article, there is recent case law interpreting these sections.[67]

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[66] 11 U.S.C.A. §§ 1521, 1523 (2009) (each addressing a foreign representative's right to utilize §§ 548 and 550 upon recognition of a foreign proceeding). Section 1521(a)(7) appears to allow a court to grant a foreign representative certain limited avoidance powers, but not the power to utilize sections 548 and 550, in an action pending under Chapter 15, while § 1523(a) appears to permit the foreign representative to exercise those broader avoidance powers should a case concerning the debtor exist under another Chapter of the Bankruptcy Code.

Section 1521 provides in relevant part:

> (a) Upon recognition of a foreign proceeding, whether main or non-main, where necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interest of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief, including —
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> (7) granting any additional relief that may be available to a trustee, except for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a).

11 U.S.C.A. § 1521(a).

Section 1523 provides in relevant part:

> (a) Upon recognition of a foreign proceeding, the foreign representative has standing in a case concerning the debtor pending under another chapter of this title to initiate actions under sections 522, 544, 545, 547, 548, 550, 553, and 724(a).

11 U.S.C.A. § 1523(a).

[67] See *In re Condor Ins. Ltd.*, 601 F.3d 319, 328–29, 52 Bankr. Ct. Dec. (CRR) 256, Bankr. L. Rep. (CCH) P 81712 (5th Cir. 2010) (allowing a foreign representative to use foreign avoidance law even though no Chapter 7 or Chapter 11 case is filed in the United States). *In re Condor Insurance Ltd.* was discussed in detail in section III.D. of the 2011 edition of this Article. See Gallagher, supra note 26. A recent bankruptcy court decision favorably cited the Fifth Circuit's holding in *In re Condor Insurance Ltd*. that a bankruptcy court has the authority under Chapter 15 of the Bankruptcy Code to decide an avoidance claim based on foreign law. *In re International Banking Corp. B.S.C.*, 439 B.R. 614, 629, 53 Bankr. Ct. Dec. (CRR) 279 (Bankr. S.D. N.Y. 2010); see also *In re Fairfield Sentry Ltd. Litigation*, 458 B.R. 665 (S.D. N.Y. 2011) (reversing bankruptcy court and holding that bankruptcy court lacked jurisdiction over claims of Foreign Representatives of offshore funds because the assets sought were located outside of the United States); *In re Awal Bank, BSC*, 455 B.R. 73, 55 Bankr. Ct. Dec. (CRR) 97, 75 U.C.C. Rep. Serv. 2d 245 (Bankr. S.D. N.Y. 2011) (External Administrator's action to recover a set-off pursuant to § 553(b)

D. *Section 544(b)(1): The Trustee's Derivative Standing*

Although it is not the specific focus of this Article, Section 544(b)(1) of the Bankruptcy Code does address fraudulent transfers arising under state law and frequently serves as a basis for commencing fraudulent transfer actions, in addition to section 548 actions to avoid fraudulent transfers. Under Section 544(b)(1) of the Bankruptcy Code, the trustee is granted standing to avoid transfers under applicable non-bankruptcy law.[68] This standing is based on the rights of an actual unsecured creditor, in existence at the time of the filing of the petition, who has an allowable claim against the debtor.[69] However, the trustee need not identify a specific creditor into whose shoes he seeks to step.[70] The existence of such a "triggering creditor" has not been heavily litigated, but is discussed at length in Section III.A.3 of this Article, in the context of the United States District Court for the Northern District of Texas' decision in *Verizon II* (defined herein).[71]

The opportunity to employ state fraudulent transfer law often affords the trustee a longer look-back period than Section 548 of the Bankruptcy Code. Though a detailed discussion of state fraud-

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not precluded by § 1521(a)(7) of the Bankruptcy Code); *In re Atlas Shipping A/S*, 404 B.R. 726, 744, 51 Bankr. Ct. Dec. (CRR) 145, 61 Collier Bankr. Cas. 2d (MB) 1141, 2009 A.M.C. 1150 (Bankr. S.D. N.Y. 2009) (a non-fraudulent transfer case stating in *dicta* that it is unclear whether Chapter 15 "precludes a foreign representative from bringing an avoidance action under foreign law").

[68] 11 U.S.C.A. § 544(b)(1). For the full text of section 544(b)(1), see supra note 23.

[69] See *Smith v. American Founders Financial, Corp.*, 365 B.R. 647, 659 (S.D. Tex. 2007) ("A trustee's rights to avoid a transfer are derivative of an actual unsecured creditor's rights."); see also *In re Mirant Corp.*, 675 F.3d 530, 534, 56 Bankr. Ct. Dec. (CRR) 56, 67 Collier Bankr. Cas. 2d (MB) 638, Bankr. L. Rep. (CCH) P 82234 (5th Cir. 2012) ("If an actual, unsecured creditor can, on the date of the bankruptcy, reach property that the debtor has transferred to a third party, the trustee may use § 544(b) to step into the shoes of that creditor and 'avoid' the debtor's transfer." (quoting *In re Moore*, 608 F.3d 253, 260, 53 Bankr. Ct. Dec. (CRR) 68, Bankr. L. Rep. (CCH) P 81781 (5th Cir. 2010) (emphasis removed))); *In re Wingspread Corp.*, 178 B.R. 938, 945 (Bankr. S.D. N.Y. 1995) (trustee must demonstrate existence of unsecured creditor against whom the transfer is avoidable under applicable state law).

[70] *In re Equip. Acquisition Res., Inc., Bankr. No. 09 B 39937, Adv. No. 11 A 02233*, 2012 WL 4754764 (Bankr. N.D. Ill. Sept. 28, 2012) (citing *Matter of Leonard*, 125 F.3d 543, 544–45, 31 Bankr. Ct. Dec. (CRR) 552, Bankr. L. Rep. (CCH) P 77511 (7th Cir. 1997)); *In re Image Worldwide, Ltd.*, 139 F.3d 574, 577, 32 Bankr. Ct. Dec. (CRR) 394 (7th Cir. 1998) ("The trustee need not identify the creditor, so long as the unsecured creditor exists.").

[71] See *U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 479 B.R. 405 (N.D. Tex. 2012).

ulent transfer law is beyond the scope of this Article, the reader should be aware that most states have adopted the Uniform Fraudulent Transfers Act, which provides a look-back period of four or more years, double the amount of time provided by section 548.[72]

E. *History and Construction of Section 550*

In enacting the Bankruptcy Code, Congress took steps to eliminate prior confusion regarding the recovery of avoided transfers under the Bankruptcy Act. Prior to the enactment of the Bankruptcy Code, each section governing avoidance included its own recovery scheme.[73] However, "under the Bankruptcy Code[,] which repealed the previous Bankruptcy Act, [s]ections 544, 545, 547, 548, and 549 govern avoidance while [s]ection 550 alone governs whether, and to what extent, such avoided transfers may be recovered. According to a House of Representatives Report, '[s]ection 550 . . . enunciates the separation between the concepts of avoiding a transfer and recovering from a transferee.' "[74]

Since its enactment, section 550 has been subject to a number of challenges. The statute has survived challenges based on the "presumption against extraterritoriality"[75] and also has survived at least one sovereign immunity challenge in which the Supreme

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[72]For a discussion of the Uniform Fraudulent Transfers Act, see supra note 24.

[73]See, e.g., 11 U.S.C.A. § 67 et seq. (repealed).

[74]*In re Coleman*, 299 B.R. 780, 788–89, 92 A.F.T.R.2d 2003-7145 (W.D. Va. 2003), aff'd in part, rev'd on other grounds in part and remanded, 426 F.3d 719, 45 Bankr. Ct. Dec. (CRR) 144, 54 Collier Bankr. Cas. 2d (MB) 1625, Bankr. L. Rep. (CCH) P 80377, 96 A.F.T.R.2d 2005-6641 (4th Cir. 2005) (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 375 (1977), reprinted in 1978 U.S.C.C.A.N. pp. 5787, 5963, 6331); see also *In re Burns*, 322 F.3d 421, 427, 40 Bankr. Ct. Dec. (CRR) 282, 49 Collier Bankr. Cas. 2d (MB) 856, Bankr. L. Rep. (CCH) P 78813, 2003 FED App. 0071P (6th Cir. 2003) ("[A]voidance and recovery are distinct concepts and processes. This is clear from both the statute itself and from its legislative history. Avoidance and recovery are addressed in two separate sections of the code . . ."). For an instructive case on avoidance versus recovery, see *In re Connolly North America, LLC*, 340 B.R. 829, 46 Bankr. Ct. Dec. (CRR) 97 (Bankr. E.D. Mich. 2006).

[75]*Securities Investor Protection Corporation v. Bernard L. Madoff Inv. Securities LLC*, 480 B.R. 501, 57 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2012) (finding that claims under section 550 of the Bankruptcy Code are not barred by the presumption of extraterritoriality); *In re French*, 440 F.3d 145, 151, 46 Bankr. Ct. Dec. (CRR) 1, 55 Collier Bankr. Cas. 2d (MB) 806 (4th Cir. 2006) ("[A]ll of a debtor's property, whether domestic or foreign, is 'property of the estate' subject to the bankruptcy court's *in rem* jurisdiction.") (relying on *In re Simon*, 153 F.3d 991, 996, 33 Bankr. Ct. Dec. (CRR) 141, Bankr. L. Rep. (CCH) P 77783 (9th Cir. 1998)). In *French*, the Fourth Circuit distinguished the

Court held that Congress had the "power to authorize courts to avoid preferential transfers and to recover the transferred property" via an action under section 550 and that this authority "operates free and clear of [a state's] claim of sovereign immunity."[76]

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presumption against extraterritoriality rule set forth in *E.E.O.C. v. Arabian American Oil Co.*, 499 U.S. 244, 248, 111 S. Ct. 1227, 113 L. Ed. 2d 274, 55 Fair Empl. Prac. Cas. (BNA) 449, 55 Empl. Prac. Dec. (CCH) P 40607 (1991) by the application of *Kollias v. D & G Marine Maintenance*, 29 F.3d 67, 72, 1995 A.M.C. 609 (2d Cir. 1994) (courts only apply a presumption against extraterritoriality when a party seeks to enforce a statute "beyond the territorial boundaries of the United States") and *Environmental Defense Fund, Inc. v. Massey*, 986 F.2d 528, 531, 36 Env't. Rep. Cas. (BNA) 1053, 23 Envtl. L. Rep. 20601 (D.C. Cir. 1993) (presumption has no bearing when "the conduct which Congress seeks to regulate occurs largely within the United States"). But see *In re Bankruptcy Estate of Midland Euro Exchange Inc.*, 347 B.R. 708, 718–19, 47 Bankr. Ct. Dec. (CRR) 32, 56 Collier Bankr. Cas. 2d (MB) 1041 (Bankr. C.D. Cal. 2006) (finding "no evidence of congressional intent to extend the application of § 548 extraterritorially" and expressly disagreeing with *In re French*).

[76]*Central Virginia Community College v. Katz*, 546 U.S. 356, 369–70, 126 S. Ct. 990, 163 L. Ed. 2d 945, 45 Bankr. Ct. Dec. (CRR) 254, 54 Collier Bankr. Cas. 2d (MB) 1233, Bankr. L. Rep. (CCH) P 80443 (2006) (holding that "[b]ankruptcy jurisdiction . . . is principally *in rem* jurisdiction . . . As such, its exercise does not, in the usual case, interfere with state sovereignty even when States' interests are affected."). Although the Supreme Court in *Katz* declined to decide "whether actions to recover preferential transfers pursuant to [§ 550] are themselves properly characterized as *in rem*," the Supreme Court noted that "[w]hatever the appropriate appellation, those who crafted the Bankruptcy Clause would have understood it to give Congress the power to authorize courts to avoid preferential transfers and to recover the transferred property" from states. Katz, 546 U.S. at 372. The Supreme Court also noted that it was not bound by "statements in both the majority and the dissenting opinions" in *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252, 34 Collier Bankr. Cas. 2d (MB) 1199, 42 Env't. Rep. Cas. (BNA) 1289, 67 Empl. Prac. Dec. (CCH) P 43952 (1996) (holding that the States' sovereign immunity can only be abrogated by an express statement by Congress made pursuant to a valid grant of congressional power) as the issue in *Katz* was not one of abrogation. Katz, 546 U.S. at 363. But see *In re 360networks (USA), Inc.*, 316 B.R. 797, 43 Bankr. Ct. Dec. (CRR) 275, 53 Collier Bankr. Cas. 2d (MB) 339 (Bankr. S.D. N.Y. 2004), decision vacated, 2005 WL 3957809, *1 (Bankr. S.D. N.Y. 2005). In *360networks*, the United States Bankruptcy Court for the Southern District of New York sought to reconcile *Seminole Tribe* with *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 453, 124 S. Ct. 1905, 158 L. Ed. 2d 764, 43 Bankr. Ct. Dec. (CRR) 1, 51 Collier Bankr. Cas. 2d (MB) 627, Bankr. L. Rep. (CCH) P 80098 (2004) (finding that a bankruptcy court's exclusive *in rem* jurisdiction over property of the debtor "allows it to adjudicate the debtor's . . . claim without *in personam* jurisdiction over the State"). The bankruptcy court's holding was subsequently vacated by an order filed pursuant to a settlement agreement between the parties. The parties specifically cited the then-upcoming Supreme Court decision in *Katz* as a reason to grant vacature.

1. *Section 550(a): Recovery of Transferred Property*

Section 550 consists of six major subsections. Section 550(a) sets forth the trustee's (or debtor-in-possession's) general recovery powers as follows:[77]

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from:
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> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
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> (2) any immediate or mediate transferee of such initial transferee.[78]

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[77]Due to the renumbering of § 550 that took place with the incorporation of the 1994 Reform Act, care should be taken when researching prior cases. For example, present § 550(d) was § 550(c) prior to the revisions.

[78]The Court of Appeals for the Eleventh Circuit, as well as some lower courts, have held that a trustee can recover from subsequent transferees without first avoiding an initial transfer, so long as the trustee demonstrates that the initial transfer is avoidable; stating that "once the plaintiff proves that an avoidable transfer exists, he can then skip over the initial transferee and recover from those next in line." *In re International Administrative Services, Inc.*, 408 F.3d 689, 706, 44 Bankr. Ct. Dec. (CRR) 178, Bankr. L. Rep. (CCH) P 80279 (11th Cir. 2005); *Picard v. Katz*, 466 B.R. 208, 214, 55 Bankr. Ct. Dec. (CRR) 266 (S.D. N.Y. 2012) (stating that § 550(a) permits avoidance of a subsequent transfer where the initial transfer could have been avoided); see also *In re Taylor*, 390 B.R. 654, 666 (B.A.P. 9th Cir. 2008), rev'd and remanded on other grounds, 599 F.3d 880 (9th Cir. 2010); *In re AVI, Inc.*, 389 B.R. 721, 734–35, 50 Bankr. Ct. Dec. (CRR) 39, 59 Collier Bankr. Cas. 2d (MB) 1753 (B.A.P. 9th Cir. 2008) (relying on *Int'l Admin. Servs., Inc.* for the same proposition). But see *In re Slack-Horner Foundries Co.*, 971 F.2d 577, 580, Bankr. L. Rep. (CCH) P 74745 (10th Cir. 1992); *In re Brooke Corp.*, 443 B.R. 847, 852–855 (Bankr. D. Kan. 2010) (following the Tenth Circuit's decision in *Slack-Horner* but noting that *Slack-Horner* is the minority position and may be wrongly decided); *In re Allou Distributors, Inc.*, 379 B.R. 5, 19, 49 Bankr. Ct. Dec. (CRR) 29 (Bankr. E.D. N.Y. 2007) ("[B]efore the trustee may obtain an 'actual recovery' from the [m]ovants under § 550(a), he must first avoid the underlying initial transfers."); *In re Furs by Albert & Marc Kaufman, Inc.*, 2006 WL 3735621, *8 (Bankr. S.D. N.Y. 2006) (essential element of a trustee's recovery under § 550(a) was avoidance of the initial transfer). *In re Resource, Recycling & Remediation, Inc.*, 314 B.R. 62, 69, 43 Bankr. Ct. Dec. (CRR) 164, 52 Collier Bankr. Cas. 2d (MB) 1636 (Bankr. W.D. Pa. 2004) ("Section 550(a) is a recovery provision and gives rise to a secondary cause of action which applies after the trustee has prevailed under one (or more) of the avoidance provisions found in the Bankruptcy Code."); *In re Morgan*, 276 B.R. 785, 789 (Bankr. N.D. Ohio 2001) (the statutory language of § 550 and its legislative history leads to the conclusion that a trustee must first avoid an underlying transfer before recovery). See generally *In re M. Fabrikant*

While recovery of the property transferred is somewhat straightforward, what constitutes value for the purposes of section 550 is not as clear, although at least one court has pondered the subjective value of property in this context.[79]

Initially, section 550(a)(1) did not grant the ability to recover from the "entity for whose benefit such transfer was made."[80] This language was added as a part of the 1984 Amendments. In adding this provision, Congress specifically noted two limitations: (i) that no duplicate recoveries should be permitted,[81] and (ii) that recovery is only permissible to the extent of actual avoidance.[82]

The Bankruptcy Code does not define initial, immediate or me-

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& Sons, Inc., 394 B.R. 721, 742–46, 50 Bankr. Ct. Dec. (CRR) 192 (Bankr. S.D. N.Y. 2008) (discussing the conflict among the counts and holding that a trustee must always avoid a transfer against a subsequent transferee unless collateral estoppel or res judicata applies, thus allowing a trustee to settle with the initial transferee and pursue subsequent transferee, or pursue a subsequent transferee when unable to sue the initial transferees). The court in *Bernard L. Madoff Investment Securities LLC* held similarly in 2012. See *Securities Investor Protection Corporation v. Bernard L. Madoff Inv. Securities LLC*, 480 B.R. 501, 57 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2012). For a complete discussion of the *Madoff* decision, see infra Section III.D.

[79] *Active Wear, Inc. v. Parkdale Mills, Inc.*, 331 B.R. 669 (W.D. Va. 2005). In *Active Wear*, a creditor reclaimed from the debtor certain quantities of yarn prior to the petition date. The debtor argued that it should be allowed to recover the value the creditor could realize by reselling the yarn. The creditor argued that the value was such as could have been realized by the debtor in a liquidation sale. The essence of these arguments is that value is subjective—that the same property held by different parties takes on different values in reflection of the party by whom it is held. If so, the net result to the estate would differ depending on the remedy elected. The court concluded that the recoveries under § 550 are simply different sides of the same coin; that the recovery of value under § 550 by a debtor is simply a procedural device that permits the debtor to avoid further disposition of property, but not one that permits a debtor to benefit from an increase in value of property held by a non-debtor. The value recovered would be that which the debtor would obtain should it sell the property. Active Wear, 331 B.R. at 674.

[80] See *In re LGI Energy Solutions, Inc.*, 460 B.R. 720, 725, 55 Bankr. Ct. Dec. (CRR) 235, 66 Collier Bankr. Cas. 2d (MB) 1329 (B.A.P. 8th Cir. 2011) (relying solely on language of § 550(a)(1) of the Bankruptcy Code, which stated trustee could recover from either defendant utility providers who received payments from debtor utility management and billing service provider, or from customers whose accounts were credited as a result of payments to utilities by debtor); see also *TOUSA II*, 444 B.R. 613 (S.D. Fla. 2011), rev'd, 680 F.3d 1298 (11th Cir. 2012). Last year's edition of this Article featured a detailed discussion of *TOUSA II*'s analysis of § 550(b)(1). See Gallagher, supra note 4.

[81] See 11 U.S.C.A. § 550(d).

[82] 11 U.S.C.A. § 550(a); see 124 Cong. Rec. 32,400 (1978); see also *In re Clark*, 2009 WL 692167 (Bankr. M.D. Ala. 2009) (granting credit for a repay-

diate transferees nor does it define the type of benefit necessary to make an entity a transferee. In this vein, courts have looked at the recipient's "dominion" over the transferred property,[83] whether the recipient was a "mere conduit,"[84] or whether a

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ment made by transferee following the avoidable transfer at issue); *In re Kingsley*, 518 F.3d 874, 878, 49 Bankr. Ct. Dec. (CRR) 167, Bankr. L. Rep. (CCH) P 81115 (11th Cir. 2008) (bankruptcy court may grant a credit for any repayments made to reduce liability following an avoidable fraudulent transfer under § 548).

[83]For discussion of recovery from entities for whose benefit a transfer is made, see *In re Harwell*, 628 F.3d 1312, 1322-23, 54 Bankr. Ct. Dec. (CRR) 12, 64 Collier Bankr. Cas. 2d (MB) 1820, Bankr. L. Rep. (CCH) P 81909 (11th Cir. 2010); *Paloian v. LaSalle Bank, N.A.*, 619 F.3d 688, 691–92, 53 Bankr. Ct. Dec. (CRR) 155, Bankr. L. Rep. (CCH) P 81840 (7th Cir. 2010) ("*Paloian*") (trustee for securitized investment pool was "initial transferee" of payments on securitized debt as the legal owner of the trust's assets); see also *Rupp v. Markgraf*, 95 F.3d 936, 29 Bankr. Ct. Dec. (CRR) 834, 36 Collier Bankr. Cas. 2d (MB) 1312 (10th Cir. 1996) (bank acting as conduit without dominion and control over funds transferred by debtor to a third party which is not an initial transferee); *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890, 893, 17 Bankr. Ct. Dec. (CRR) 299, 18 Collier Bankr. Cas. 2d (MB) 155 (7th Cir. 1988) ("[T]he minimum requirement of status as an [initial] transferee with dominion over the money or other asset, the right to put the money to one's own purposes.") (citations omitted); *In re Antex, Inc.*, 397 B.R. 168, 172–73, 50 Bankr. Ct. Dec. (CRR) 266, 61 Collier Bankr. Cas. 2d (MB) 15 (B.A.P. 1st Cir. 2008) (holding "it is widely accepted that a transferee is one who at least has dominion over the money or other asset, the right to put the money to one's own purposes") (citations and quotations omitted); *In re Sunglasses and Then Some, Inc.*, 51 Bankr. Ct. Dec. (CRR) 257, 2009 WL 2058564, *4 (Bankr. D. Mass. 2009) (in interpreting the definition of "transferee," the court determined that defendant principals or the debtor corporation did not have "dominion and control" over funds transferred directly from the debtor to defendants' other corporation); *In re CVEO Corp.*, 327 B.R. 210, 216, 45 Bankr. Ct. Dec. (CRR) 30 (Bankr. D. Del. 2005) ("To have dominion and control means to be capable of using the funds for 'whatever purpose he or she wishes, be it to invest in lottery tickets or uranium stocks.' ") (citations omitted).

[84]See *In re Harwell*, 628 F.3d at 1312 (recognizing the equitable mere conduit or control defense, but denying summary judgment with respect to the defense because issues of fact existed as to whether attorney acted in good faith while engaging in the transfers at issue); *Paloian*, 619 F.3d at 691–92 (holding that securitized investment trust was initial transferee and not a mere conduit even though payments to the trust were passed on to the trust's investors); *In re Pony Exp. Delivery Services, Inc.*, 440 F.3d 1296, 46 Bankr. Ct. Dec. (CRR) 24, Bankr. L. Rep. (CCH) P 80465 (11th Cir. 2006) (holding that under the "control" test, broker was not the "initial transferee" but, instead, was a mere conduit for debtors' insurance premiums); *In re International Administrative Services, Inc.*, 408 F.3d 689, 44 Bankr. Ct. Dec. (CRR) 178, Bankr. L. Rep. (CCH) P 80279 (11th Cir. 2005) (discussing the proper scenario for application of "mere conduit" defense, but denying application); *In re Chase & Sanborn Corp.*, 813 F.2d 1177, Bankr. L. Rep. (CCH) P 71753 (11th Cir. 1987) (conclud-

transferee received a benefit from the transfer,[85] but no clear-cut test exists and courts continue to struggle with these terms and the benefit requirement.[86]

2. *Section 550(b): Subsequent Transferees*

Section 550(b) provides for a safe harbor and for separate treatment of subsequent transferees:

> (b) The trustee may not recover under [sub]section (a)(2) of this section from:
>
> (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or
>
> (2) any immediate or mediate good faith transferee of such transferee.

If the recipient of an avoidable transfer is the initial transferee, the Bankruptcy Code imposes strict liability and the trustee may recover the transfer. However, if the recipient was not the initial transferee, he or she may assert a good faith and for value defense

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ing "that the debtor corporation was a mere conduit" and consequently finding transfers unavoidable); *In re Warnaco Group, Inc.*, 97 A.F.T.R.2d 2006-958, 2006 WL 278152 (S.D. N.Y. 2006) (denying "mere conduit" defense in preference action).

[85] See *Freeland v. Enodis Corp.*, 540 F.3d 721, 740, 50 Bankr. Ct. Dec. (CRR) 134, 60 Collier Bankr. Cas. 2d (MB) 524, Bankr. L. Rep. (CCH) P 81315 (7th Cir. 2008) ("[R]equiring that the entity actually receive a benefit from the transfer is consistent with the well-established rule that fraudulent transfer recovery is a form of disgorgement, so that no recovery can be had from parties who participated in a fraudulent transfer but did not benefit from it.") (citations omitted); *In re Meredith*, 527 F.3d 372, 375–77, 50 Bankr. Ct. Dec. (CRR) 45, 59 Collier Bankr. Cas. 2d (MB) 1382, Bankr. L. Rep. (CCH) P 81252 (4th Cir. 2008) (CPA transferred accounting practice to his wife for a brief period; she had no control and received no benefit from the practice and, therefore, recovery under § 550(a)(1) could not be had from her for the transfer).

[86] See, e.g., Paloian, 619 F.3d at 691–92; In re Meredith, 527 F.3d at 376–77; In re Antex, Inc., 397 B.R. at 173 (controlling a corporation and causing checks to be issued does not make a principal of a corporation an *initial transferee*, since after the issuance of checks the principal has no legal dominion and control over use of payment); see also *In re Hurtado*, 342 F.3d 528, 532–36, 41 Bankr. Ct. Dec. (CRR) 229, Bankr. L. Rep. (CCH) P 78904, 2003 FED App. 0312P (6th Cir. 2003) (mother-in-law of debtor to whom property was transferred was the *initial transferee* because, even though she followed the debtor's instructions with respect to disposition of the property, she nonetheless was not legally obligated to do so); In re CVEO Corp., 327 B.R. at 217; *In re Cassandra Group*, 312 B.R. 491, 497–98, 43 Bankr. Ct. Dec. (CRR) 116 (Bankr. S.D. N.Y. 2004) (finding that, despite the fact that he paid himself out of collected proceeds, the agent of the landlord did not have *sufficient dominion* over collected rents to make him an initial transferee).

pursuant to section 550(b).[87] Nonetheless, the legislative history to section 550 appears to make it clear that the recovery provisions only apply to the extent a transaction is avoidable.[88] Thus, if the underlying avoidance statute contains defenses,[89] those defenses will be effective regardless of the strict liability of initial transferees[90] provided in section 550(a).[91]

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[87]See, e.g., *In re Nieves*, 648 F.3d 232, 242, 65 Collier Bankr. Cas. 2d (MB) 1442, Bankr. L. Rep. (CCH) P 82024 (4th Cir. 2011) (subsequent transferee may assert good faith defense, but good faith must be determined under an objective standard and accordingly courts should analyze what the transferee knew or should have known); *In re Red Dot Scenic, Inc.*, 351 F.3d 57, 58 (2d Cir. 2003) ("If the recipient of debtor funds was the initial transferee, the bankruptcy code imposes strict liability and the bankruptcy trustee may recover the funds. If the recipient was not the initial transferee, however, he or she may assert a good faith defense." (citing 11 U.S.C § 550(a)); *In re Bower*, 462 B.R. 347, Bankr. L. Rep. (CCH) P 82143 (Bankr. D. Mass. 2012) (mortgage assignee who took for value not protected by § 550(b) because a defect on the face of mortgage made assignee aware of facts that would have alerted a reasonable person to avoidability of mortgage under Massachusetts law); *In re Resource, Recycling & Remediation, Inc.*, 314 B.R. 62, 70–71, 43 Bankr. Ct. Dec. (CRR) 164, 52 Collier Bankr. Cas. 2d (MB) 1636 (Bankr. W.D. Pa. 2004) (employee who took property transferred by debtor to a shell corporation and subsequently abandoned it to the employee in return for disposing of barrels of ink, took "for value" under § 550(b)). Courts are split on which party bears the burden of proof under § 550(b), but it appears that the better reasoned position is that the transferee has the burden of showing good faith, value and lack of knowledge. See 5 Collier on Bankruptcy ¶ 550.03[5] (Alan J. Resnick and Henry J. Sommer eds., 16th ed. 2012).

[88]See H. R. Rep. No. 95-595 (1977); S. Rep. No. 95-989 (1978).

[89]See, e.g., 11 U.S.C.A. §§ 548(c) & 546(e).

[90]For cases recognizing that initial transferees of avoided transfers are strictly liable under § 550(a), see In re Red Dot Scenic, Inc, 351 F.3d at 58; In re Hurtado, 342 F.3d at 532–33; *In re Ogden*, 314 F.3d 1190, 1196, 40 Bankr. Ct. Dec. (CRR) 208, Bankr. L. Rep. (CCH) P 78794 (10th Cir. 2002); *In re Cohen*, 300 F.3d 1097, 1102, 40 Bankr. Ct. Dec. (CRR) 9, 48 Collier Bankr. Cas. 2d (MB) 1397, Bankr. L. Rep. (CCH) P 78706, 48 U.C.C. Rep. Serv. 2d 469 (9th Cir. 2002).

[91]See *In re Pace*, 456 B.R. 253, 276 (Bankr. W.D. Tex. 2011) (discussing defenses under section 550(b) and holding that "no such good faith defense is available to the initial transferee"); *In re Dreier LLP*, 453 B.R. 499, 510 n.6, 55 Bankr. Ct. Dec. (CRR) 71 (Bankr. S.D. N.Y. 2011) (defense under section 550(b) "is only available to transferees of the initial transferee" and not the initial transferee itself); *In re Teleservices Group, Inc.*, 444 B.R. 767, 790–95 (Bankr. W.D. Mich. 2011) (§ 548(c), not § 550(b), is the sole good faith defense for initial transferees of allegedly fraudulent transfers); *In re General Search.com*, 322 B.R. 836, 842, 54 Collier Bankr. Cas. 2d (MB) 46 (Bankr. N.D. Ill. 2005) (same); *In re H. King & Associates*, 295 B.R. 246, 285–86 (Bankr. N.D. Ill. 2003) (same); *In re Food & Fibre Protection, Ltd.*, 168 B.R. 408, 419–20, 25 Bankr. Ct. Dec.

3. *Section 550(c): Transfers to Insiders*

Section 550(c)[92] was added by the 1994 Reform Act in response to the *Deprizio* case regarding preferential transfers involving insiders.[93] In *Deprizio*, the Seventh Circuit considered whether and to what extent a transfer for the benefit of an insider of the debtor, but nonetheless to a non-insider, could be recovered as an avoidable preference. The case involved a debtor who made a payment to a lender more than 90 days but less than one year prior to bankruptcy, on loans either guaranteed by insiders of the debtor or which were secured by collateral in which the insiders had an interest.[94] The lender was not considered an insider.[95] The Court held that the trustee could recover the payment from the lender, even though the lender was not an insider, because the transfer benefited the insider.[96] The *Deprizio* court further held that, pursuant to section 550(a), the trustee could recover either the transferred property or its value from either the lender as initial transferee or the guarantor, the insider "for whose benefit such transfer was made."

Section 550(c) was intended to solve the *Deprizio* problem. It makes clear that recovery of an avoidable transfer to an insider cannot be obtained from an initial transferee where the initial

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(CRR) 1019 (Bankr. D. Ariz. 1994) (same); see also *Nelmark v. Helms*, 2003 WL 1089363, *3–5 (N.D. Ill. 2003) (upholding bankruptcy court determination that defendants were initial transferees who were not entitled to defense of § 550(b) and who did not prove they had acted in good faith for purposes of § 548(c)).

[92] Section 550(c) of the Bankruptcy Code provides:

> (c) If a transfer made between 90 days and one year before the filing of the petition:
> (1) is avoided under section 547(b) of this title; and
> (2) was made for the benefit of a creditor that at the time of such transfer was an insider;
>
> the trustee may not recover under subsection (a) from a transferee that is not an insider.

11 U.S.C.A. § 550(c).

[93] *Levit v. Ingersoll Rand Financial Corp.*, 874 F.2d 1186, 19 Bankr. Ct. Dec. (CRR) 574, 22 Collier Bankr. Cas. 2d (MB) 36, 11 Employee Benefits Cas. (BNA) 1323, Bankr. L. Rep. (CCH) P 72910 (7th Cir. 1989) (disapproved of by, In re Arundel Housing Components, Inc., 126 B.R. 216, 21 Bankr. Ct. Dec. (CRR) 959, Bankr. L. Rep. (CCH) P 73922 (Bankr. D. Md. 1991)).

[94] Levit, 874 F.2d at 1187–88.

[95] Levit, 874 F.2d at 1198.

[96] Levit, 874 F.2d at 1200–01.

transferee was not an insider, regardless of whether the transfer ultimately benefited an insider.[97]

While the addition of the language "or the entity for whose benefit such transfer was made" to section 550(a)(1) in the 1984 Amendments[98] was intended to clarify that recovery can be sought from an insider under such circumstances even though such insider is not a transferee for the purposes of Section 550(a) of the Bankruptcy Code, section 550(c) clarifies that recovery for preferential transfers cannot be sought from the non-insider initial transferee under such facts.[99] However, this clarification is still subject to debate, largely because Congress continued to mistake the distinction between avoidance and recovery.[100]

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[97]See *In re Exide Technologies, Inc.*, 299 B.R. 732, 746 (Bankr. D. Del. 2003) (holding that it is consistent with the legislative intent behind § 550(c) to prohibit a trustee from recovering from a non-insider transferee); *In re Mid-South Auto Brokers, Inc.*, 290 B.R. 658, 662, 41 Bankr. Ct. Dec. (CRR) 22, 49 Collier Bankr. Cas. 2d (MB) 1544 (Bankr. E.D. Ark. 2003) (same).

[98]See H.R. Rep. No. 103-835; 1994 U.S.C.C.A.N. 3340.

[99]See *In re Exide Techs., Inc.*, 299 B.R. at 746; *In re Mid-South Auto Brokers, Inc.*, 290 B.R. at 662.

[100]Though intertwined, avoidance and recovery are two independent remedies. Even absent recovery, other benefits may inure simply from avoidance depending on the nature of the transfer avoided. *In re Burns*, 322 F.3d 421, 427, 40 Bankr. Ct. Dec. (CRR) 282, 49 Collier Bankr. Cas. 2d (MB) 856, Bankr. L. Rep. (CCH) P 78813, 2003 FED App. 0071P (6th Cir. 2003) (avoidance legally negates the transfer and, as the property was still in possession of the debtor, there was no need to invoke § 550 for recovery); *In re Morgan*, 276 B.R. 785, 792 (Bankr. N.D. Ohio 2001) (when a non-possessory interest in property is avoided, there is nothing left to recover). The quintessential case is where the transfer is a lien placed by a non-insider on property of the debtor's estate, securing an obligation of an insider. By avoiding the lien, the property is "free and clear" of that interest even though no recovery from the non-insider lender is possible. See *In re Rosen Auto Leasing, Inc.*, 346 B.R. 798, 805–06, 46 Bankr. Ct. Dec. (CRR) 235 (B.A.P. 8th Cir. 2006) (lien on debtor's condominium extinguished when not exchanged for value and labeled a fraudulent transfer to non-insider lender). The avoidance/recovery distinction was featured in several prominent cases in 2005. See *In re Coleman*, 426 F.3d 719, 726, 45 Bankr. Ct. Dec. (CRR) 144, 54 Collier Bankr. Cas. 2d (MB) 1625, Bankr. L. Rep. (CCH) P 80377, 96 A.F.T.R.2d 2005-6641 (4th Cir. 2005) (holding that "the concepts are intertwined to the extent that property cannot be recovered under § 550 until an action is brought to avoid the transfer of that property. . . . But the opposite is certainly not true" when debtor avoided deeds of trust and no recovery was necessary as the "avoidance itself was the meaningful event"); *In re International Administrative Services, Inc.*, 408 F.3d 689, 703, 44 Bankr. Ct. Dec. (CRR) 178, Bankr. L. Rep. (CCH) P 80279 (11th Cir. 2005) (noting that the "demarcation between avoidance and recovery is underscored by § 550(f), which places a separate statute of limitations on recovery actions").

4. *Section 550(d): Prohibition Against Double Recoveries*

Section 550(d) states that "[t]he trustee is entitled to only a single satisfaction under subsection (a) of this section."[101] This section has generated relatively little case law, but the cases examining section 550(d) have confirmed the plain meaning of the statute.[102]

In BAPCPA, Congress again attempted a fix with respect to preferential transfers, this time in § 547(i), which reads:

> If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of the filing of the petition, by the debtor to an entity that is not an insider for the benefit of a creditor that is an insider, such transfer shall be considered to be avoided under this section only with respect to the creditor that is an insider.

11 U.S.C.A. § 547(i). However, there is a possible issue with this fix. Section 547(i) is limited on its face to transfers benefiting insiders who are creditors. It is possible that an insider benefiting from such transfer may *not* also be a creditor. At least on its face, avoidance as opposed to recovery would not give rise to creditor status under § 502(h) and § 101(10)(B) unless recovery—as opposed to avoidance—was sought against the insider/creditor. Compare 11 U.S.C.A. § 101(10) (defining "creditor"), with 11 U.S.C.A. § 101(31) (defining "insider"). In such case, it appears that the problem of avoidance without transfer for the non-insider initial transferee may still exist. When an estate is faced with a *Deprizio* transfer and a judgment-proof insider, the result is a "catch-22." In one of the few decisions discussing § 547(i), a bankruptcy court in Wisconsin considered whether a debtor's son who guaranteed the debtor's loan was a creditor for purposes § 547(i) and found that absent a waiver of contribution or indemnification rights in the guarantee, the son was considered a creditor. *In re Halling*, 449 B.R. 911, 915–16 (Bankr. W.D. Wis. 2011).

[101] 11 U.S.C.A. § 550(d).

[102] See *In re Sherman*, 67 F.3d 1348, 1358, 27 Bankr. Ct. Dec. (CRR) 1237, 34 Collier Bankr. Cas. 2d (MB) 655, Bankr. L. Rep. (CCH) P 76671 (8th Cir. 1995) (double recovery prohibited); *In re Skywalkers, Inc.*, 49 F.3d 546, 549, 26 Bankr. Ct. Dec. (CRR) 1006, Bankr. L. Rep. (CCH) P 76394 (9th Cir. 1995) (duplicative recoveries inappropriate); *In re Friedman's Inc.*, 394 B.R. 623, 628–29 (S.D. Ga. 2008) (same); *In re G-I Holdings, Inc.*, 2006 WL 1751793, *15 (D.N.J. 2006) (same); *In re Bean*, 251 B.R. 196, 205 (E.D. N.Y. 2000), aff'd, 252 F.3d 113, 37 Bankr. Ct. Dec. (CRR) 268, Bankr. L. Rep. (CCH) P 78465 (2d Cir. 2001) (same); see also *In re Sawran*, 359 B.R. 348 (Bankr. S.D. Fla. 2007) (trustee denied recovery where debtor transferred $20,000 to her father, who transferred it to third parties, who paid the debtor $12,000 prior to the bankruptcy because permitting recovery would result in a windfall to the estate); *In re Ames Dept. Stores, Inc.*, 161 B.R. 87, 91 (Bankr. S.D. N.Y. 1993) (debtor reimbursed for transfer, thus no diminishment in estate and no recovery permitted). At least one court has held that damages are an appropriate remedy for fraudulent transfer under federal law. See *In re IVDS Interactive Acquisition Partners*, 302 Fed. Appx. 574, 576–77 (9th Cir. 2008) (partnership's founders were jointly and severally liable on a recovery action for funds fraudulently transferred from the partnership).

One court has creatively used section 550(d) to prohibit a trustee from recovering from a bank that, without notice of the bankruptcy case, continued to sweep the debtor's bank accounts and make advances to the debtor post-petition.[103] The district court found that while the strict requirements for recovery under section 550 had been met, the post-petition advances more than offset the sweeps, and therefore ruled that the trustee's attempt to recover was duplicative of the advances and prohibited under section 550(d).[104]

5. *Section 550(e): Protections for Good Faith Transferees*

Section 550(e) provides limited remedies for good faith transferees from whom a transfer is recoverable, namely a lien in the property recovered, to the extent of the lesser of the cost of any improvement the transferee makes in the transferred property and the increase in value of the property as a result of the improvement.[105] The clear intent of the statute is that this section only protects good faith "initial" transferees. As noted above, only initial transferees are strictly liable due to the operation of section 550(b), and therefore good faith subsequent transferees will not need this section as they will not have their transfers avoided. Moreover, where a transfer is avoided under section 548 but not

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[103] *In re Cybridge Corp.*, 312 B.R. 262, 43 Bankr. Ct. Dec. (CRR) 81, 52 Collier Bankr. Cas. 2d (MB) 615 (D.N.J. 2004).

[104] *In re Cybridge Corp.*, 312 B.R. 262, 43 Bankr. Ct. Dec. (CRR) 81, 52 Collier Bankr. Cas. 2d (MB) 615 (D.N.J. 2004).

[105] Section 550(e) provides:

> (e)(1) A good faith transferee from whom the trustee may recover under subsection (a) of this section has a lien on the property recovered to secure the lesser of:
>
> (A) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit realized by or accruing to such transferee from such property; and
>
> (B) any increase in the value of such property as a result of such improvement, of the property transferred.
>
> (2) In this subsection, "improvement" includes:
>
> (A) physical additions or changes to the property transferred;
>
> (B) repairs to such property;
>
> (C) payment of any tax on such property;
>
> (D) payment of any debt secured by a lien on such property that is superior or equal to the rights of the trustee; and
>
> (E) preservation of such property.

11 U.S.C.A. § 550(e).

recovered under section 550, the protections set forth in section 550(e) do not apply.[106]

6. *Section 550(f): Statute of Limitations*

Finally, section 550(f) provides a statute of limitations for recovery actions by stating that "[a]n action or proceeding under [section 550] may not be commenced after the earlier of (1) one year after the avoidance of the transfer on account of which recovery under this section is sought; or (2) the time the case is closed or dismissed."[107] Section 550(f) is jurisdictional in nature, and is not waived by the defendant's failure to timely plead.[108] Note that the time frame runs from the date the transfer was avoided, not the date of the transfer.[109]

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[106] *In re Burns*, 322 F.3d 421, 427, 40 Bankr. Ct. Dec. (CRR) 282, 49 Collier Bankr. Cas. 2d (MB) 856, Bankr. L. Rep. (CCH) P 78813, 2003 Fed. Appx. 0071P (6th Cir. 2003) (when debtor transferred title to property to third party but retained possession, the transfer was preserved for the benefit of the estate under § 551, no recovery after avoidance was necessary, and the protections of § 550 do not apply).

[107] See *In re International Administrative Services, Inc.*, 408 F.3d 689, 703, 44 Bankr. Ct. Dec. (CRR) 178, Bankr. L. Rep. (CCH) P 80279 (11th Cir. 2005) ("The transaction must first be avoided before a plaintiff can recover under 11 U.S.C.A. § 550. . . . This demarcation between avoidance and recovery is underscored by § 550(f), which places a separate statute of limitations on recovery actions; it provides that a suit for recovery must be commenced within one year of the time that the transaction is avoided or by the time the case is closed or dismissed, whichever occurs first"); see also *In re Enron Corp.*, 343 B.R. 75, 80, 46 Bankr. Ct. Dec. (CRR) 147, 56 Collier Bankr. Cas. 2d (MB) 195 (Bankr. S.D. N.Y. 2006), rev'd on other grounds and remanded, 388 B.R. 489 (S.D. N.Y. 2008) ("Section 546(a) sets forth the statute of limitations for an avoidance action and section 550(f) sets forth the limitation period for a recovery"); *In re Menk*, 241 B.R. 896, 911, 43 Collier Bankr. Cas. 2d (MB) 336 (B.A.P. 9th Cir. 1999) (rejected by, Industrial Clearinghouse, Inc. v. Jackson Walker, L.L.P., 162 S.W.3d 384 (Tex. App. Dallas 2005)) (closing of a bankruptcy case terminates many of the trustee's avoiding and recovery powers).

[108] *In re Sandoval*, 470 B.R. 195, 200-01, 67 Collier Bankr. Cas. 2d (MB) 707 (Bankr. D. N.M. 2012); *In re Phimmasone*, 249 B.R. 681, 683, 44 Collier Bankr. Cas. 2d (MB) 890 (Bankr. W.D. Va. 2000).

[109] See *Securities Investor Protection Corporation v. Bernard L. Madoff Inv. Securities LLC*, 480 B.R. 501, 57 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2012) (where transfer is not formally avoided and is instead resolved pursuant to a settlement, statute begins to run at the time of the settlement); *In re Enron Corp.*, 343 B.R. at 80 (the limitations period starts to run once the trustee avoids the transfer sought to be recovered); *In re Serrato*, 233 B.R. 833, 835, 41 Collier Bankr. Cas. 2d (MB) 1461 (Bankr. N.D. Cal. 1999). The decision in *In re Bernard L. Madoff Investment Securities LLC* is discussed in-depth in Section III.D of this Article.

III. CASE LAW DEVELOPMENTS IN 2012

This section summarizes and analyzes certain decisions issued in 2012 addressing aspects of Sections 548 and/or 550 of the Bankruptcy Code that the authors believe to be of import and general interest to bankruptcy practitioners. This section is not a complete analysis of the issues discussed or the case law regarding the same, but rather is intended to provide the reader with a selected sampling of interesting issues which courts have considered during the past year. As noted in the introduction, a lengthy discussion of the much-anticipated opinion of the Eleventh Circuit Court of Appeals in *TOUSA* and the district court's opinion it reversed was included in last year's edition of this Article and is summarized in note 4 of this Article.

A. *Verizon I, II and III: Recovery, Triggering Creditors, and the Safe Harbor*

In 2012, three notable and related decisions were issued in the Chapter 11 bankruptcy cases of Idearc, Inc. ("Idearc") and SuperMedia, LLC.[110] Collectively, these decisions examined some of the most relevant topics in fraudulent transfer law—the recoverability of avoidable obligations, the identity and existence of a triggering creditor for purposes of section 544, and the safe harbor of section 546. Significantly, *Verizon I* (defined herein) made clear that the incurrence of debt obligations does not qualify as a "transfer" for purposes of recovery pursuant to Section 550(a) of the Bankruptcy Code. *Verizon II* (defined herein) examined in-depth the "triggering creditor" requirement a trustee must satisfy to bring a claim under Section 544 of the Bankruptcy Code. *Verizon III* (defined herein) helped to further clarify the murky waters of the section 546(e) safe harbor and the meaning of the terms "settlement payment" and "financial institution" for purposes of the safe harbor.

1. *Background*

Idearc was a spin-off of Verizon Communications Inc.'s ("Verizon") print and online telephone directories business and was formed on November 17, 2006.[111] As part of the spin-off transaction, Verizon transferred to Idearc its interests in Idearc Information Services, LLC ("IIS"), as well as its other assets associ-

[110] *In re Idearc, Inc., et al.*, Case No. 09-31828 (Bankr. N.D. Tex. 2009).

[111] *U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 2012 WL 3100778, *1 (N.D. Tex. 2012) ("*Verizon I*").

ated with the telephone directories business.[112] In return, Idearc provided to Verizon the following consideration: (1) the assumption of certain of Verizon's contractual obligations; (2) the issuance to Verizon of 145,851,861 shares of Idearc's common stock; (3) the issuance to Verizon of two unsecured notes totaling $2.85 billion (the "Unsecured Notes"); (4) the transfer of $2,441,532,374.71 in cash (the "Cash") to Verizon's wholly-owned subsidiary, VFS; and (5) a grant of indebtedness to Verizon for $4.3 billion pursuant to a credit agreement dated November 17, 2006 (the "Verizon Tranche B").[113]

Subsequent to the spin-off transaction, Verizon exchanged the Unsecured Notes and the Verizon Tranche B for outstanding Verizon debt in the amount of $7.15 billion,[114] reducing Verizon's outstanding indebtedness by the same amount.[115] Less than three years later, on March 31, 2009, Idearc filed for protection under Chapter 11 of the Bankruptcy Code.[116] During its bankruptcy case, Idearc maintained that, at the time of the spin-off transaction in 2006, it was "saddled with too much debt."[117] Idearc's Chapter 11 plan of reorganization, confirmed on December 22, 2009, created a litigation trust and appointed U.S. Bank National Association ("U.S. Bank" or the "Trustee") as litigation trustee.[118]

On September 15, 2010, U.S. Bank commenced an adversary proceeding against Verizon, certain of its subsidiaries, and one Verizon insider, alleging actual fraudulent transfer, breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, unlawful dividend,[119] promoter liability, unjust enrichment, and alter ego claims, all stemming from the 2006 spin-off

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[112] Verizon I, 2012 WL 3100778, at *1.

[113] Verizon I, 2012 WL 3100778, at *1.

[114] Verizon I, 2012 WL 3100778, at *1.

[115] Verizon I, 2012 WL 3100778, at *1.

[116] Verizon I, 2012 WL 3100778, at *2.

[117] Verizon I, 2012 WL 3100778, at *2.

[118] Verizon I, 2012 WL 3100778, at *2.

[119] The unlawful dividend claims were based on alleged violations of Delaware state law arising out of the transfer of the Cash, Verizon Tranche B, and the Unsecured Notes. Under Delaware law, a corporation's directors may only declare and pay a dividend out of the corporation's surplus. 8 Del. C. §§ 170 & 173. If a dividend is paid when a corporation has no surplus or if a dividend is paid in excess of the corporation's surplus, a director may be liable for the full amount of the unlawful dividend plus interest. 8 Del. C. § 174.

transaction.[120] U.S. Bank alleged that the entire spin-off transaction was a "scheme" devised by Verizon to "obtain approximately $9.5 billion—not in the marketplace, but through the use of lawyers and Wall Street investment bankers."[121] U.S. Bank's complaint alleged that the Verizon directory business had experienced a marked decline, with revenues decreasing by $169 million between 2005 and 2006 alone.[122] In light of this decline, U.S. Bank posited that Verizon used the spin-off transaction to "reap [a] windfall to the injury of Idearc and Idearc's creditors by stripping Idearc of cash and burdening Idearc with massive debt."[123]

2. *Verizon I*

The *Verizon I* court evaluated U.S. Bank's claims in the context of the defendants' motion to dismiss all counts of the complaint.[124] For purposes of this Article, we will focus on the fraudulent transfer claims and the barriers to recovery under section 550 of the Bankruptcy Code.

U.S. Bank sought avoidance of the spin-off transaction under Texas fraudulent transfer law[125] and section 544 of the Bankruptcy Code,[126] and recovery of the transferred property under section 550 of the Bankruptcy Code.[127] U.S. Bank alleged that Idearc provided the following "fraudulent consideration" to Verizon: (1) Idearc's assumption of contractual obligations; (2) the issuance of 145,851,861 shares of Idearc common stock; (3) the issuance of the Unsecured Notes; (4) the transfer of the Cash; and (5) the Verizon Tranche B, under which Idearc became indebted to Verizon for $4.3 billion.[128] The court analyzed each part of the consideration and the Trustee's related claims in turn.

a. *Recovery of a "Transfer" vs. an "Obligation"*

The court turned first to the issuance of the Unsecured Notes

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[120] Verizon I, 2012 WL 3100778, at *2.

[121] Verizon I, 2012 WL 3100778, at *1.

[122] Verizon I, 2012 WL 3100778, at *1.

[123] Verizon I, 2012 WL 3100778, at *1.

[124] Verizon I, 2012 WL 3100778, at *2.

[125] Tex. Bus. & Com. Code §§ 24.005, 24.006, 24.008 (West). These statutes provide a framework for both actual and constructive fraudulent transfers, as well as recovery.

[126] For the discussion of section 544 of the Bankruptcy Code, see supra Section II.D.

[127] Verizon I, 2012 WL 3100778, at *4.

[128] Verizon I, 2012 WL 3100778, at *4.

and Verizon Tranche B, examining them in the context of Texas fraudulent transfer law and Sections 544 and 550 of the Bankruptcy Code, which together allow a trustee to avoid transfers and obligations and recover property fraudulently transferred by a debtor.[129] The defendants argued that the Unsecured Notes and the Verizon Tranche B should be considered "obligations" rather than "transfers" for purposes of recovery under Section 550(a) of the Bankruptcy Code.[130] The rationale underlying this argument was that because the issuance of the Unsecured Notes and Verizon Tranche B created obligations of Idearc, they were not transfers and therefore would not be recoverable under the plain language of section 550.[131] In evaluating this argument, the court noted that, while Section 544(b) of the Bankruptcy Code allows a trustee to "avoid *any transfer of an interest of the debtor in property or any obligation incurred by the debtor* that is voidable under applicable law,"[132] section 550, the section of the Bankruptcy Code authorizing recovery for avoidance claims, appears to distinguish between transfers of property and the incurrence of obligations, and only allows recovery for transfers made, but not obligations incurred, by the debtor.[133]

Comparing the two sections, the court observed that while the Bankruptcy Code defines "transfer,"[134] it does not define

[129] Verizon I, 2012 WL 3100778, at *4. In relevant part, Section 550 of the Bankruptcy Code provides:

> (a) Except as otherwise provided in this section, to the extent that a *transfer* is avoided under section 544 . . . 548 . . . of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property . . .

11 U.S.C.A. § 550. (emphasis added).

[130] Verizon I, 2012 WL 3100778, at *4.

[131] Verizon I, 2012 WL 3100778, at *4.

[132] Verizon I, 2012 WL 3100778, at *4 (quoting 11 U.S.C. § 544(b)) (emphasis added).

[133] Verizon I, 2012 WL 3100778, at *4 (citing *In re Asia Global Crossing, Ltd.*, 333 B.R. 199, 202, 45 Bankr. Ct. Dec. (CRR) 182, 55 Collier Bankr. Cas. 2d (MB) 24 (Bankr. S.D. N.Y. 2005) ("If the trustee avoids a 'transfer,' he can recover the property transferred or the value of the property under § 550. If, on the other hand, he avoids an obligation, the obligation is rendered unenforceable, there is nothing to return and § 550 affords no remedy.")); see also *In re MacMenamin's Grill Ltd.*, 450 B.R. 414, 429 (Bankr. S.D. N.Y. 2011) ("There clearly is a difference between making a transfer and incurring an obligation; otherwise, the relevant statutory provisions would not have used both terms.").

[134] Verizon I, 2012 WL 3100778, at *5 (citing 11 U.S.C.A. § 101(54) ("The term 'transfer' means the creation of a lien; the retention of title as a security

"obligation."[135] Looking to case law for a definition of "obligation," the court cited with approval case law defining the term as "[a] formal binding agreement or acknowledgment of a liability to pay a certain amount or to do a certain thing for a particular person or set of persons; esp., a duty arising by contract,"[136] and cases holding that loan obligations, notes, and guarantees are correctly classified as obligations rather than transfers.[137]

U.S. Bank attempted to distinguish those cases by pointing out that none addressed circumstances where the debtor became indebted by a note or other instrument to a party who then sold the instrument to an innocent third party, as Verizon did when it transferred the Unsecured Notes and the Verizon Tranche B to Verizon's former debt holders.[138] The court framed this argument as the proposition that "because [] debt can be transferred as easily as property, the debt effectively becomes property when it is transferred to a third party[.]"[139] Rejecting the argument, the court simply stated that it found it unpersuasive and that U.S. Bank did not provide any supporting case law.[140]

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interest; the foreclosure of a debtor's equity of redemption; or each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or an interest in property.") (internal punctuation and lettering omitted).

[135]Verizon I, 2012 WL 3100778, at *5.

[136]Verizon I, 2012 WL 3100778, at *5 (citing Asia Global Crossing, 333 B.R. at 203).

[137]Verizon I, 2012 WL 3100778, at *5 (citing In re MacMenamin's Grill Ltd., 450 B.R. at 429 (concluding that the debtor's incurrence of a loan obligation was not a transfer of property)); *Covey v. Commercial Nat. Bank of Peoria*, 960 F.2d 657, 661, 22 Bankr. Ct. Dec. (CRR) 1316, 26 Collier Bankr. Cas. 2d (MB) 1046, Bankr. L. Rep. (CCH) P 74530 (7th Cir. 1992) ("Although a note or guarantee is not a 'transfer' for purposes of 11 U.S.C. § 101(54) . . . both [a] note and guarantee are obligations."); *In re Foxmeyer Corp.*, 290 B.R. 229, 234, 40 Bankr. Ct. Dec. (CRR) 287 (Bankr. D. Del. 2003) ("[A] guarantee obligation . . . even if the same is avoidable as a fraudulent conveyance, cannot result in any recovery to the Trustee under § 550(a)(1) given that only transfers of property are remediable under § 550(a) (1)."); *Don E. Williams Co. v. C. I. R.*, 1977-1 C.B. 109, 429 U.S. 569, 582–83, 97 S. Ct. 850, 51 L. Ed. 2d 48, 1 Employee Benefits Cas. (BNA) 1201, 77-1 U.S. Tax Cas. (CCH) P 9221, 21 U.C.C. Rep. Serv. 152, 39 A.F.T.R.2d 77-743 (1977) ("[A] promissory note, even when payable on demand and fully secured, is still, as its name implies, only a promise to pay, and does not represent the paying out or reduction of assets.").

[138]Verizon I, 2012 WL 3100778, at *5.

[139]Verizon I, 2012 WL 3100778, at *5.

[140]Verizon I, 2012 WL 3100778, at *5.

Alternatively, U.S. Bank argued that the incurrence of debt pursuant to the Unsecured Notes and Verizon Tranche B qualified as a transfer because the issuance of a company's stock, bonds, or notes constitutes transfers of that company's property.[141] In rejecting this argument, the court observed that not only have some courts held otherwise,[142] but the decisions cited in support of U.S. Bank's position applied only to stock transfers, and not bonds, notes, or other debt instruments.[143]

U.S. Bank further endeavored to label the incurrence of the Verizon Tranche B as a transfer, rather than an obligation, by arguing that it satisfied the definition of "transfer" under Section 101(54)(A) of the Bankruptcy Code because it created a lien on Idearc's assets.[144] Unconvinced, the court observed that section 101(54)(D) excludes the incurrence of debt from the definition of "transfer" because it expressly limits the definition of transfer to "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with . . . property; or an interest in property," and the obligation created by the Verizon Tranche B was not the act of disposing of or parting with property.[145] In further support of this holding, the court noted that Section 550 of the Bankruptcy Code was drafted to expressly limit recovery to avoided transfers "of property".[146] Finally, the court stated that, even if it were to accept the proposition that the creation of a lien was a transfer "of property," there could be no recovery under section 550, because avoidance of the transfer

[141] Verizon I, 2012 WL 3100778, at *6 (citing *Global Crossing Estate Representative v. Winnick*, 2006 WL 2212776, *8 (S.D. N.Y. 2006); *In re Pitt Penn Holding Co., Inc.*, 55 Bankr. Ct. Dec. (CRR) 126, 2011 WL 4352373, *5–6 (Bankr. D. Del. 2011) (citing *Asia Global Crossing* with approval)).

[142] Verizon I, 2012 WL 3100778, at *6 (citing *Decker v. Advantage Fund, Ltd.*, 362 F.3d 593, 596, 42 Bankr. Ct. Dec. (CRR) 224, Bankr. L. Rep. (CCH) P 80077 (9th Cir. 2004) and *In re Curry and Sorensen, Inc.*, 57 B.R. 824, 829, 14 Bankr. Ct. Dec. (CRR) 103, 14 Collier Bankr. Cas. 2d (MB) 606, Bankr. L. Rep. (CCH) P 71022 (B.A.P. 9th Cir. 1986)).

[143] Verizon I, 2012 WL 3100778, at *6.

[144] Verizon I, 2012 WL 3100778, at *6. Section 101(54)(A) states that "transfer" means, inter alia, "the creation of a lien." 11 U.S.C.A. § 101(54)(A).

[145] Verizon I, 2012 WL 3100778, at *6 (citing 11 U.S.C. § 101(54)(D) (internal lettering omitted)).

[146] Verizon I, 2012 WL 3100778, at *6. Note, however, that the Bankruptcy Code does not define "property."

would merely remove the lien on Idearc's assets, leaving no property to recover.[147]

In an effort to support its position, U.S. Bank relied on two decisions[148] in which courts appeared to classify the issuance of debt instruments as transfers of property.[149] The court distinguished these cases from the facts in *Verizon*.[150] In *Weaver v. Kellogg*, the court held that the execution of notes constituted transfers of property because they conveyed property to the defendants and altered the defendants' rights with respect to the debtor.[151] The *Verizon I* court, however, found *Weaver* distinguishable because the notes in that case were issued by the defendants to the debtor, not by the debtor to the defendants, as in *Verizon I*.[152] Moreover, the *Verizon I* court reasoned, "the 'transfer' in *Weaver* was the loss of rights that the debtor held against the defendants. It would be odd to refer to such an action as the incurrence of the obligation [but] . . . it is easy to see [the Unsecured Notes] and the Verizon Tranche B as obligations incurred."[153]

The court then distinguished the holding in the second case relied upon by U.S. Bank, *In re Verestar, Inc.,* pointing out that, while the facts in *Verestar* were similar to those in *Verizon I* (notes issued by the debtor to the defendant), the holding in *Verestar* was based on *Weaver,* perhaps erroneously.[154] Further, the *Verizon I* court pointed out that *Verestar* only stands for the proposition that the issuance of the notes constituted a transfer of property for purposes of avoidance under Section 548 of the Bankruptcy Code, and the *Verestar* opinion did not address recovery under Section 550 of the Bankruptcy Code, the issue in *Verizon I*.[155]

Next, the court rejected U.S. Bank's suggestion that the court should exercise its equitable power under Section 105 of the

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[147] Verizon I, 2012 WL 3100778, at *6.

[148] U.S. Bank cited *Weaver v. Kellogg*, 216 B.R. 563, 571 (S.D. Tex. 1997), and *In re Verestar, Inc.*, 343 B.R. 444 (Bankr. S.D. N.Y. 2006) in support of the proposition that the issuance of a debt instrument is a transfer of property under Section 550 of the Bankruptcy Code.

[149] Verizon I, 2012 WL 3100778, at *6.

[150] Verizon I, 2012 WL 3100778, at *6–7.

[151] Verizon I, 2012 WL 3100778, at *6.

[152] Verizon I, 2012 WL 3100778, at *6.

[153] Verizon I, 2012 WL 3100778, at *6.

[154] Verizon I, 2012 WL 3100778, at *6.

[155] Verizon I, 2012 WL 3100778, at *6.

Bankruptcy Code to hold that the issuance of the Unsecured Notes and the Verizon Tranche B were transfers of property subject to avoidance as fraudulent transfers and recovery under Section 550 of the Bankruptcy Code.[156] In so holding, the court dissected the language of Section 105 of the Bankruptcy Code to demonstrate why such an expansion of the scope of recovery under section 550 would be improper.[157] Section 105 empowers the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[158] The court noted that Congress' use of the term "provisions . . . suggests that an exercise of section 105 power [must] be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective."[159] Further, the court cited Fifth Circuit authority specifically holding that section 105 "cannot alter another provision of the [C]ode."[160] Thus, the court declined to invoke section 105 to broaden section 550 to expand the meaning of "transfer" to include the incurrence of the Verizon Tranche B and Unsecured Notes.[161]

Next, U.S. Bank argued that a decision barring recovery for the incurrence of obligations under notes or other debt instruments would produce an unjust result for immediate or mediate transferees of such instruments.[162] Under such a scheme, a trustee would be able to recover from the immediate or mediate transferee because it received a "transfer," but not the initial transferee, because such initial transferee would only have incurred an obligation, thereby leaving "innocent third parties" exposed to liability.[163] However, the court disagreed, reasoning that an immediate or mediate transferee of a debt instrument issued by a debtor would logically have had to receive the transfer with some knowledge of the debtor, and thus, would not qualify

[156] Verizon I, 2012 WL 3100778, at *7.

[157] Verizon I, 2012 WL 3100778, at *7.

[158] 11 U.S.C.A. § 105.

[159] Verizon I, 2012 WL 3100778, at *7 (citing Collier on Bankruptcy ¶ 105.01 (Alan N. Resnick and Henry J. Sommer eds., 16th ed. 2012)).

[160] Verizon I, 2012 WL 3100778, at *7 (citing *Matter of Zale Corp.*, 62 F.3d 746, 760, Bankr. L. Rep. (CCH) P 76617 (5th Cir. 1995)).

[161] Verizon I, 2012 WL 3100778, at *7.

[162] Verizon I, 2012 WL 3100778, at *8.

[163] Verizon I, 2012 WL 3100778, at *8.

as a good faith transferee lacking knowledge under section 550(b)(2).[164]

Finally, the court rejected U.S. Bank's argument that it should be permitted recovery for the Unsecured Notes and the Verizon Tranche B, based on cases in which courts "collapsed" certain complex financial transactions to satisfy the goals of fraudulent transfer statutes.[165] The court held that reliance on those cases was misplaced, as the right to recovery under section 550 was at issue with respect to the debtors' obligations, and not whether the obligations were fraudulent transfers.[166] Based on the foregoing, the court granted the defendants' motion to dismiss with respect to recovery for avoidance of the Unsecured Notes and the Verizon Tranche B.[167]

b. *The Cash Transfer Was a Transfer of Idearc's Property*

The court declined to dismiss the fraudulent transfer claim related to the Cash transfer, rejecting the defendants' arguments that the transfer did not meet the requirements of section 544(b) because no transfer of an interest of the debtor in property had occurred.[168] The defendants contended that (i) the debtor had no control over the Cash at the time of the transfer because the funds were immediately transferred from Idearc to Verizon, and, (ii) the Cash was subject to the "earmarking doctrine."[169] In disposing of these arguments, the court explained that "[t]he earmarking doctrine is a judicially created, equitable exception to [section] 547(b) that holds that money loaned to a debtor by a new creditor to pay an existing debt to an old creditor is not a 'transfer of an interest of the debtor in property' " as required for avoidance under section 547(b).[170] The policy underlying the earmarking doctrine is that if the disputed transfer only consists of the substitution of one creditor for another, no transfer of

[164] Verizon I, 2012 WL 3100778, at *8. For the text of section 550(b)(2), see supra Section II.E.2.

[165] Verizon I, 2012 WL 3100778, at *9.

[166] Verizon I, 2012 WL 3100778, at *8. The collapsing doctrine is addressed more fully in Section III.C of this Article.

[167] Verizon I, 2012 WL 3100778, at *9.

[168] Verizon I, 2012 WL 3100778, at *9.

[169] Verizon I, 2012 WL 3100778, at *9.

[170] Verizon I, 2012 WL 3100778, at *9 (quoting *In re Entringer Bakeries, Inc.*, 548 F.3d 344, 347 n.3, 50 Bankr. Ct. Dec. (CRR) 221, 60 Collier Bankr. Cas. 2d (MB) 1793, Bankr. L. Rep. (CCH) P 81350 (5th Cir. 2008)).

estate property has taken place.[171] However, when applying the earmarking doctrine to the facts of the *Verizon* case, the court found that the transfer of the Cash qualified as a transfer of an interest of the debtor in property because Idearc held the Cash prior to transferring it to Verizon and thus, the transfer of the Cash diminished Idearc's assets.[172]

c. ***Pleading Standards Examined***

The court next turned to the contractual obligations assumed by Idearc as part of the spin-off transaction.[173] The defendants' motion to dismiss the fraudulent transfer claim as to these obligations was predicated upon the allegation that the count was insufficiently pled and failed to specifically identify the obligations challenged.[174] In evaluating this allegation, the court first noted the lack of circuit-level precedent,[175] but then observed that the prevailing trend in the district was to find that fraudulent transfer claims are not subject to Rule 9(b)'s heightened pleading requirements.[176] Analogizing U.S. Bank's claims to claims for actual fraud, the court agreed that the heightened pleading standards should not be applied to fraudulent transfer claims, because the elements necessary to prove actual fraud are not relevant to proof of a fraudulent transfer and the policies underlying the heightened pleading standards for fraud claims do not apply in the fraudulent transfer context.[177] Accordingly, the court denied the motion to dismiss the claim seeking avoidance of the

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[171] Verizon I, 2012 WL 3100778, at *9 (citing *Coral Petroleum, Inc. v. Banque Paribas-London*, 797 F.2d 1351, 1356, Bankr. L. Rep. (CCH) P 71434 (5th Cir. 1986)). The court cited authority in support of this point, noting that while the authority it cited specifically references preference actions, the doctrine applies with equal force to fraudulent transfer actions. Verizon I, 2012 WL 3100778, at *9.

[172] Verizon I, 2012 WL 3100778, at *10.

[173] Verizon I, 2012 WL 3100778, at *10. The contractual obligations assumed by Idearc included a publishing agreement, a non-competition agreement, a branding agreement, a billing and collection agreement, a listing license agreement, an intellectual property agreement, a tax sharing agreement, an employee matters agreement and a transition services agreement. Verizon I, 2012 WL 3100778, at *10.

[174] Verizon I, 2012 WL 3100778, at *10.

[175] Verizon I, 2012 WL 3100778, at *11 (citing *Janvey v. Alguire*, 647 F.3d 585, 599 (5th Cir. 2011)).

[176] Verizon I, 2012 WL 3100778, at *10–11 (citing *Janvey v. Alguire*, 846 F. Supp. 2d 662, 675 (N.D. Tex. 2011)).

[177] Verizon I, 2012 WL 3100778, at *11.

contractual obligations assumed by the debtors as part of the spin-off.[178]

d. *The Stock Transfer as a Transfer of the Debtor's Property*

In evaluating the portion of the motion to dismiss relating to the issuance of Idearc stock, the court acknowledged the existence of conflicting authority on the issue of whether a stock transfer qualifies as a transfer of an interest of the debtor in property under Section 544(b) of the Bankruptcy Code.[179] The *Verizon I* court determined that it need not reach this issue because the Trustee's allegation that the stock was fraudulently transferred was predicated upon the assertion that the Idearc stock was worthless because Idearc was insolvent at the time of the transfer.[180] It followed, the court opined, that a transfer of worthless property cannot harm a debtor or its creditors, and therefore cannot qualify as a fraudulent transfer.[181] Thus, the court dismissed that count of the complaint.[182]

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[178]Verizon I, 2012 WL 3100778, at *11.

[179]Verizon I, 2012 WL 3100778, at *11. See *Decker v. Advantage Fund, Ltd.*, 362 F.3d 593, 596, 42 Bankr. Ct. Dec. (CRR) 224, Bankr. L. Rep. (CCH) P 80077 (9th Cir. 2004) (concluding that a trustee could not avoid stock sale because "unissued stock is not an interest of the debtor corporation in property; it is merely equity in the corporation itself"); *In re Curry and Sorensen, Inc.*, 57 B.R. 824, 829, 14 Bankr. Ct. Dec. (CRR) 103, 14 Collier Bankr. Cas. 2d (MB) 606, Bankr. L. Rep. (CCH) P 71022 (B.A.P. 9th Cir. 1986) (concluding that "[a] share of capital stock represents a unit of ownership interest and has no extrinsic value to the corporation itself" and thus "an action directed at recovery of corporate stock could only affect equitable ownership of the corporation and would not restore property to the estate or avoid an estate obligation"). But see *Global Crossing Estate Representative v. Winnick*, 2006 WL 2212776, *8 (S.D. N.Y. 2006) ("an issuance of stock involves a corporation exchanging stock in itself for money or other valuable property. Given a corporation's power to transfer stock to third parties in exchange for value, the argument that the corporation lacks an interest in the stock itself at the time of issuance blinks economic reality."); see also *In re Pitt Penn Holding Co., Inc.*, 55 Bankr. Ct. Dec. (CRR) 126, 2011 WL 4352373, *5–6 (Bankr. D. Del. 2011) (citing *Global Crossing* with approval).

[180]Verizon I, 2012 WL 3100778, at *12.

[181]Verizon I, 2012 WL 3100778, at *12.

[182]Verizon I, 2012 WL 3100778, at *12. Finally, the court held that the promoter liability claim and the alter ego claim both survived the motion to dismiss, but the unjust enrichment claim was barred by the statute of limitations. Verizon I, 2012 WL 3100778, at *14–16.

3. *Verizon II — Standing to Bring a Claim Under Section 544 of the Bankruptcy Code*

Following the determination of the motion to dismiss in *Verizon I,* the defendants moved for partial summary judgment on the issues of whether (1) the Trustee had satisfied the standing requirements of Section 544 of the Bankruptcy Code and (2) the Trustee could avoid and recover the interest payments made by Idearc to its banks and bondholders within the two years prior to Idearc's bankruptcy filing.[183] Under section 544, a trustee "may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law *by a creditor holding an unsecured claim that is allowable*[.]"[184] As explained in *Verizon II*, this language means that a trustee's rights to avoid a fraudulent transfer under applicable state law[185] are first derived from the rights of an actual unsecured creditor whose claim existed at the time of the bankruptcy filing.[186] This creditor is called a "triggering" creditor in relevant case law.[187] To begin this analysis, the court examined the potential triggering creditors in this case, finding that a former Idearc employee with a judgment for wrongful termination qualified as the triggering creditor for purposes of section 544 because he would have had standing to assert a fraudulent transfer claim at the time of Idearc's bankruptcy filing.[188]

In so holding, the *Verizon II* court rejected the defendants' arguments that the Trustee was not entitled to bring the fraudulent transfer claims because (1) the Trustee was standing in the shoes of a "sophisticated financial institution" and not the Idearc estate; (2) any recovery on the fraudulent transfer claims would not be for the benefit of the estate because confirmation of the plan of reorganization had extinguished the Idearc estate; (3) the triggering creditor used for the section 544 analysis was not a beneficiary of the litigation trust established by the confirmed plan; and (4) allowing the Trustee to recover on the fraudulent

[183]*U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 479 B.R. 405 (N.D. Tex. 2012) ("*Verizon II*").

[184]Verizon II, 479 B.R. at 410 (quoting 11 U.S.C.A. § 544(b)(1)) (emphasis added).

[185]The Trustee relied on section 544 to employ the fraudulent transfer laws applicable in Texas.

[186]Verizon II, 479 B.R. at 410 (citing *Smith v. American Founders Financial, Corp.*, 365 B.R. 647, 659 (S.D. Tex. 2007)).

[187]Verizon II, 479 B.R. at 410, 412.

[188]Verizon II, 479 B.R. at 412.

transfer claims would be a "mockery of justice" because it would allow Idearc's banks and bondholders to benefit from claims that they themselves could not have brought.[189]

In dismissing the first argument, the court noted that the Trustee had been designated as the estates' representative under the plan of reorganization and that the defendants had repeatedly argued during the course of the case that the Trustee did, indeed, stand in the shoes of the Idearc estate.[190] Next, the court found that the defendants' argument that confirmation of a plan extinguished the Trustee's right to bring avoidance claims was untenable because it would preclude avoidance claims from ever being brought post-confirmation and thus would cause bankruptcies to drag on for years before being confirmed.[191] Further, the court found that such a result would contravene the Bankruptcy Code's goal of a quick reorganization and the purpose behind section 1123(b)(3)(B), which "authorizes post-confirmation pursuit of a debtor's causes of action."[192] In disposing of the defendants' third argument, the court held that the fact that the triggering creditor was not a beneficiary of the litigation trust because his claim had already been satisfied[193] was of no import, as the Trustee's right to avoid a claim is determined as of the petition date, when the triggering creditor's claim was still outstanding.[194] Finally, in dismissing the fourth "mockery of justice" argument, the court simply stated that it could not ignore the law simply to achieve a party's desired result.[195]

Thus, the *Verizon II* court found that the Trustee had satisfied the standing requirements to bring the fraudulent transfer claims

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[189] Verizon II, 479 B.R. at 413–14. The court found that the banks and bondholders could not have brought these claims because they were estopped by their ratification of the transfers. Verizon II, 479 B.R. at 410–12.

[190] Verizon II, 479 B.R. at 413.

[191] Verizon II, 479 B.R. at 413.

[192] Verizon II, 479 B.R. at 413.

[193] The triggering creditor's claim was paid pursuant to the plan of reorganization confirmed in the debtors' bankruptcy cases.

[194] Verizon II, 479 B.R. at 414 (citing *In re Mirant Corp.*, 675 F.3d 530, 534, 56 Bankr. Ct. Dec. (CRR) 56, 67 Collier Bankr. Cas. 2d (MB) 638, Bankr. L. Rep. (CCH) P 82234 (5th Cir. 2012)).

[195] Verizon II, 479 B.R. at 414 (noting that other courts have condoned similar outcomes and citing *In re Musicland Holding Corp.*, 424 B.R. 95, 98–99, 102–03, 52 Bankr. Ct. Dec. (CRR) 214 (Bankr. S.D. N.Y. 2010) (permitting a $35 million transfer to be set aside on the basis of a $500 triggering claim); Mirant, 675 F.3d at 534 ("[A]n entire transfer may be set aside even though the [triggering] creditor's claim is nominal.")).

under section 544.[196] The court deferred decision on the merits of the fraudulent transfer claim as to the interest payments because it was briefed in greater depth in the cross-motions for summary judgment discussed immediately below.[197]

4. *Verizon III — Clarification of the Bankruptcy Code's Safe Harbor*

Soon after the decision in *Verizon II*, the parties cross-moved for summary judgment on certain claims, including the Trustee's fraudulent transfer claim seeking avoidance of the $1 million in interest payments made prior to Idearc's bankruptcy filing, the unlawful dividend claims,[198] and the defendants' affirmative defense to the fraudulent transfer claim related to the Cash transfer, which the defendants argued was sheltered by the safe harbor provided in section 546(e) of the Bankruptcy Code.[199] This Article focuses on the fraudulent transfer claims.

a. *The Cash Transfer Was Sheltered by Section 546(e) of the Bankruptcy Code Because it was a "Settlement Payment" made by a "Financial Institution."*

The Idearc spin-off transaction included the Cash transfer of approximately $2.4 billion executed through Mellon Bank, from Idearc to VFS, a Verizon subsidiary and defendant.[200] The Trustee sought to avoid the transfer under section 544 of the Bankruptcy Code and to recover the Cash pursuant to section 550.[201] The defendants argued that the Cash transfer was excepted from

[196]Verizon II, 479 B.R. at 414–15.

[197]Verizon II, 479 B.R. at 415.

[198]The court denied summary judgment on the unlawful dividend claim arising out of the transfer of the Cash, holding that it was preempted by the Bankruptcy Code, because it had ruled that the fraudulent transfer claim arising out of the Cash transfer was barred by section 546(e) of the Bankruptcy Code. *U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 892 F. Supp. 2d 805, 822–27 (N.D. Tex. 2012) ("*Verizon III*"). However, the *Verizon III* court found that the unlawful dividend claim as to the $7.1 billion in debt was not preempted by the Bankruptcy Code, and thus declined to deny summary judgment as to that count of the complaint. Verizon III, 892 F. Supp. 2d at 826–27.

[199]Verizon III, 892 F. Supp. 2d at 814–17.

[200]Verizon III, 892 F. Supp. 2d at 814. In 2007, subsequent to the transfer discussed above, Mellon Bank and The Bank of New York merged to form BNY Mellon.

[201]Verizon III, 892 F. Supp. 2d at 814. As noted previously, U.S. Bank relied upon section 544 in order to assert fraudulent transfer claims arising under Texas law.

avoidance by the safe harbor provided by Section 546(e) of the Bankruptcy Code[202] which was enacted to "minimize the displacement caused in the commodities and securities markets in the event [of] a major bankruptcy affecting those industries."[203] Section 546(e) states, among other things, that, notwithstanding section 544, a bankruptcy trustee may not avoid a transfer that is a "settlement payment" made by, to, or for the benefit of a "financial institution."[204]

In order to evaluate the applicability of section 546(e) to the Cash transfer, the court first examined the meaning of the term "settlement payment."[205] The court observed that the Bankruptcy Code's definition of settlement payment, "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used the securities trade[,]"[206] has been interpreted broadly.[207] The court then noted that the term encompasses "most transfers of money or securities made to complete a securities transaction"[208] and that the Bankruptcy Code defines "security" to include "note[s]," "stock[s]," and "bond[s]."[209] The court next turned to the term "financial institution," which is defined under the Bankruptcy Code to include a "commercial or savings bank."[210]

Applying the requirements of section 546(e) to the Cash

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[202] Verizon III, 892 F. Supp. 2d at 814. For the full text of Section 546(e) of the Bankruptcy Code, see supra note 54.

[203] Verizon III, 892 F. Supp. 2d at 815 (citing *In re Olympic Natural Gas Co.*, 294 F.3d 737, 742 n.5, 39 Bankr. Ct. Dec. (CRR) 221, Bankr. L. Rep. (CCH) P 78683, 159 O.G.R. 555 (5th Cir. 2002)).

[204] 11 U.S.C.A. § 546(e). For the full text of section 546(e) of the Bankruptcy Code, see supra note 54.

[205] Verizon III, 892 F. Supp. 2d at 815.

[206] 11 U.S.C.A. § 741(8).

[207] Verizon III, 892 F. Supp. 2d at 815 (citing *Contemporary Industries Corp. v. Frost*, 564 F.3d 981, 985–86, 51 Bankr. Ct. Dec. (CRR) 157, Bankr. L. Rep. (CCH) P 81473 (8th Cir. 2009); *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 334, 336–37, 55 Bankr. Ct. Dec. (CRR) 12, 65 Collier Bankr. Cas. 2d (MB) 1833 (2d Cir. 2011); *In re Resorts Intern., Inc.*, 181 F.3d 505, 515, 34 Bankr. Ct. Dec. (CRR) 736, Bankr. L. Rep. (CCH) P 77952 (3d Cir. 1999)).

[208] Verizon III, 892 F. Supp. 2d at 815 (citing *Contemporary Indus. Corp.*, 564 F.3d at 985–86; *Enron Creditors Recovery Corp.*, 651 F.3d at 334, 336–37; *In re Resorts Int'l, Inc.*, 181 F.3d at 515).

[209] Verizon III, 892 F. Supp. 2d at 815 (citing 11 U.S.C. § 101(49)).

[210] Verizon III, 892 F. Supp. 2d at 815 (citing 11 U.S.C. § 101(22)).

transfer, the court held that the Cash Transfer was a "settlement payment" under section 546(e) of the Bankruptcy Code because it was made to complete a securities transaction.[211] The court came to this conclusion because the Cash transfer was made in exchange for IIS stock, a security, as the term is defined in section 101(49) of the Bankruptcy Code.[212] Next, the court considered whether Mellon Bank satisfied the "financial institution" requirement of section 546(e), finding that because Mellon Bank was a commercial bank, the "financial institution" requirement was met satisfied.[213] Thus, the court concluded that avoidance of the Cash transfer was barred by Section 546(e) of the Bankruptcy Code.[214]

U.S. Bank argued that such an interpretation of section 546(e) was at odds with section 546(e)'s intent, because Congress did not intend to protect transfers that do not implicate the securities settlement process.[215] However, the court dismissed this argument, citing Fifth Circuit case law that has squarely rejected such an interpretation.[216] U.S. Bank further contended that Congress did not intend for section 546(e) to apply to transactions not made at arm's-length, such as the intercompany transaction at issue.[217] In rejecting this argument, the court simply stated that many courts have declined to look beyond the plain

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[211]Verizon III, 892 F. Supp. 2d at 815.

[212]Verizon III, 892 F. Supp. 2d at 815.

[213]Verizon III, 892 F. Supp. 2d at 815.

[214]Verizon III, 892 F. Supp. 2d at 817.

[215]Verizon III, 892 F. Supp. 2d at 816. In 2012, the district court for the Southern District of New York also addressed the question of whether transfers must implicate the securities settlement process in order to be sheltered under section 546(e), in the context of payments made to effectuate a leveraged buyout. *AP Services LLP v. Silva*, 483 B.R. 63, Bankr. L. Rep. (CCH) P 82377 (S.D. N.Y. 2012). The *AP Services* court held that the plain language of the statute, coupled with decisions from within the Second Circuit and other circuits holding that the term "settlement payment" should be construed broadly, indicate that a transaction need not involve a financial intermediary that takes title to the transferred assets in order to be sheltered by section 546(e). Verizon III, 892 F. Supp. 2d at 816 (citing In re Resorts Int'l, Inc., 181 F.3d at 515–16).

[216]Verizon III, 892 F. Supp. 2d at 816 (citing *In re Olympic Natural Gas Co.*, 294 F.3d 737, 742, 39 Bankr. Ct. Dec. (CRR) 221, Bankr. L. Rep. (CCH) P 78683, 159 O.G.R. 555 (5th Cir. 2002)).

[217]Verizon III, 892 F. Supp. 2d at 816.

language of section 546(e) to create additional exceptions not contained in its text.[218]

The court also rejected U.S. Bank's efforts to persuade it that the defendants failed to satisfy the "financial institution" requirement.[219] U.S. Bank argued that Mellon Bank was merely a conduit for the funds and thus did not qualify as a financial institution for purposes of section 546(e), which requires that the transfer be made "by" a financial institution.[220] In support of this argument, U.S. Bank cited an Eleventh Circuit Court of Appeals decision, *Munford v. Valuation Research Corporation*,[221] which stands for the proposition that a bank that operates merely as a conduit and that never acquires a beneficial interest in the funds or shares transferred as part of a transaction does not qualify as a financial institution under Section 546(e) of the Bankruptcy Code.[222] However, the *Verizon III* court observed that many courts have criticized or rejected *Munford*'s analysis because it is contrary to the plain language of section 546(e).[223] Specifically, the court cited *In re Refco, Inc. Securities Litigation*,[224] which examined the plain meaning of the term "financial institution," rejected *Munford*, and held that an entity need not acquire a beneficial interest in property in order to qualify as a financial institution under section 546(e).[225] The *Refco* court relied on the Eighth Circuit Court of Appeals' opinion in *In re Contemporary*

[218] Verizon III, 892 F. Supp. 2d at 816 (citing *Kaiser Steel Corp. v. Charles Schwab & Co., Inc.*, 913 F.2d 846, 850, 20 Bankr. Ct. Dec. (CRR) 1650, 23 Collier Bankr. Cas. 2d (MB) 1403, Bankr. L. Rep. (CCH) P 73620 (10th Cir. 1990) ("[B]ecause of the variety and scope of different securities transactions, and the absence of any restrictions in sections 546(e) and 741(8), it would be an act of judicial legislation to establish such a limitation.")).

[219] Verizon III, 892 F. Supp. 2d at 816.

[220] Verizon III, 892 F. Supp. 2d at 816.

[221] Verizon III, 892 F. Supp. 2d at 816 (citing *Matter of Munford, Inc.*, 98 F.3d 604, 610, 36 Collier Bankr. Cas. 2d (MB) 1673 (11th Cir. 1996)).

[222] Verizon III, 892 F. Supp. 2d at 816 (citing Munford, 98 F.3d at 610).

[223] Verizon III, 892 F. Supp. 2d at 816.

[224] Verizon III, 892 F. Supp. 2d at 816 (citing No. 07-MDL-1902-GEL, 2009 WL 7242548, at *6–8 (S.D.N.Y. Nov. 13, 2009), report and recommendation adopted sub nom. *In re Refco Securities Litigation*, 2010 WL 5129072 (S.D. N.Y. 2010)).

[225] Verizon III, 892 F. Supp. 2d at 816 (citing In re Refco, Inc. Sec. Litig., 2009 WL 724258, at *6–7).

Industries Corporation,[226] which also employed the plain language approach, stating that "[w]here statutory language is plain and does not lead to an absurd result, we must enforce it as written."[227] *Contemporary Industries* held that section 546(e) "does not expressly require that the financial institution obtain a beneficial interest in the funds."[228]

Finally, and perhaps most noteworthy, the court addressed U.S. Bank's argument that section 546(e)'s safe harbor simply does not apply to intentional fraudulent transfers.[229] Section 546(e) provides that a trustee may not avoid certain transfers "[n]otwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title"[230] U.S. Bank contended that the exclusion of section 548(a)(1)(A), the Bankruptcy Code section addressing intentional fraudulent transfers, from the list of provisions covered by the safe harbor meant that section 546(e) should also not bar the prosecution of functionally similar claims, such as those in *Verizon* where the action is brought pursuant to section 544 and applicable state law.[231] The court found this argument unconvincing, reasoning that if Congress wanted to exclude state law actual fraudulent transfer claims, it "could have expressly done so" in section 546(e).[232]

b. *The Interest Payments Made Following the Spin-Off Were Not Recoverable from Verizon*

The court next addressed U.S. Bank's fraudulent transfer claim seeking to avoid the $1 million in interest payments made by Idearc to its banks and bondholders in the two years immediately preceding the bankruptcy filing and recover those payments from

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[226] *In re Refco, Inc. Sec. Litig.*, 2009 WL 724258, at *6–7 (citing *Contemporary Industries Corp. v. Frost*, 564 F.3d 981, 51 Bankr. Ct. Dec. (CRR) 157, Bankr. L. Rep. (CCH) P 81473 (8th Cir. 2009)).

[227] In re Contemporary Indus. Corp., 564 F.3d at 987–88.

[228] Contemporary Indus., 564 F.3d at 987. The *Refco* and *Contemporary Industries* courts both cite *In re QSI Holdings, Inc.*, 571 F.3d 545, 550, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009) ("[T]he plain language of § 546(e) simply does not require a financial institution to have a beneficial interest in the transferred funds.") (internal quotations omitted).

[229] Verizon III, 892 F. Supp. 2d at 816–17.

[230] Verizon III, 892 F. Supp. 2d at 816–17.

[231] Verizon III, 892 F. Supp. 2d at 816–17.

[232] Verizon III, 892 F. Supp. 2d at 816–17.

Verizon.[233] This claim was brought pursuant to Section 548 of the Bankruptcy Code.[234] Importantly, under Section 550(a)(1) of the Bankruptcy Code, after a transfer is avoided under section 548, the trustee can recover from "the initial transferee of such transfer or the entity for whose benefit such transfer was made."[235]

The court found that U.S. Bank could not recover the interest payments from Verizon because Verizon was neither the initial transferee nor was it the entity for whose benefit the transfers were made.[236] The court reasoned that Verizon did not receive the interest payments—Idearc's lenders and bondholders did, making them and not Verizon the initial transferees.[237] Verizon was also not the entity for whose benefit the transfers were made, the court reasoned, because Verizon was not a guarantor, the paradigm entity of the scenario contemplated by section 550(c)(i).[238] The court rejected U.S. Bank's argument that Verizon was the beneficiary of the interest payments, because the payments arose out of the spin-off transaction, which transaction ultimately inured to the benefit of Verizon.[239] In so holding, the court reasoned that Verizon would have suffered no adverse effects if the payments were not made.[240]

The court also found unpersuasive the argument that Verizon "forced" the debtor to make the interest payments because Verizon and Idearc were separate entities at the time of the transfers and Verizon had no ability to force Idearc to make interest payments.[241] Finally, the court found U.S. Bank's reliance on *In re TOUSA,* in support of its argument that Verizon benefited from the interest payments, to be misplaced,[242] pointing out that *TOUSA* involved an initial payment to a former lender that was required under the new loan documents and did not involve

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[233] Verizon III, 892 F. Supp. 2d at 820–21.

[234] Verizon III, 892 F. Supp. 2d at 820.

[235] 11 U.S.C.A. § 550.

[236] Verizon III, 892 F. Supp. 2d at 820–21.

[237] Verizon III, 892 F. Supp. 2d at 820–21.

[238] Verizon III, 892 F. Supp. 2d at 821 (citing *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890, 895, 17 Bankr. Ct. Dec. (CRR) 299, 18 Collier Bankr. Cas. 2d (MB) 155 (7th Cir. 1988)).

[239] Verizon III, 892 F. Supp. 2d at 821.

[240] Verizon III, 892 F. Supp. 2d at 821.

[241] Verizon III, 892 F. Supp. 2d at 821.

[242] Verizon III, 892 F. Supp. 2d at 821 (citing *In re TOUSA*, 680 F.3d 1298 (11th Cir. 2012)).

subsequent interest payments. Thus, the court granted the defendants' motion for summary judgment with respect to the claims seeking avoidance and recovery of the interest payments.[243]

5. *Conclusion*

The *Verizon I, II,* and *III* decisions are instructive on several issues in the fraudulent transfer arena. Specifically, *Verizon I* thoroughly analyzes the recoverability of obligations in the context of debt instruments, synthesizing case law from across the Circuits. In doing so, it sets a clear precedent barring recovery of obligations under Section 550 of the Bankruptcy Code and makes a strong case for the "plain language" approach to statutory interpretation. *Verizon II* examines the unique issue of a triggering creditor whose claim has been satisfied and who is not the beneficiary of a post-confirmation litigation trust, clarifying several issues commonly faced by trustees under Section 544 of the Bankruptcy Code. *Verizon III's* holding continues the trend of expanding the reach of the safe harbor contained in Section 546(e) of the Bankruptcy Code through reliance on the "plain language" approach to statutory interpretation, and further clarifies the "for whose benefit" language, following the controversial decisions in the *TOUSA* bankruptcy.

B. *Stern v. Marshall's Impact on the Adjudication of Fraudulent Transfer Claims*

In the wake of the United States Supreme Court's holding in *Stern v. Marshall*,[244] the question of a bankruptcy court's authority to enter a final judgment on core matters has become the

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[243]Subsequent to its decision in *Verizon III*, the court entered an order on August 22, 2012 bifurcating the issue of Idearc's solvency from the remainder of the factual issues. U.S. Bank Nat'l Ass'n v. Verizon Commc'ns Inc., No. 3:10-CV-1842-G (N.D. Tex. Aug. 22, 2012), ECF No. 504. After a 10-day bench trial on the solvency issue, the court issued its decision on January 22, 2013, holding that, at the time of the spin-off transaction, Idearc had an enterprise value of at least $12 billion. U.S. Bank Nat'l Ass'n v. Verizon Commc'ns Inc., No. 3:10-CV-1842-G (N.D. Tex. Jan. 22, 2013), ECF No. 646. U.S. Bank's original complaint alleged that Idearc's debts exceeded its assets by approximately $9 billion. Verizon III, 892 F. Supp. 2d at 808–09. Thereafter, the court issued an order to show cause as to why judgment should not be entered for the defendant on the remaining issues, namely (i) Idearc's insolvency; (ii) whether Idearc received reasonably equivalent value for the debt and cash it transferred; and (iii) whether Idearc had sufficient surplus at the time of the spin-off. *U.S. Bank Nat'l Ass'n v. Verizon Commc'ns Inc.*, No. 3:10-CV-1842-G (N.D. Tex. Jan. 22, 2013), ECF No. 647. At the time this Article was completed, the issues had been briefed but no decision had been entered.

[244]*Stern v. Marshall*, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032

topic of much discussion and debate, especially in the fraudulent transfer context, as *Stern* left the issue unresolved.[245] This section discusses some of the most notable 2012 decisions examining the ramifications of *Stern* on fraudulent transfer causes of action and examines whether, notwithstanding the jurisdictional limits imposed by *Stern*, defendants may (a) consent to or (b) waive their rights to contest the jurisdiction of a bankruptcy court to enter final orders in fraudulent transfer actions.

The cases discussed indicate a clear preference for finding that parties have either waived their objections to or consented to the bankruptcy court's entry of a final judgment on fraudulent transfer claims. While often holding that the bankruptcy court possesses the statutory but not the constitutional authority to

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(2011) ("*Stern*"). Briefly, *Stern* held that a state law tortious interference counterclaim to a proof of claim could only be finally adjudicated by an Article III court, and not a bankruptcy court, despite the fact that the bankruptcy court had statutory authority to determine the claim as a "core" proceeding under 28 U.S.C.A. § 157.

In response to the Supreme Court's *Stern* decision, the American Bar Association ("ABA") adopted a resolution supporting the position that bankruptcy judges can, in certain circumstances, adjudicate so-called "core" proceedings that go beyond a bankruptcy court's constitutional authority. Since the Supreme Court rendered the *Stern* decision, lower courts have grappled with the extent of the bankruptcy courts' judicial authority, by in large concluding that the determination is no longer founded solely by a matter's status as "core" to a bankruptcy proceeding. The ABA's resolution would allow bankruptcy judges to rule on matters in a "core" proceeding even if the matters underlying the proceeding are beyond the court's constitutional authority, provided that the parties to the proceeding consent to the bankruptcy court's jurisdiction. As stated in the proposal, "[t]he statute is best construed to authorize a bankruptcy judge to adjudicate . . . a core proceeding requiring the judicial power of the United States in the same manner as the judge already may adjudicate a noncore proceeding — upon the express consent of the parties." See Mary Beth M. Clary, American Bar Ass'n, Section of Business Law, Report to the House of Delegates and Resolution (Feb. 11, 2013), available at http://articles.law360.s3.amazonaws.com/0414000/414476/1357334307_31_1_1_9_resolution_summary.docx (last visited Apr. 29, 2013).

[245] Courts have disagreed on whether, post-*Stern*, bankruptcy courts have the constitutional authority to enter final judgments in fraudulent transfer actions. Compare *In re Custom Contractors, LLC*, 462 B.R. 901, 55 Bankr. Ct. Dec. (CRR) 242 (Bankr. S.D. Fla. 2011) (holding bankruptcy courts have constitutional authority to enter final judgments in fraudulent transfer actions); *In re Direct Response Media, Inc.*, 466 B.R. 626, 645–46 (Bankr. D. Del. 2012) (same), with *In re Heller Ehrman LLP*, 464 B.R. 348 (N.D. Cal. 2011) (holding bankruptcy courts lack constitutional authority to enter final judgments in fraudulent transfer actions); *In re Teleservices Group, Inc.*, 456 B.R. 318, 55 Bankr. Ct. Dec. (CRR) 98 (Bankr. W.D. Mich. 2011) (same); *In re Canopy Financial, Inc.*, 464 B.R. 770 (N.D. Ill. 2011) (same).

finally adjudicate fraudulent transfer claims, courts have also found that the parties' willingness to litigate their claims before the bankruptcy courts, as well as their assertions of the bankruptcy court's jurisdiction in their pleadings, constitute consent to the entry of a final order by the bankruptcy court.

1. *Kirschner v. Agoglia* (*In re Refco, Inc.*)

The United States District Court for the Southern District of New York in *Kirschner v. Agoglia* (*In re Refco*)[246] examined the question of whether, in light of *Stern*, a bankruptcy court has the authority to finally resolve state law fraudulent transfer claims, or, if it does not, whether it may submit related findings of fact and conclusions of law to the district court.[247]

In October 2005, Refco, Inc. ("Refco"), at that time one of the largest commodities brokers in the United States, disclosed that certain insiders were using money in customer brokerage accounts to fund the firm's operating expenses and hide Refco's insolvency.[248] Days after this disclosure, Refco filed for bankruptcy protection.[249] Thereafter, the bankruptcy court confirmed a reorganization plan that created the Refco Litigation Trust (the "Litigation Trust") for the benefit of Refco's unsecured creditors.[250] The trustee of the Litigation Trust filed an adversary proceeding in October 2007 against former insiders asserting fraudulent

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[246] *Kirschner v. Agoglia*, 476 B.R. 75 (S.D. N.Y. 2012).

[247] In re Refco, 476 B.R. at 77–78. On January 31, 2012, the district court for the Southern District of New York entered an Amended Standing Order of Reference, which states that, in the event that a bankruptcy judge determines that entry of final judgment on a core matter would be inconsistent with Article III of the Constitution, the bankruptcy judge shall hear the proceeding and submit proposed findings of fact and conclusions of law to the district court. The Amended Standing Order of Reference also provides that the district court may treat any order of the bankruptcy court as proposed findings of fact and conclusions of law in the event that the district court determines that the bankruptcy judge could not have properly entered a final order in the proceeding. Amended Standing Order of Reference, *In the Matter of Standing Order of Reference Re: Title 11*, 12 Misc. 00032 (S.D.N.Y. Feb. 2, 2012). The district court for the District of Delaware entered a substantially similar order on February 29, 2013. Amended Standing Order of Reference, In the Matter of Standing Order of Reference Re: Title 11 (D. Del. Feb. 29, 2012).

[248] In re Refco, 476 B.R. at 78.

[249] In re Refco, 476 B.R. at 78.

[250] In re Refco, 476 B.R. at 78.

transfer claims under New York Debtor Creditor Law, and unjust enrichment claims under New York common law.[251]

a. *The Statutory Landscape Underlying Stern*

After the Supreme Court's 2011 decision in *Stern*, the district court in *Refco* withdrew the reference to address the following issues: (1) whether a bankruptcy court has constitutional authority to finally resolve the trustee's state law claims, including the fraudulent transfer claims; and (2) if the bankruptcy court cannot finally resolve those claims, whether the bankruptcy court had statutory authority to recommend findings of fact and conclusions of law for the district court to consider.[252]

In evaluating these questions, the court examined the landscape upon which *Stern* was decided.[253] In so doing, the court reviewed the basic tenets of bankruptcy jurisdiction, starting with the district courts' original jurisdiction over bankruptcy cases and all civil proceedings "arising under title 11, or arising in or related to cases under title 11."[254] As a threshold matter, the court observed that, pursuant to Section 157(a) of title 28 of the United States Code, a district court may refer cases within its jurisdiction to the bankruptcy court of that district.[255] Section 157 also delineates two types of proceedings: " 'core proceedings,' which the bankruptcy court may 'hear and determine' and on which the bankruptcy court 'may enter appropriate orders and judgments,' [and] 'non-core proceedings,' which the bankruptcy court may hear, but for which the bankruptcy court is only empowered to submit proposed findings of fact and conclusions of

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[251] In re Refco, 476 B.R. at 78.

[252] In re Refco, 476 B.R. at 77.

[253] In re Refco, 476 B.R. at 78.

[254] In re Refco, 476 B.R. at 78 (citing 28 U.S.C. § 1334).

[255] In re Refco, 476 B.R. at 78. The court also noted that the Southern District of New York has in place a standing order referring bankruptcy cases to the bankruptcy court for that district. In re Refco, 476 B.R. at 78; see supra note 247.

28 U.S.C.A. § 157 was enacted to address the implications of the Supreme Court's decision in *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598, 6 Collier Bankr. Cas. 2d (MB) 785, Bankr. L. Rep. (CCH) P 68698 (1982) ("*Northern Pipeline*"). *Northern Pipeline* held that the jurisdiction granted to bankruptcy courts under the Bankruptcy Act of 1978 violated Article III of the Constitution. See 1 Collier on Bankruptcy § 3.02[1] (Alan N. Resnick and Henry J. Sommer eds., 16th ed. 2012).

law to the district court for de novo review, § 157(c)(1)."[256] Specifically, section 157 provides that "[c]ore proceedings include, but are not limited to — . . . (H) proceedings to determine, avoid, or recovery fraudulent conveyances . . ."[257] Earlier in the proceeding, the bankruptcy court determined that the fraudulent transfer claims in the *Refco* case were statutorily core.[258]

b. *Stern and the Public Rights Doctrine*

The court began its discussion of *Stern* by delving into the "public rights doctrine."[259] In *Stern*, the Supreme Court held that common law tortious interference claims did not implicate "public rights" and could not be finally determined by a bankruptcy court.[260] The *Refco* court reviewed the Supreme Court's analysis in *Stern*, which concluded that "private rights" claims were the "stuff" of common law, over which only an Article III court can render final judgment, and "public rights" claims are claims "derived from" or "closely intertwined" with a federal regulatory scheme and can therefore "be fully adjudicated by an Article I bankruptcy court without intruding on the separation of powers set out by Article III."[261] In determining that a state law tortuous interference claim did not implicate public rights, the *Stern* court opined that private rights were those "traditional actions at common law tried by the courts at Westminster in 1789."[262]

The court in *Refco* turned next to the case law underlying the public rights exception, first addressed by the Supreme Court in *Northern Pipeline*.[263] The court observed that while the plurality and concurrence in *Stern* disagreed on the scope of the public rights doctrine, a majority of the Supreme Court did agree that the common law tortious interference claims at issue in *Stern* were not matters of "public right."[264] The *Refco* court next discussed the Supreme Court's decision in *Granfinanciera, S.A. v.*

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[256] In re Refco, 476 B.R. at 78 (citing *In re Orion Pictures Corp.*, 4 F.3d 1095, 1100–01, 24 Bankr. Ct. Dec. (CRR) 1139, 29 Collier Bankr. Cas. 2d (MB) 1341, Bankr. L. Rep. (CCH) P 75459, 123 A.L.R. Fed. 681 (2d Cir. 1993)).

[257] 28 U.S.C.A. § 157(b)(2)(H).

[258] See In re Refco, 476 B.R. at 78 n.1.

[259] In re Refco, 476 B.R. at 79–80.

[260] Stern, 131 S. Ct. 2594, 2621 (2011)

[261] In re Refco, 476 B.R. at 80 (citing *Stern*, 131 S. Ct. at 2611–16).

[262] Stern, 131 S. Ct. at 2609.

[263] In re Refco, 476 B.R. at 80.

[264] In re Refco, 476 B.R. at 80 (citing *Northern Pipeline*, 458 U.S. 50, 69–72, 90–91 (1982)).

Nordberg,[265] which held that the Seventh Amendment right to a jury trial applied to fraudulent transfer actions in which the defendant has not submitted a proof of claim.[266] The *Refco* court noted that the Supreme Court in *Stern* relied heavily on *Granfinanciera's* treatment of a fraudulent transfer claim as a private right matter, where the *Stern* opinion analogized the tortuous interference claim before it to the fraudulent transfer claim in *Granfinanciera*.[267]

The *Granfinanciera* court "reasoned that fraudulent conveyance suits were 'quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res.' "[268] Accordingly, the *Refco* court reasoned that a determination that a fraudulent transfer claim falls into the public rights exception would be at odds with the *Stern* court's reliance on *Granfinanciera.*[269] In holding that the fraudulent transfer claim in *Refco* did not fall under the public rights exception and thus could not be finally adjudicated by a non-Article III judge, the court analogized the fraudulent transfer claim to the tortious interference claim in *Stern*, and observed both types of claims "exist without regard to the bankruptcy proceeding," as the debtor's plan had been confirmed and the fraudulent transfer claim was merely to augment the estate.[270] Further, the court noted,

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[265]In re Refco, 476 B.R. at 80 (citing 492 U.S. 33 (1989) ("*Granfinanciera*")).

[266]In re Refco, 476 B.R. at 80.

[267]In re Refco, 476 B.R. at 80 (citing Stern, 131 S. Ct. at 2614).

[268]In re Refco, 476 B.R. at 80 (citing Stern, 131 S. Ct. at 2614).

[269]In re Refco, 476 B.R. at 80.

[270]In re Refco, 476 B.R. at 80–81. The district court also cited several courts that reached the same conclusion after *Stern.* See, e.g., *In re Lyondell Chemical Co.*, 467 B.R. 712 (S.D. N.Y. 2012); *In re Heller Ehrman LLP*, 464 B.R. 348, 354 (N.D. Cal. 2011) ("*Stern* clearly implied that the bankruptcy court lacks constitutional authority to enter final judgment on . . . fraudulent conveyance claims. . . ."); *In re Coudert Bros. LLP*, 2011 WL 5593147, *7–9 (S.D. N.Y. 2011) (holding bankruptcy court lacked constitutional authority to finally decide trustee's private state law claims, including, inter alia, fraudulent transfer claim). But see *In re Refco Inc.*, 461 B.R. 181, 186, 55 Bankr. Ct. Dec. (CRR) 226 (Bankr. S.D. N.Y. 2011) (in related litigation, collecting bankruptcy court decisions split on whether *Stern* dictates that bankruptcy courts have no constitutional authority to finally decide fraudulent transfer claims).

the defendants had not filed a proof of claim or otherwise submitted themselves to the jurisdiction of the bankruptcy court.[271]

The court acknowledged that its holding was opposite the conclusion reached by the bankruptcy court overseeing the *Refco* bankruptcy just six months earlier.[272] Relying on the Supreme Court's statement that its holding in *Stern* was "limited," "narrow," and not intended to upset the historical division of labor between bankruptcy courts and Article III courts, the *Refco* bankruptcy court held that it was empowered to enter final judgments in fraudulent transfer actions.[273] The district court posited, however, that "cautionary dicta and past practice do not overcome the logic of the Supreme Court's holding in *Stern.*"[274]

c. *Findings of Fact and Conclusions of Law on "Core" Claims*

After addressing the bankruptcy court's constitutional authority, the court next turned to the bankruptcy court's statutory authority to submit proposed findings of fact and conclusions of law on "core" claims.[275] On this issue, the court determined that the bankruptcy court had authority to issue findings of fact and conclusions of law in core proceedings, subject to *de novo* review by the district court. While Section 157(b)(1) of Title 28 of the United States Code provides that a bankruptcy court "may enter appropriate orders and judgments" on core claims, that section was enacted prior to *Stern,* which clearly alters the bankruptcy courts' authority under section 157(b)(1).[276] The court observed that, as a result of *Stern,* there is no express authority that authorizes a bankruptcy court to issue reports and recommendations in cases such as *Refco*—core proceedings in which a bankruptcy court lacks constitutional authority to issue a final judgment.[277] Analyzing the relevant legislative history,[278] the court concluded that Congress, in enacting section 157, clearly "wanted [b]ankruptcy [j]udges to finally adjudicate bankruptcy-

[271] In re Refco, 476 B.R. at 81.

[272] In re Refco, 476 B.R. at 81.

[273] In re Refco, 476 B.R. at 81 (citing In re Refco Inc., 461 B.R. at 189).

[274] In re Refco, 476 B.R. at 81.

[275] In re Refco, 476 B.R. at 81–82.

[276] In re Refco, 476 B.R. at 81 (citing 28 U.S.C. § 157).

[277] In re Refco, 476 B.R. at 81. As noted earlier, in the District of Delaware and the Southern District of New York, the most recent standing orders of reference to the bankruptcy court have addressed this point. See supra note 247.

[278] Parsing the legislative history, the court observed:

related matters whenever Article III permitted them to do so, and to issue recommended findings subject to *de novo* review in the [d]istrict [c]ourt whenever it did not."[279] Accordingly, the court held that, under *Stern,* bankruptcy courts have the authority to submit proposed findings of fact and conclusions of law on core matters.[280]

2. *In re Bellingham Insurance Agency, Inc.*

In the landmark case of *Bellingham Insurance Agency, Inc. v. Arkison* (*In re Bellingham Insurance Agency, Inc.*),[281] the Court of Appeals for the Ninth Circuit examined the question of whether a non-Article III judge (i.e., a bankruptcy judge) has the authority to enter a final judgment in a fraudulent transfer action brought under both state law and the Bankruptcy Code.[282] Overruling its prior decision on the issue, the Court of Appeals held that the Constitution forbids the entry of such a final judgment, but that a bankruptcy court does have authority to hear such a case and to enter proposed findings of fact and conclusions of law.[283]

Prior to its bankruptcy filing in the United States Bankruptcy Court for the Western District of Washington, Bellingham Insurance Agency ("BIA") transferred its business to defendant Execu-

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In their origin, bankruptcy courts were court-appointed "referees" who functioned much as magistrate judges to assist the district courts in carrying out their work. *See Northern Pipeline,* 458 U.S. at 53. After *Northern Pipeline* largely eviscerated Congress' attempt to create formal autonomous bankruptcy courts, *see id.*; *see generally* Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts,* 62 Stan. L. Rev. 747, 757–66 (2011). Congress returned to the previous system of bankruptcy judges assisting the district courts, by enacting the Bankruptcy Amendments and Federal Judgeship Act of 1984, codified in 28 U.S.C. § 157, pursuant to which bankruptcy courts had authority only over the cases referred to them by the District Courts. *See* 28 U.S.C. § 157(a) (district court can refer bankruptcy cases to bankruptcy courts); 28 U.S.C. § 1334 (district courts have original jurisdiction for all bankruptcy cases).

In re Refco, 476 B.R. at 80.

[279]In re Refco, 476 B.R. at 82 (citing *In re Coudert Bros. LLP*, 2011 WL 5593147, *13 (S.D. N.Y. 2011)).

[280]In re Refco, 476 B.R. at 82.

[281]*In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 57 Bankr. Ct. Dec. (CRR) 89, 68 Collier Bankr. Cas. 2d (MB) 1429, Bankr. L. Rep. (CCH) P 82404 (9th Cir. 2012), cert. granted, 2013 WL 3155257 (U.S. 2013).

[282]Bellingham, 702 F.3d at 556.

[283]Bellingham, 702 F.3d at 556 (overruling *In re Mankin*, 823 F.2d 1296, 17 Collier Bankr. Cas. 2d (MB) 469, Bankr. L. Rep. (CCH) P 71918 (9th Cir. 1987) (overruled by, In re Bellingham Ins. Agency, Inc., 702 F.3d 553, 57 Bankr. Ct. Dec. (CRR) 89, 68 Collier Bankr. Cas. 2d (MB) 1429, Bankr. L. Rep. (CCH) P 82404 (9th Cir. 2012)) ("*Mankin*")).

tive Benefits Insurance Agency ("EBIA"), and, as part of this transfer, EBIA received certain insurance commissions from BIA.[284] Subsequent to BIA's Chapter 7 filing, the Chapter 7 trustee sued EBIA to avoid and recover the transfer of the insurance commissions, alleging, inter alia, that the transfer was constructively fraudulent under both state law and section 548 of the Bankruptcy Code.[285] Similar to the facts in *Refco,* supra, the defendant in *Bellingham* was not a creditor of the bankruptcy estate.

In the adversary proceeding before the bankruptcy court, EBIA demanded a jury trial.[286] The district court treated the jury demand as a motion to withdraw the reference.[287] However, that withdrawal motion was never heard, because, in March 2010, while it was pending, EBIA petitioned the district court for a stay to allow the bankruptcy court to rule on the Chapter 7 trustee's summary judgment motion, which had been filed in the interim.[288] Shortly thereafter, the bankruptcy court granted summary judgment in favor of the trustee and entered a final judgment against EBIA.[289] EBIA appealed to the district court, failing to raise the argument that the bankruptcy court lacked the authority to enter final judgment on the fraudulent transfer claims.[290] The district court affirmed the bankruptcy court's ruling.[291] EBIA further appealed the decision to the Ninth Circuit Court of Appeals, raising for the first time, the issue of the bankruptcy court's authority to enter a final judgment in the fraudulent transfer action and moving to vacate the judgment for lack of subject matter jurisdiction, citing *Stern*.[292]

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[284] Bellingham, 702 F.3d at 556–57.

[285] Bellingham, 702 F.3d at 557.

[286] Bellingham, 702 F.3d at 568.

[287] Bellingham, 702 F.3d at 568.

[288] Bellingham, 702 F.3d at 568.

[289] Bellingham, 702 F.3d at 557.

[290] Bellingham, 702 F.3d at 557.

[291] Bellingham, 702 F.3d at 557.

[292] Bellingham, 702 F.3d at 557.

a. *The History of the Public Rights Exception in the Ninth Circuit*

Beginning its analysis, the court first reviewed the background leading to the *Stern* ruling.[293] In so doing, it noted that the Supreme Court's decision in *Northern Pipeline*[294] hinted that the public rights exception, which permits Article I judges to decide certain issues, might extend to some bankruptcy matters.[295] After several other Supreme Court decisions that "created substantial new ambiguity about the content and import of the public rights exception,"[296] but prior to *Stern*, the Ninth Circuit Court of Appeals held in *Mankin*[297] that a bankruptcy court had the constitutional authority to finally adjudicate a fraudulent transfer action, reasoning that "certain controversies at the core of the bankruptcy process implicate[] public rights."[298] However, in light of *Stern* and its predecessor *Granfinanciera*,[299] the Ninth Circuit in *Bellingham* overruled *Mankin* and held that a bankruptcy court lacks constitutional authority to enter a final judgment in a fraudulent transfer action against a party who is not a creditor of the bankruptcy estate.[300]

In 1989, after the Ninth Circuit's decision in *Mankin*, the Supreme Court held in *Granfinanciera* that a bankruptcy trustee's right to prosecute a fraudulent transfer claim was a matter of private, and not public right, when a noncreditor defendant retained the right to a jury trial in the fraudulent transfer

[293] Bellingham, 702 F.3d at 558–59.

[294] Bellingham, 702 F.3d at 558–59 (citing *Northern Pipeline*, 458 U.S. 50 (1982)).

[295] Bellingham, 702 F.3d at 558–59 (citing Northern Pipeline, 458 U.S. at 50). The *Northern Pipeline* court stated:

> [T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case. The former may well be a "public right," but the latter obviously is not.

Northern Pipeline, 458 U.S. at 71.

[296] Bellingham, 702 F.3d at 560.

[297] *In re Mankin*, 823 F.2d 1296, 17 Collier Bankr. Cas. 2d (MB) 469, Bankr. L. Rep. (CCH) P 71918 (9th Cir. 1987) (overruled by, *In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 57 Bankr. Ct. Dec. (CRR) 89, 68 Collier Bankr. Cas. 2d (MB) 1429, Bankr. L. Rep. (CCH) P 82404 (9th Cir. 2012)).

[298] Bellingham, 702 F.3d at 561.

[299] Granfinanciera, 492 U.S. 33.

[300] Bellingham, 702 F.3d at 561–562.

action.[301] However, as the Ninth Circuit pointed out in *Bellingham*, not all courts interpreted *Granfinanciera* to mean that such actions must be heard by an Article III judge.[302] The Ninth Circuit observed that two circuit-level decisions issued after *Granfinanciera* held that fraudulent transfer actions may be finally adjudicated by non-Article III courts.[303]

The Ninth Circuit in *Bellingham* analyzed the *Stern* decision, taking into consideration both the *Granfinanciera* opinion and the earlier Supreme Court decision *Katchen v. Landy*,[304] which held that bankruptcy referees acting under the Bankruptcy Acts of 1898 and 1938 could exercise summary jurisdiction over a preference claim brought by a bankruptcy trustee against a creditor who filed a proof of claim in the bankruptcy proceeding.[305] The Ninth Circuit observed that several *amici* briefs filed in the *Bellingham* case argued that a bankruptcy court can, indeed, render final judgment on a fraudulent transfer claim[306] by distinguishing the claim in *Stern* from that in *Bellingham* and comparing it instead to the preference claim in *Katchen*.[307] The Ninth Circuit recognized the merits of such an argument, based on the statement in the *Granfinanciera* that preferences are "indistinguishable . . . in all relevant respects" from fraudulent transfer actions.[308] However, the Ninth Circuit dismissed the argument, noting that because the defendant in *Katchen* had filed a proof of claim against the bankruptcy estate, the preference at issue would necessarily have been resolved in the claims

[301] Bellingham, 702 F.3d at 562 (citing Granfinanciera, 492 U.S. at 55–56).

[302] Bellingham, 702 F.3d at 562.

[303] Bellingham, 702 F.3d at 562. (citing *Matter of Texas General Petroleum Corp.*, 40 F.3d 763, 770, 26 Bankr. Ct. Dec. (CRR) 601, 32 Collier Bankr. Cas. 2d (MB) 1362, Bankr. L. Rep. (CCH) P 76319 (5th Cir. 1994), opinion recalled and superseded, 52 F.3d 1330, 27 Bankr. Ct. Dec. (CRR) 399, Bankr. L. Rep. (CCH) P 76512 (5th Cir. 1995) (holding that bankruptcy court could finally adjudicate fraudulent transfer claim); *In re Investment Bankers, Inc.*, 4 F.3d 1556, 1561, 29 Collier Bankr. Cas. 2d (MB) 1327, Bankr. L. Rep. (CCH) P 75448, Fed. Sec. L. Rep. (CCH) P 97764 (10th Cir. 1993) (same).

[304] Bellingham, 702 F.3d at 563–564 (citing *Katchen v. Landy*, 382 U.S. 323, 86 S. Ct. 467, 15 L. Ed. 2d 391, 9 Fed. R. Serv. 2d 38A.2, Case 6 (1966) ("*Katchen*")).

[305] Bellingham, 702 F.3d at 564 (citing *Katchen*, 382 U.S. at 329–30, 332–33).

[306] Bellingham, 702 F.3d at 563–64.

[307] Bellingham, 702 F.3d at 564.

[308] Bellingham, 702 F.3d at 564 (citing *Granfinanciera,* 492 U.S. 33, 48–49 (1989)).

allowance process.[309] In contrast, the Ninth Circuit observed, that the state law counterclaim at issue in *Stern* (a tortious interference claim filed in response to a proof of claim asserting damages for defamation) required the bankruptcy court to "make several factual and legal determinations that were not disposed of in passing on objections to [the] proof of claim."[310]

The Ninth Circuit applied that analysis to the facts at hand, stating that, since EBIA was not a creditor to the bankruptcy estate and not subject to the court's equitable jurisdiction, the trustee could only recover property fraudulently conveyed to EBIA by initiating a legal action.[311] That action, the Ninth Circuit found, need not be resolved in the claims allowance process. Thus, pursuant to *Stern*, the court held that the trustee's fraudulent transfer claim against EBIA could not be finally adjudicated by a non-Article III court.[312]

b. *The Scope of the Bankruptcy Court's Limited Authority*

Having made its determination that the bankruptcy court could not constitutionally enter final judgment on fraudulent transfer claims against a party who was not a creditor of the bankruptcy estate, the Ninth Circuit court next turned to the question also posed in the *Refco* decision discussed above: does a bankruptcy court have the authority to hear such claims and prepare recommendations for *de novo* review by the federal district courts?[313] Like the *Refco* court, the Ninth Circuit observed that Congress enacted section 157[314] with "a view toward expanding bankruptcy court's jurisdiction to its constitutional limit."[315] In light of this objective, the court opined that the bankruptcy courts must be vested with "as much adjudicatory power as the Constitution will bear," so the power to hear and determine a core proceeding

[309] Bellingham, 702 F.3d at 564 (citing *Stern*, 131 S. Ct. 2594, 2618 (2012)).

[310] Bellingham, 702 F.3d at 564 (citing Stern, 131 S. Ct. at 2617).

[311] Bellingham, 702 F.3d at 564.

[312] Bellingham, 702 F.3d at 565.

[313] Bellingham, 702 F.3d at 565.

[314] 28 U.S.C.A. § 157.

[315] Bellingham, 702 F.3d at 565 (citing *Mankin*, 823 F.2d 1296, 1301 (9th Cir. 1987); *Celotex Corp. v. Edwards*, 514 U.S. 300, 308, 115 S. Ct. 1493, 131 L. Ed. 2d 403, 27 Bankr. Ct. Dec. (CRR) 93, 32 Collier Bankr. Cas. 2d (MB) 685, Bankr. L. Rep. (CCH) P 76456, 31 Fed. R. Serv. 3d 355 (1995)).

under section 157 must encompass the power to hear the proceeding and submit proposed findings of fact and conclusions of law.[316]

The Ninth Circuit noted that its conclusion is consistent with *Stern*, as the Supreme Court in *Stern* was careful to make clear that its judgment was "narrow" and the opinion specifically stated that the decision was not intended to "bar[] [bankruptcy courts] from hearing all counterclaims or proposing findings of fact and conclusions of law on those matters."[317]

c. *Waiver of Adjudication by an Article III Court*

The Ninth Circuit turned next to the question of whether a defendant's right to adjudication by an Article III court on a fraudulent transfer claim is waivable.[318] In addressing this issue, the court first observed that the waivable nature of the allocation of adjudicative authority between bankruptcy courts and Article III courts is well-established.[319] Further, the court stated that Supreme Court precedent clarifies that Article III's guarantee of an independent and impartial adjudication is a personal right subject to waiver.[320]

Having established that the right to adjudication by an Article III court is waivable,[321] the court found that EBIA did indeed, by its actions, impliedly consent to the bankruptcy court's jurisdic-

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[316]Bellingham, 702 F.3d at 565.

[317]Bellingham, 702 F.3d at 566 (citing *Stern*, 131 S. Ct. 2594, 2620 (2012)).

[318]Bellingham, 702 F.3d at 566–567.

[319]Bellingham, 702 F.3d at 566–567. The court recounted that, prior to enactment of the Bankruptcy Act of 1978, federal law distinguished between "summary" matters involving property in possession of the court, and "plenary" matters, which did not. Bellingham, 702 F.3d at 566–567 (citing *Northern Pipeline*, 458 U.S. 50, 53 (1982)). Further, bankruptcy referees were vested with jurisdiction over summary matters and plenary suits could only be tried by an Article III judge, but such right could be waived. Bellingham, 702 F.3d at 566–567 (citing *MacDonald v. Plymouth County Trust Co.*, 286 U.S. 263, 52 S. Ct. 505, 76 L. Ed. 1093 (1932)).

[320]Bellingham, 702 F.3d at 567 (citing *Commodity Futures Trading Com'n v. Schor*, 478 U.S. 833, 848, 106 S. Ct. 3245, 92 L. Ed. 2d 675 (1986)).

[321]The *Bellingham* court's conclusion that the right to adjudication by an Article III court is waivable conflicts with the Sixth Circuit's decision in *Waldman v. Stone*, 698 F.3d 910, 57 Bankr. Ct. Dec. (CRR) 45 (6th Cir. 2012), cert. denied, 133 S. Ct. 1604, 185 L. Ed. 2d 581 (2013), which held that a litigant cannot waive the constitutional requirement that only Article III judges can exercise the federal judicial power of the United States. Waldman, 698 F.3d at 918. On April 3, 2013, EBIA filed a petition for a writ of certiorari with the Supreme Court of the United States. A response to the petition was filed on May 20, 2013 and, as of the date of completion of this Article, a decision has not yet been rendered.

tion when it failed to timely object.[322] Even after EBIA demanded a jury trial (which demand the district court treated as a motion to withdraw the reference), EBIA petitioned for a stay of consideration of that motion to allow the bankruptcy court time to adjudicate the trustee's motion for summary judgment.[323] Further, after EBIA lost on summary judgment and appealed to the district court, it failed to raise the constitutionality of the bankruptcy court's final judgment and abandoned its motion to withdraw the reference.[324] It was only after the appeal of the bankruptcy court's denial of EBIA's summary judgment motion was briefed and the parties were poised to begin oral argument that EBIA raised the constitutional issue by filing a motion to vacate the bankruptcy court's judgment.[325] The Ninth Circuit held that, taken together, these actions constituted consent to adjudication by the bankruptcy court.[326]

After determining that EBIA had consented to the bankruptcy court's jurisdiction, the Ninth Circuit anticipated two potential objections to its holding and dismissed them each in turn.[327] The first potential objection was that Federal Rules of Bankruptcy Procedure 7008[328] and 7012[329] preclude a finding of implied consent, because such rules require a statement of whether the

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[322] Bellingham, 702 F.3d at 568, 570. Similarly, the court in *Bank of Neb. v. Rose (In re Rose)*, citing to the decision in *Bellingham*, also held that the debtor had consented to the bankruptcy court's entry of a final order on certain state-law counterclaims where it had ample opportunity to object to the bankruptcy court's entering of a final judgment but failed to do so until it received an adverse ruling. *In re Rose*, 483 B.R. 540, 545 (B.A.P. 8th Cir. 2012).

[323] Bellingham, 702 F.3d at 568.

[324] Bellingham, 702 F.3d at 568.

[325] Bellingham, 702 F.3d at 568.

[326] Bellingham, 702 F.3d at 568. But see *In re Arbco Capital Management, LLP*, 479 B.R. 254 (S.D. N.Y. 2012) (holding that express consent is required to waive right to Article III hearing).

[327] Bellingham, 702 F.3d at 568–69.

[328] Federal Rule of Bankruptcy Procedure 7008(a) states:

> Rule 8 F.R.Civ.P. applies in adversary proceedings. The allegation of jurisdiction required by Rule 8(a) shall also contain a reference to the name, number, and chapter of the case under the Code to which the adversary proceeding relates and to the district and division where the case under the Code is pending. In an adversary proceeding before a bankruptcy judge, the complaint, counterclaim, cross-claim, or third-party complaint shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy judge.

Fed. R. Bankr. P. 7008(a).

[329] Federal Rule of Bankruptcy Procedure 7012(b) states:

pleading party consents to final orders by a bankruptcy judge.[330] However, the Ninth Circuit found that case law supports the proposition that implied consent is not precluded where a statute speaks only of consent without regard to the form of such consent.[331]

As for the second potential argument that EBIA was unaware of the constitutional grounds for objection because *Stern* had not yet been decided when EBIA's appeal was pending, the Ninth Circuit quickly disposed of this argument.[332] In doing so, the court observed that EBIA was a sophisticated party who was well aware of the other precedent that formed the basis for such an objection prior to the issuance of the *Stern* decision.[333] Further, the court noted that EBIA had fully litigated the fraudulent transfer action before the bankruptcy court, even abandoning its motion to withdraw the reference in the district court, only to later argue that the district court was the proper venue.[334] Taking the foregoing into account, the court concluded that EBIA was or should have been aware that there existed a basis for a jurisdictional objection prior to the Supreme Court's decision in *Stern.*[335]

d. *The Merits of the Fraudulent Transfer Claim*

Finally, having determined the constitutional and jurisdictional issues, the court turned to the merits of the fraudulent transfer claim against EBIA and the district court's grant of summary judgment in favor of the trustee.[336] As previously discussed, the trustee's claim for constructive fraudulent transfer was based on

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> Rule 12(b) to (i) F.R.Civ.P. applies in adversary proceedings. A responsive pleading shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy judge. In non-core proceedings final orders and judgments shall not be entered on the bankruptcy judge's order except with the express consent of the parties.

Fed. R. Bankr. P. 7012(b).

[330] Bellingham, 702 F.3d at 569.

[331] Bellingham, 702 F.3d at 569 (citing *Roell v. Withrow*, 538 U.S. 580, 586, 123 S. Ct. 1696, 155 L. Ed. 2d 775, 55 Fed. R. Serv. 3d 1 (2003)).

[332] Bellingham, 702 F.3d at 569–70.

[333] Bellingham, 702 F.3d at 569–70.

[334] Bellingham, 702 F.3d at 570.

[335] Bellingham, 702 F.3d at 570.

[336] Bellingham, 702 F.3d at 570.

the transfer of commissions to EBIA prior to the bankruptcy.[337] The disputed funds were deposited into an account held jointly by EBIA and an affiliate of the debtor, but were later transferred to EBIA through an intercompany transfer.[338] The district court affirmed the bankruptcy court's holding that the trustee had satisfied all the elements of constructive fraudulent transfer because the debtor transferred all of its assets to EBIA and received nothing in return.[339]

In defense, EBIA argued that it received nothing of value from the debtor prior to the bankruptcy filing and contended that any commission streams transferred went to its affiliate joint account holder, not EBIA, and that anything else transferred to EBIA was either an asset of negligible value or a liability.[340] Examining the evidence, the Ninth Circuit found it overwhelmingly clear that EBIA had received the commission transfer and thus confirmed that there was no genuine dispute of material fact that the transfers were constructively fraudulent and recoverable by the trustee and affirmed the district court's ruling.[341]

3. *Gibson v. Tucker* (*In re G&S Livestock*)

The District Court for the Southern District of Indiana also addressed the issue of a bankruptcy courts' constitutional authority to enter final judgments in fraudulent transfer actions in *Gibson v. Tucker* (*In re G&S Livestock*).[342] In *G&S Livestock*, the district court found, consistent with *Stern*, that while the bankruptcy court had statutory authority to enter final judgment on a trustee's fraudulent transfer claim, it lacked constitutional authority to do so.[343] The district court nonetheless held that the bankruptcy court's judgment was valid and final because the defendants had expressly consented to the bankruptcy court's entering of judgment.[344]

The fraudulent transfer action at issue arose out of the prepeti-

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[337] Bellingham, 702 F.3d at 556.

[338] Bellingham, 702 F.3d at 556.

[339] Bellingham, 702 F.3d at 570. The court did not address the issue of the debtor's insolvency.

[340] Bellingham, 702 F.3d at 571.

[341] Bellingham, 702 F.3d at 571. The court also affirmed the grant of summary judgment on the issue of successor liability.

[342] *In re G & S Livestock Co.*, 478 B.R. 906, Bankr. L. Rep. (CCH) P 82370 (S.D. Ind. 2012).

[343] G&S Livestock, 478 B.R. at 908.

[344] G&S Livestock, 478 B.R. at 908.

tion conduct of defendants Paul Gibson, Sr. ("Paul Sr."), Paul Gibson, Jr. ("Paul Jr.") and Melinda Hart ("Hart"), Paul Sr.'s girlfriend.[345] Prior to the bankruptcy of G&S Livestock Company ("G&S"), a wholesale hog dealer, Paul Sr. and Paul, Jr. ran G&S.[346] G&S ceased operations in August 2010, and failed to pay several of its creditors for goods it received in the month prior.[347] Certain creditors filed an involuntary petition against G&S, and the bankruptcy court entered an order for relief on October 8, 2010.[348] Shortly thereafter a Chapter 7 trustee (the "Trustee") was appointed, and the Trustee commenced an adversary proceeding against Paul Sr., Paul Jr., and Hart (together, the "Defendants"). The complaint alleged that during 2010, when it became apparent that G&S would not be able to repay its obligations to its creditors, Paul Sr. and Paul Jr. transferred certain real estate assets to Hart in exchange for inadequate consideration.[349]

After a trial in November 2011, the bankruptcy court found that the transfers were avoidable under Section 544(b) of the Bankruptcy Code and, by incorporation, Indiana law. The Defendants appealed, arguing for the first time that, pursuant to *Stern,* the bankruptcy court lacked constitutional authority to enter a final judgment on a fraudulent transfer claim.[350]

a. *The Bankruptcy Court's Statutory and Constitutional Authority*

The district court began its discussion by noting that the Seventh Circuit Court of Appeals had not directly addressed the issue of whether a bankruptcy court possesses the authority to enter final judgment on fraudulent transfer claims.[351] In analyzing whether the bankruptcy court had issued a valid final judg-

[345] G&S Livestock, 478 B.R. at 908–09.

[346] G&S Livestock, 478 B.R. at 908–09.

[347] G&S Livestock, 478 B.R. at 909.

[348] G&S Livestock, 478 B.R. at 909.

[349] G&S Livestock, 478 B.R. at 909.

[350] G&S Livestock, 478 B.R. at 909. The defendants failed to timely appeal the bankruptcy court's order and instead sought leave to file a belated appeal, which was denied. G&S Livestock, 478 B.R. at 909. The appeal that is the subject of this decision is both an appeal from the order denying the Defendants' motion for leave to file the belated appeal and an appeal of the underlying substantive decision.

[351] G&S Livestock, 478 B.R. at 910. The court also noted that courts across the country are divided on this issue. G&S Livestock, 478 B.R. at 910 (citing *In re Agriprocessors, Inc.*, 479 B.R. 835, 839, 67 Collier Bankr. Cas. 2d (MB) 1684

ment, the district court examined both the bankruptcy court's statutory authority and its constitutional authority to enter judgments in fraudulent transfer actions.[352] As to the issue of the bankruptcy court's statutory authority, the court observed that Section 157(b)(2)(H) of title 28 of the Unites States Code designates "proceedings to determine, avoid, or recover fraudulent conveyances" as "core proceedings" over which the bankruptcy court "may enter appropriate orders and judgments."[353] Accordingly, the court concluded that the bankruptcy court had statutory authority "to hear, determine, and enter judgment on the Trustee's fraudulent conveyance claim."[354]

As to the "thornier"[355] issue of whether the bankruptcy court had constitutional authority to enter a final judgment on the fraudulent transfer claim, the court noted that it was guided by the Seventh Circuit's recent analysis of *Stern* in *Ortiz v. Aurora Health Care, Inc.*[356] In its *Ortiz* opinion, the Seventh Circuit

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(Bankr. N.D. Iowa 2012) (Bankr. N.D. Iowa) (collecting cases and summarizing the split of authority on post-*Stern* issues concerning fraudulent transfer claims)).

[352]G&S Livestock, 478 B.R. at 914 (citing *Stern*, 131 S. Ct. 2594, 2606 (2012); *In re Ortiz*, 665 F.3d 906, 912, 55 Bankr. Ct. Dec. (CRR) 255 (7th Cir. 2011)).

[353]G&S Livestock, 478 B.R. at 911 (quoting 28 U.S.C. § 157(b)(2)(H)).

[354]G&S Livestock, 478 B.R. at 915.

[355]G&S Livestock, 478 B.R. at 915. The court refers to the issue of the bankruptcy court's constitutional authority to enter a final judgment in a fraudulent transfer action as the "thornier" issue due to the split in authority following the Supreme Court's decision in *Stern*. Compare *In re Safety Harbor Resort and Spa*, 456 B.R. 703, 718, 55 Bankr. Ct. Dec. (CRR) 121 (Bankr. M.D. Fla. 2011) (emphasizing the "narrow" holding of *Stern* and concluding that "the job of bankruptcy courts is to apply the law as it is written and interpreted today" and not to extend *Stern* to other core proceedings "simply because dicta in *Stern* suggests the Supreme Court may do the same down the road"), with *In re Canopy Financial, Inc.*, 464 B.R. 770 (N.D. Ill. 2011) (analyzing *Stern*'s rational and holding that it "made clear that the Bankruptcy Court lacks constitutional authority to enter final judgment" on fraudulent transfer claims).

[356]In re G&S Livestock, 478 B.R. at 913 (citing 665 F.3d 906 (7th Cir. 2011)). The Seventh Circuit Court of Appeals in *Ortiz v. Aurora Health Care, Inc.* held that the bankruptcy court lacked authority to enter final judgment on the debtors' state-law claims, where debtors sued a healthcare provider and creditor for wrongful disclosure of medical records. Ortiz, 665 F.3d at 906. The Seventh Circuit found that the debtors' claims did not fall under the public rights exception and instead involved only "the liability of one individual to another" under Wisconsin law and did not implicate a "particularized area of the law" where "Congress devised an 'expert and inexpensive method for dealing with a class of questions of fact which are particularly suited to examination and determination by an administrative agency specially assigned to that task.' " In re G&S

analogized the disclosure claims at issue to the counterclaim involved in *Stern* to conclude that the Supreme Court's reasoning in *Stern* applied.[357] Adopting the same approach, the district court in *G&S Livestock* considered whether the Trustee's fraudulent transfer claim was analogous to the counterclaim addressed in *Stern*.[358]

In *Stern*, the Supreme Court analogized the tortious interference counterclaim at issue to a fraudulent transfer claim. The Supreme Court explained that "fraudulent conveyance suits [are] 'quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy *res*.' "[359] The *Stern* decision further noted that it saw no reason to treat the counterclaim any differently from a fraudulent transfer action referring to the counterclaim as "one at common law that simply attempts to augment the bankruptcy estate—the very type of claim that [the Supreme Court] held in [ ] *Granfinanciera* must be decided by an Article III court."[360]

Accordingly, the court in *G&S Livestock* concluded that "the Supreme Court had made it clear that there is a constitutional right to have an Article III court enter final judgment on a trustee's fraudulent conveyance claim."[361] Moreover the court found that the Trustee's fraudulent transfer claim, like the counterclaim in *Stern*, "exists without regard to any bankruptcy proceeding," as the Trustee's complaint alleged wrongdoing under

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Livestock, 478 B.R. at 913 (internal citations omitted). Moreover, the Seventh Circuit found that Aurora's filing of proofs of claim in the debtors' bankruptcy cases did not give the bankruptcy court the authority to adjudicate the debtors' claims, just as the filing of a proof of claim in *Stern* did not confer to the bankruptcy court authority to adjudicate over the tortious interference counterclaim in that case. In re G&S Livestock, 478 B.R. at 914. Finally, the Court of Appeals found that the bankruptcy court's orders were neither final or interlocutory, and that in order to treat the bankruptcy court's determinations as proposed findings of fact or conclusions of law under 28 U.S.C.A. § 157(c)(1), it would have had to hold that the debtors' claims were non-core. In re G&S Livestock, 478 B.R. at 915. This conclusion was opposite the conclusion reached by *Refco* and *Bellingham Insurance Co.* on the same issue.

[357] In re G&S Livestock, 478 B.R. at 911, 914.

[358] In re G&S Livestock, 478 B.R. at 915.

[359] In re G&S Livestock, 478 B.R. at 915 (citing Stern, 131 S. Ct. at 2616 (quoting *Granfinanciera*, 492 U.S. 33, 56 (1989))).

[360] In re G&S Livestock, 478 B.R. at 915 (citing Stern, 131 S. Ct. at 2616, 2618).

[361] In re G&S Livestock, 478 B.R. at 915–16.

Indiana state law and not necessarily federal bankruptcy law.[362] For these reasons, the district court held that the bankruptcy court lacked the constitutional authority to enter final judgment on the Trustee's fraudulent transfer claim against the Defendants.[363]

b. *Consent to the Bankruptcy Court's Entry of Final Judgment*

The conclusion that the bankruptcy court lacked constitutional authority to finally determine the Trustee's fraudulent transfer claim, however, was not the end of the analysis. Upon the Trustee's request, the court further considered whether the bankruptcy court could enter a valid final judgment on the Trustee's fraudulent transfer action on the basis of the Defendants' consent to entry of such judgment, regardless of the court's lack of constitutional authority to do so.[364] The court noted that the Seventh Circuit's *Ortiz* decision neither endorsed nor foreclosed the possibility of implied consent in situations where the bankruptcy court lacked constitutional authority to enter final judgment.[365] On this issue, the Defendants argued that the bankruptcy court's lack of constitutional authority deprived the bankruptcy court of jurisdiction to enter a final judgment on the fraudulent transfer claim, and therefore any argument premised on the Defendants' consent was inappropriate.[366]

The court found the Defendants' argument flawed because "[t]he Defendants ignore[ed] that the Supreme Court expressly held in *Stern* that the applicable statute is not jurisdictional."[367] More specifically, the Supreme Court held that Section 157 of

[362] In re G&S Livestock, 478 B.R. at 916. The court also clarified that the Trustee's fraudulent transfer claim had little to do with federal bankruptcy law because the fraudulent transfer claim was intended to increase payouts to creditors, and not to hierarchically order claims for a share of the bankruptcy res. In re G&S Livestock, 478 B.R. at 916.

[363] In re G&S Livestock, 478 B.R. at 916.

[364] In re G&S Livestock, 478 B.R. at 916–18.

[365] In re G&S Livestock, 478 B.R. at 916–18 (citing *In re Ortiz*, 665 F.3d 906, 915, 55 Bankr. Ct. Dec. (CRR) 255 (7th Cir. 2011)).

[366] In re G&S Livestock, 478 B.R. at 916. The Defendants' argument focused "on first year law that Subject Matter Jurisdiction is an issue that can be raised by any party at any time and [cannot] be waived by any party." In re G&S Livestock, 478 B.R. at 916.

[367] In re G&S Livestock, 478 B.R. at 916.

Title 28 of the United States Code[368] "does not have the hallmarks of a jurisdictional decree" and that statutes should not be interpreted "as creating a jurisdictional bar when they are not framed as such."[369] Relying on this reasoning the court disregarded the Defendants' jurisdictional argument and considered whether the Defendants had consented to the bankruptcy court's entry of final judgment.

Like the Ninth Circuit in *Bellingham*, the court compared the Defendants' failure to raise their jurisdictional argument earlier in the proceedings to the similar conduct of the plaintiff in *Stern*, where the Supreme Court held that the plaintiff had implicitly "consented to the bankruptcy court's resolution of [his] defamation claim[.]"[370] In so holding in *Stern*, the Supreme Court recognized consent as "the consequences of a litigant sandbagging the court — remaining silent about his objection and belatedly raising the error only if the case does not conclude in his favor."[371] Accordingly, the court in *G&S Livestock* endorsed the Supreme Court's reasoning and found that a litigant may impliedly consent to a bankruptcy court entering final judgment on a fraudulent transfer claim if that party fully litigates a claim, and only after an adverse judgment raises an issue with a bankruptcy court's authority to enter such judgment.[372]

The *G&S Livestock* court found, however, that the Defendants expressly consented to the entry of the judgment by the bankruptcy court, and pointed to the Defendants' response to the Trustee's complaint, and the Defendants' trial brief, which was filed nearly four months after *Stern* was issued, "in which [the Defendants] stipulated that the bankruptcy court 'has jurisdiction over them as defendants and the matters contained therein pursuant to 28 U.S.C. § 157 and 28 U.S.C. § 1334 and 11 U.S.C. § 723(a)' "[373] The court stated that "the effect of the Defendants' admission [was] clear — they expressly submitted to the author-

[368] 28 U.S.C.A. § 157 addresses cases and proceedings arising in bankruptcy cases and outlines matters which may be heard by bankruptcy courts.

[369] In re G&S Livestock, 478 B.R. at 916 (citing Stern, 131 S. Ct. at 2607).

[370] In re G&S Livestock, 478 B.R. at 915.

[371] In re G&S Livestock, 478 B.R. at 917 (citing Stern, 131 S. Ct. at 2608).

[372] In re G&S Livestock, 478 B.R. at 917.

[373] In re G&S Livestock, 478 B.R. at 917 (noting that although the Defendants improperly used the word "jurisdiction" in reference to 28 U.S.C.A. § 157, which is not jurisdictional, they also referenced 28 U.S.C.A. § 1334, which is a jurisdictional statute).

ity of the bankruptcy court to enter final judgment on the Trustee's claim."[374]

The court found further support for this conclusion in the *Stern's* holding that a party may forfeit a constitutional right by failing to make a timely assertion of that right.[375] "Allowing the Defendants to invalidate the adverse judgment of the bankruptcy court on the Trustee's fraudulent conveyance claim would contravene that principle and allow [the Defendants] to sandbag this court, the bankruptcy court, and the Trustee by only raising the issue because the case did not conclude in their favor."[376] In light of these conclusions, the court held that the bankruptcy court's lack of constitutional authority to enter final judgment did not invalidate its judgment because "the Defendants consented to the entry of judgment and cannot now be heard to complain."[377]

4. *Conclusion*

Even though it is still early to draw a definitive conclusion on *Stern's* impact on bankruptcy courts' authority to determine fraudulent transfer actions, the decisions discussed *supra* indicate a trend. While some fraudulent transfer actions may not find their conclusion in the bankruptcy courts, and will instead be litigated in bankruptcy court and finally adjudicated in the district courts, many courts that have opined on the issue thus far appear to have found a work-around. The cases examined in this Article indicate that courts have not been hesitant to find that parties have either impliedly or expressly consented to the bankruptcy court's entry of final judgment on fraudulent transfer claims. It is likely that these cases will be instructive for those litigants who either wish to litigate in the bankruptcy court or seek final review of fraudulent transfer claims by a district court.

C. *Collapsing Transactions in the LBO Context*

The "collapsing doctrine" is a tool that places substance over form by combining a series of related transactions into a single integrated transaction. It has been most often applied to determine fraudulent transfer liability of lenders and former

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[374] In re G&S Livestock, 478 B.R. at 917.

[375] In re G&S Livestock, 478 B.R. at 917 (citing Stern, 131 S. Ct. at 2608).

[376] In re G&S Livestock, 478 B.R. at 917; see also Stern, 131 S. Ct. at 2608 (citing *U.S. v. Olano*, 507 U.S. 725, 731, 113 S. Ct. 1770, 123 L. Ed. 2d 508 (1993)).

[377] In re G&S Livestock, 478 B.R. at 918.

shareholders in a leveraged buyout ("LBO")[378] transaction where the target company became insolvent as a result of the transaction.[379] Fraudulent transfer liability in a LBO arises where the burden of debt created by the transactions renders the target company hopelessly insolvent, and thus, the related payment to the former shareholders is considered a fraudulent transfer because the company received no value in exchange for the value paid to its shareholders.[380]

1. *In re Bachrach Clothing, Inc.*

The District Court for the Northern District of Illinois in the case of *Bachrach Clothing, Inc. v. Bachrach (In re Bachrach Clothing, Inc.)*[381] recently addressed the applicability of the collapsing doctrine in the context of a fraudulent transfer action arising out of a LBO.[382] After acknowledging a lack of applicable precedent in the Sixth Circuit and reviewing relevant decisions from outside the circuit, the *Bachrach* court employed a test developed by the Bankruptcy Court for the District of Delaware.[383]

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[378] A leveraged buyout, or "LBO" is:

> [A] complex series of transactions that rearranges a corporation's financial structure without altering the nature of the company's business. An LBO changes the ownership of the corporation and focuses the corporation on the preeminent goal of servicing the large LBO debt. Although there are many ways of structuring LBOs, the most common structure involves the merger of the operating company with a shell corporation formed for the sole purpose of accomplishing the LBO. The LBO investors form the acquisition shell and capitalize it with their minimal equity contribution. A complex series of transactions effects a merger of the shell and the operating company. Ultimately, the shareholders of the [target] company are bought out in a transaction financed almost entirely by debt. Usually senior secured bank debt is insufficient to finance the entire transaction, and "mezzanine financing"—unsecured subordinated debt (often called "junk bonds") or preferred stock—supplies the remainder of the money needed for the LBO. Whether or not the acquisition shell or the target company initially incurs the debt, after the merger is effected the debt belongs solely to the target and is almost always secured by all of the target's assets.

Raymond J. Blackwood, Applying Fraudulent Conveyance Law To Leveraged Buyouts, 42 Duke L.J. 340, 344 (1992).

[379] See generally *In re Sunbeam Corp.*, 284 B.R. 355, 370, 40 Bankr. Ct. Dec. (CRR) 101 (Bankr. S.D. N.Y. 2002); *In re Mervyn's Holdings, LLC*, 426 B.R. 488, 498 (Bankr. D. Del. 2010).

[380] See *Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787, 792, 52 Bankr. Ct. Dec. (CRR) 101, Bankr. L. Rep. (CCH) P 81628 (7th Cir. 2009).

[381] *In re Bachrach Clothing, Inc.*, 480 B.R. 820 (Bankr. N.D. Ill. 2012).

[382] *In re Bachrach Clothing, Inc.*, 480 B.R. 820 (Bankr. N.D. Ill. 2012).

[383] Bachrach Clothing, 480 B.R. at 856.

The debtor in *Bachrach* was previously a family-owned retailer acquired through an LBO by a private investment firm.[384] The debtor later alleged that the transfer of the company was constructively fraudulent pursuant to Section 548(a)(1)(B) of the Bankruptcy Code and Illinois state law and sought to avoid the sale and related transfers made to the company's former owners.[385] The debtor also alleged breach of fiduciary duty relating to the sale and sought to disallow the former owners' proofs of claim and to subordinate their claims and liens.[386] After a multi-day trial, the court found for the defendants.[387] This section of the Article focuses on the fraudulent transfer claims and accompanying analysis.

The *Bachrach* case is significant because it examines the collapsing doctrine and includes an in-depth discussion of the tests utilized across the circuits to determine whether to collapse a series of transactions for the purposes of determining fraudulent transfer liability.[388] Ultimately, the court in *Bachrach* declined to

[384] Bachrach Clothing, 480 B.R. at 856.

[385] Bachrach Clothing, 480 B.R. at 824. The complaint cited 11 U.S.C. §§ 544(b), 548 and 550, and 740 Ill. Comp. Stat. §§ 160/5 & 160/6 (2012).

[386] Bachrach Clothing, 480 B.R. at 824.

[387] Bachrach Clothing, 480 B.R. at 824.

[388] The *Bachrach* case is also noteworthy for its analysis of the bankruptcy court's authority to render final judgment on fraudulent transfer, breach of fiduciary duty, and equitable subordination claims following the Supreme Court's *Stern* decision. The *Bachrach* court held that a bankruptcy court's authority hinges on whether resolution of the debtor's independent claim is necessary to determine the creditor's proof of claim. Bachrach Clothing, 480 B.R. at 827. Applying this analysis, the *Bachrach* court concluded that resolution of the fraudulent transfer claims against the defendants was integral and necessary to resolving the defendants' proofs of claim because all of defendants' proofs of claim sought payments arising solely out of the sale, the transaction at issue in the complaint. Bachrach Clothing, 480 B.R. at 827. Applying this analysis to the breach of fiduciary duty and equitable subordination claims, the court held that *Stern* did not prohibit the court from rendering a final judgment on either claim, reasoning that the equitable subordination count was essentially a claims resolution matter and that the breach of fiduciary duty count was closely related to the claims resolution process because the defendants' alleged breach of fiduciary duty was decisive in the allowance or subordination of their claims. Bachrach Clothing, 480 B.R. at 827–28. In so holding, the court noted that the defendants had withdrawn their proofs of claim prior to the *Stern* decision. Bachrach Clothing, 480 B.R. at 829–30. Even though the defendants had not asserted that such withdrawal stripped the bankruptcy court of its power to adjudicate the claims at issue, the court briefly addressed such an argument. Bachrach Clothing, 480 B.R. at 829–30. The court cited case law analogizing the situation to that of a federal court's diversity jurisdiction, and held that the

collapse the transactions at issue there, based on its application of a test developed by the Third Circuit.

a. *The Sale of Bachrach to Sun Capital*

The debtor Bachrach Clothing, Inc. ("BCI"), filed suit against its former owners and insiders Edgar H. Bachrach ("Ed"), his sisters (together, the "Sellers"), and Barsaled, LLC, an entity created by the Sellers as part of the process of selling BCI ("Barsaled," and together with the Sellers, the "Defendants").[389] The complaint alleged violations of both federal bankruptcy and state fraudulent transfer laws arising out of the sale (the "Sale") of BCI to Sun Capital Partners ("Sun") in 2005.[390]

Sun purchased BCI for stated consideration of $8 million. In exchange for their interests in BCI, the Sellers received $4 million cash (the "Cash") and a $4 million subordinated note (the "Note") at closing.[391] The amount of the Cash transferred to the Sellers was subject to later adjustment pursuant to an agreement between Sun and the Sellers that provided that the Cash amount would be adjusted up or down depending on the amount of working capital BCI had at the time of the closing.[392] The Note was issued by Bachrach Clothing Holding Corporation ("Holdings"), an entity formed by Sun to hold BCI's stock.[393] As part of the Sale, the Sellers were also issued 7.5% of the shares of Holdings, and Sun held the remainder of Holdings' shares in a company they formed for that purpose, Sun Bachrach, LLC ("Sun Bachrach").[394] Prior to the Sale, BCI held certain real estate and cash valued at

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withdrawal of claims did not change its holding that the bankruptcy court had authority to finally adjudicate the claims. Bachrach Clothing, 480 B.R. at 830 (citing *Anderson v. Watts*, 138 U.S. 694, 702–03, 11 S. Ct. 449, 34 L. Ed. 1078 (1891); *Minneapolis & St. L. R. Co. v. Peoria & P. U. Ry. Co.*, 270 U.S. 580, 586, 46 S. Ct. 402, 70 L. Ed. 743 (1926)).

The *Bachrach* court also held that the parties had consented to final adjudication by the bankruptcy court because the debtor alleged in its complaint that the adversary proceeding was a "core proceeding within the meaning of one or more subsections of 28 U.S.C. § 157(b)" and the defendants had admitted this allegation in their responsive pleadings. Bachrach Clothing, 480 B.R. at 831–32. Moreover, the defendants "heavily litigated" the action in the bankruptcy court and waited nineteen months to object to its jurisdiction. Bachrach Clothing, 480 B.R. at 832.

[389] Bachrach Clothing, 480 B.R. at 832.

[390] Bachrach Clothing, 480 B.R. at 824, 834.

[391] Bachrach Clothing, 480 B.R. at 837.

[392] Bachrach Clothing, 480 B.R. at 837.

[393] Bachrach Clothing, 480 B.R. at 837.

[394] Bachrach Clothing, 480 B.R. at 837.

over $7.1 million, which assets Sun was not interested in acquiring.[395] Accordingly, the Sellers formed Barsaled to hold title to the real estate assets (and to effectuate a leaseback to BCI),[396] and the Sellers received the cash from BCI as of the Sale closing.[397] Auditors' reports indicated that the purchase price of BCI was about $5 million below the historical book value of its assets at the time of the Sale.[398]

To determine whether the Sale constituted a fraudulent transfer, the court carefully examined the flow of funds from the Sale, which proceeded as follows: two Sun entities transferred a total of $2 million to Sun Bachrach in exchange for all of the equity interest in Sun Bachrach, and Sun Bachrach then contributed the $2 million to Holdings.[399] Of the $2 million, $500,000 was earmarked for Sun Bachrach's purchase of all of Holdings stock except for the 7.5% interest in Holdings held by the Sellers.[400] The remaining $1.5 million was a loan by Sun Bachrach to Holdings.[401] Further, on the day the Sale closed, the Sellers loaned to Holdings approximately $1.9 million of the $4 million cash due to Sellers at closing.[402] To effectuate immediate repayment of this loan, the Sellers were replaced as directors of BCI by two Sun executives immediately after Holdings acquired BCI.[403] The new directors caused BCI to borrow $2 million from Harris Bank, with the loan guaranteed by Sun.[404] The new directors then immediately declared a dividend from BCI to Holdings in the amount of the loan made by the Sellers to Holdings, and Holdings used the funds to repay the loan to the Sellers.[405]

In sum, the court pointed out that, notwithstanding the $8 mil-

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[395] Bachrach Clothing, 480 B.R. at 836–37.

[396] When calculating the rent under the sale-leaseback transaction, Ed made a million dollar math error in favor of BCI for each year of the lease. Bachrach Clothing, 480 B.R. at 843. When the error was discovered, Sun/BCI refused to pay the higher rent amount, so Ed honored the lower amount, resulting in a lease that was substantially below market. Bachrach Clothing, 480 B.R. at 843.

[397] Bachrach Clothing, 480 B.R. at 843.

[398] Bachrach Clothing, 480 B.R. at 837.

[399] Bachrach Clothing, 480 B.R. at 838.

[400] Bachrach Clothing, 480 B.R. at 838.

[401] Bachrach Clothing, 480 B.R. at 838.

[402] Bachrach Clothing, 480 B.R. at 838.

[403] Bachrach Clothing, 480 B.R. at 838.

[404] Bachrach Clothing, 480 B.R. at 838.

[405] Bachrach Clothing, 480 B.R. at 838.

lion purchase price, Sun managed to satisfy its obligations in the Sale with a "mere" $500,000 of its own capital and a $1.5 million loan to Holdings.[406] The court observed that the Sellers financed the balance of the Sale by accepting a $4 million Note from Holdings, which was subordinate to other debt, including Holdings' $1.5 million debt to Sun Bachrach.[407] The court was careful to note in its findings of fact that the Sellers were not involved in structuring the transaction.[408]

b. *BCI's Post-Sale Performance*

The court next reviewed BCI's performance after it was acquired by Sun, examining the actions of the new management installed by BCI's new directors.[409] The new management team initiated an extraordinary inventory markdown, resulting in a reduction of BCI's inventory that wiped out $3 million in working capital by reducing BCI's ability to draw on its credit facility.[410] Further, new management terminated a long-term incentive plan, resulting in a $1 million charge.[411] The court found that these actions exhausted BCI's borrowing availability sooner than expected and contributed to a liquidity crunch, despite BCI opening $22 million in new lines of credit shortly after the sale.[412] Because of this crunch, the working capital adjustment the Sellers agreed to as part of the Sale was invoked, and the Sellers returned approximately $545,000 to BCI.[413] Sun also charged BCI for several fees relating to the Sale, including $1 million in attorneys' fees and due diligence costs and $400,000 a year in management fees.[414]

As a result of BCI's decline, Sun Bachrach made its first additional investment in BCI in late 2005, when it purchased the $2 million bank note incurred by BCI as part of the acquisition, thereby infusing BCI with additional capital.[415] However, within months, BCI executed a $5 million secured note in favor of Sun

[406] Bachrach Clothing, 480 B.R. at 838.

[407] Bachrach Clothing, 480 B.R. at 838.

[408] Bachrach Clothing, 480 B.R. at 838–39.

[409] Bachrach Clothing, 480 B.R. at 839–42.

[410] Bachrach Clothing, 480 B.R. at 842.

[411] Bachrach Clothing, 480 B.R. at 843.

[412] Bachrach Clothing, 480 B.R. at 840–45.

[413] Bachrach Clothing, 480 B.R. at 843.

[414] Bachrach Clothing, 480 B.R. at 843.

[415] Bachrach Clothing, 480 B.R. at 844.

Bachrach (the "$5 Million Note").[416] The $5 Million Note was dated March 2006, but was executed only days after Sun began to discuss putting BCI into bankruptcy in May 2006.[417] Of the $5 Million Note, $2 million represented the bank's assignment of its $2 million BCI loan to Sun Bachrach, and the remaining $3 million was new dollars invested in BCI by Sun Bachrach.[418] The court characterized the $5 Million Note as Sun "paper[ing] over" its equity investment once it decided to stop funding BCI, and converting most of its earlier $2 million capital contribution into a secured claim, ahead of BCI's unsecured creditors.[419] BCI filed for bankruptcy protection a few weeks later on June 6, 2006.[420]

c. *The LBO as a Fraudulent Transfer*

Turning to the substance of the complaint, the court reviewed the elements of a constructive fraudulent transfer claim under Section 548 of the Bankruptcy Code and Illinois state law.[421] The court stated that, in order to prevail, BCI must prove that: (1) BCI made a transfer for which it did not receive reasonably equivalent value; and (2) the transfer was made while BCI was insolvent, or the transfer rendered it insolvent or resulted in insufficient capital.[422] The first element, the court stated, was straightforward because the transaction at issue involved money and debt in exchange for the stock of BCI.[423] The court noted that, as long as the value of BCI's stock was reasonably close to the Sale price, there would be little controversy.[424] However, the court observed the heart of the dispute was the value of BCI for the purposes of proving insolvency or undercapitalization, and it would be unnecessary to reach the reasonably equivalent value issue if insolvency or undercapitalization could not be

[416] Bachrach Clothing, 480 B.R. at 844.

[417] Bachrach Clothing, 480 B.R. at 844–45.

[418] Bachrach Clothing, 480 B.R. at 844.

[419] Bachrach Clothing, 480 B.R. at 845.

[420] Bachrach Clothing, 480 B.R. at 845.

[421] Bachrach Clothing, 480 B.R. at 850.

[422] Bachrach Clothing, 480 B.R. at 852 (citing *Baldi v. Samuel Son & Co., Ltd.*, 548 F.3d 579, 581, 50 Bankr. Ct. Dec. (CRR) 243, Bankr. L. Rep. (CCH) P 81365 (7th Cir. 2008) (Illinois and bankruptcy fraudulent transfer statutes require proof of the same elements, except the former section 548 of the Bankruptcy Code required the action to be brought in shorter time period)).

[423] Bachrach Clothing, 480 B.R. at 852.

[424] Bachrach Clothing, 480 B.R. at 852.

demonstrated.[425] As a result, neither party argued reasonably equivalent value and instead concentrated the value of BCI for purposes of proving insolvency or undercapitalization.[426]

BCI argued that, in order to properly analyze the effect of the LBO that transferred BCI to Sun, the individual transactions before, during, and after the Sale must be collapsed.[427] Collapsing each step, BCI argued, would shift the court's focus to the intent of the parties rather than the formal structure of the LBO.[428] The court observed that BCI favored this approach because the only evidence BCI had produced to demonstrate its insolvency or undercapitalization was an expert report that relied on combining the actions of the Sellers and Sun, before, during, and after the Sale.[429]

d. *The "Collapsing" Doctrine*

"The 'collapsing' doctrine is essentially an equitable doctrine allowing a court to dispense with the formal structure of a transaction or a series of transactions."[430] Collapsing determines which parts of the sale transaction should be analyzed by examining the intent and knowledge of the parties to the transaction.[431] To determine whether the transactions in *Bachrach* should be collapsed, and which approach to use, the court reviewed the case law discussing the collapsing doctrine before settling on a three factor test developed by a court within the Third Circuit.[432]

The court first examined the precedent set by the Seventh Circuit Court of Appeals' decision in *Boyer v. Crown Stock Distribution, Inc.*,[433] which held that a $3.3 million payment to the sellers in a LBO violated Indiana's Uniform Fraudulent Transfer Act where the sellers knew that the sale price was twice the company's value and that virtually the entire purchase price was

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[425] Bachrach Clothing, 480 B.R. at 852.

[426] Bachrach Clothing, 480 B.R. at 852.

[427] Bachrach Clothing, 480 B.R. at 852.

[428] Bachrach Clothing, 480 B.R. at 852.

[429] Bachrach Clothing, 480 B.R. at 853.

[430] Bachrach Clothing, 480 B.R. at 852 (citing *In re Route 70 & Massachusetts, L.L.C.*, 2011 WL 1883856, *5 (Bankr. D. N.J. 2011); *In re Ginn-La St. Lucie Ltd., LLLP*, 2010 WL 8756756, *4–5 (Bankr. S.D. Fla. 2010)).

[431] Bachrach Clothing, 480 B.R. at 852.

[432] Bachrach Clothing, 480 B.R. at 853–56.

[433] Bachrach Clothing, 480 B.R. at 853 (citing *Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787, 52 Bankr. Ct. Dec. (CRR) 101, Bankr. L. Rep. (CCH) P 81628 (7th Cir. 2009)).

obtained through loans secured by the target company's assets.[434] The court noted that the *Crown* court did not provide a specific test for determining when a series of transactions in a LBO should be collapsed, but instead focused on the "the equities" and the fact that the LBO in that case was "*highly* likely to plunge the company into bankruptcy," because it left the company with only a few heavily encumbered assets.[435]

The court also reviewed precedent from within its district in *Wieboldt Stores, Inc. v. Schottenstein*,[436] in which the court focused on the knowledge and intent of the parties.[437] The *Wieboldt* court denied a motion to dismiss sought by the debtor's former board and insider shareholders who were confronted with allegations that they knew that the transaction was intended to be an LBO, knew that the company was insolvent before the LBO, and that the LBO would result in further encumbrance of the company's already encumbered assets.[438] However, the court in *Bachrach* observed that the *Wieboldt* court declined to collapse the transactions as to non-insider shareholders who were not alleged to have such knowledge.[439] The *Bachrach* court took note that the *Wieboldt* court explained in its opinion that the drafters of the Bankruptcy Code intended to shield "innocent recipients" of property in the fraudulent transfer context.[440]

The *Bachrach* opinion next examined the judicial divide on the level of knowledge required to invoke the collapsing doctrine.[441] Some courts have imputed constructive knowledge to a transferee

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[434] Bachrach Clothing, 480 B.R. at 853–54, 856 (citing Crown, 587 F.3d at 790, 793–94).

[435] Bachrach Clothing, 480 B.R. at 853 (citing Crown, 587 F.3d at 792–93).

[436] Bachrach Clothing, 480 B.R. at 855 (citing *Wieboldt Stores, Inc. v. Schottenstein*, 94 B.R. 488, 18 Bankr. Ct. Dec. (CRR) 1134, 20 Collier Bankr. Cas. 2d (MB) 776, Bankr. L. Rep. (CCH) P 72574A, Fed. Sec. L. Rep. (CCH) P 94872 (N.D. Ill. 1988), on reconsideration in part, 1989 WL 18112 (N.D. Ill. 1989)).

[437] Bachrach Clothing, 480 B.R. at 854–55 (citing Wieboldt, 94 B.R. at 502). The court cited other cases in which a similar standard has been used. See *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 635–36, 31 Fed. R. Serv. 3d 1422 (2d Cir. 1995); *Kupetz v. Wolf*, 845 F.2d 842, 847–48, 17 Bankr. Ct. Dec. (CRR) 941, Bankr. L. Rep. (CCH) P 72290 (9th Cir. 1988) (rejected by, In re Morse Tool, Inc., 108 B.R. 389 (Bankr. D. Mass. 1989)); *In re National Forge Co.*, 344 B.R. 340, 348 (W.D. Pa. 2006); *In re Sunbeam Corp.*, 284 B.R. 355, 370, 40 Bankr. Ct. Dec. (CRR) 101 (Bankr. S.D. N.Y. 2002).

[438] Bachrach Clothing, 480 B.R. at 854 (citing Wieboldt, 94 B.R. at 502–03).

[439] Bachrach Clothing, 480 B.R. at 854 (citing Wieboldt, 94 B.R. at 502–03).

[440] Bachrach Clothing, 480 B.R. at 854 (citing Wieboldt, 94 B.R. at 502–03).

[441] Bachrach Clothing, 480 B.R. at 855.

where the transferee fails to perform ordinary diligence, while others require "an active avoidance of the truth,"[442] and another court has even required actual intent to defraud.[443] Still other courts emphasize instead the interdependence of the transactions and whether the participants knew or should have known that no single transaction could occur without all of the others also taking place.[444]

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[442] Bachrach Clothing, 480 B.R. at 855 (comparing HBE Leasing Corp., 48 F.3d at 636, with In re Sunbeam Corp., 284 B.R. at 371).

[443] Bachrach Clothing, 480 B.R. at 855 (citing *In re Allou Distributors, Inc.*, 379 B.R. 5, 22, 49 Bankr. Ct. Dec. (CRR) 29 (Bankr. E.D. N.Y. 2007)).

[444] Bachrach Clothing, 480 B.R. at 855. The court took special care to cite the cases so holding, quoting from the bankruptcy court for the Southern District of New York's 2011 opinion in *In re M. Fabrikant & Sons, Inc.*, 447 B.R. 170, 186–87 (Bankr. S.D. N.Y. 2011), aff'd, 480 B.R. 480 (S.D. N.Y. 2012) ("*Fabrikant I*"), which cited: *HBE Leasing Corp.*, 48 F.3d at 635 (setting forth the paradigmatic scheme and test for collapsing transactions in order to establish fraudulent transfer liability: (1) a party gave the debtor fair value in exchange for the debtor's property, but the debtor then gratuitously reconveyed what it received to a third party, taking nothing in return; and (2) the party to the transaction with the debtor that is sought to be avoided, "must have [had] actual or constructive knowledge of the entire scheme that renders [its] exchange with the debtor fraudulent."); *Voest-Alpine Trading USA Corp. v. Vantage Steel Corp*., 919 F.2d 206 at 212 (3d Cir. 1990) (collapsing transactions where each part of the transaction was dependent on the occurrence of the other and the defendant would not have consented to one of the transactions if the other would not occur); *Sher v. SAF Financial, Inc.*, 2010 WL 4034272, *7 (D. Md. 2010) (collapsing transaction where defendants had knowledge about each step of the transaction and steps where interdependent); *In re National Forge Co.*, 344 B.R. 340, 348 (W.D. Pa. 2006) ("Among other things, courts consider whether all of the defendants were aware of the multiple steps of the transaction [and] whether each step would have occurred on its own or, alternatively, whether each step depended upon the occurrence of the additional steps in order to fulfill the parties' intent."); *In re Hechinger Inv. Co. of Del.*, 327 B.R. 537, 546–47 (D. Del. 2005), aff'd, 278 Fed. Appx. 125 (3d Cir. 2008) (collapsing transaction where the defendants knew about the multiple steps of the transaction, each step of the transaction would not have occurred on its own, and each step relied on additional steps to fulfill the parties' intent); *MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Services Co.*, 910 F. Supp. 913, 934 (S.D. N.Y. 1995) (collapsing LBO where no single transfer would have taken place without the expectation that the entire transaction would be consummated, and the parties were aware of the overall LBO).

The *Fabrikant I* case reached the district court for the Southern District of New York in 2012 on appeal from, *inter alia,* the bankruptcy court's decision to dismiss the "collapsing" fraudulent transfer claims. *In re M. Fabrikant & Sons, Inc.*, 480 B.R. 480 (S.D. N.Y. 2012) ("*Fabrikant II*"). The *Fabrikant II* court employed the *HBE Leasing Corp. v. Frank* test and affirmed the bankruptcy court's decision to dismiss the fraudulent transfer claims, holding that the plaintiff had failed to adequately plead the elements required to collapse the

e. *The Jevic Test for Collapsing Transactions*

After reviewing the somewhat inconsistent precedent addressing collapsing of related transactions, the *Bachrach* court decided to utilize the test employed in a recent case from the Bankruptcy Court for the District of Delaware, *In re Jevic Holding Corporation,*[445] a case that also involved a LBO structured by Sun.[446] In *Jevic*, Sun purchased the equity of a debtor using a loan secured by the debtor's assets and guaranteed by Sun and, post-closing, the loan was replaced with an even larger financing facility under which the debtor was almost immediately in default.[447] Like BCI, the debtor in *Jevic* transferred its real estate to its former owners who then leased it back to the debtor, in order to reduce the company's total liabilities.[448] Given the similarities, the *Bachrach* court adopted the *Jevic* test and employed the following factors to determine whether the *Bachrach* transactions should be collapsed: (1) whether all parties involved in the individual transactions had knowledge of the overall scheme; (2) whether each transaction sought to be collapsed would have occurred on its own;[449] and (3) whether each transaction was dependent or conditioned on the other transactions.[450]

Applying the *Jevic* test, the *Bachrach* court found that BCI had failed to establish that the Sellers were aware of the overall scheme or that the sale of BCI could only be consummated if the

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transactions. Fabrikant II, 480 B.R. at 490. The *Fabrikant II* court found that the plaintiff failed to plausibly allege knowledge on the part of the defendants and also failed to adequately plead that the property was reconveyed by identifying the specific transactions. Fabrikant II, 480 B.R. at 487.

[445] Bachrach Clothing, 480 B.R. at 855–56 (citing *In re Jevic Holding Corp.*, 2011 WL 4345204 (Bankr. D. Del. 2011)).

[446] Bachrach Clothing, 480 B.R. at 856 (citing *In re Jevic Holding Corp.*, 2011 WL 4345204 (Bankr. D. Del. 2011)).

[447] Bachrach Clothing, 480 B.R. at 856 (citing *In re Jevic Holding Corp.*, 2011 WL 4345204, at *1).

[448] Bachrach Clothing, 480 B.R. at 856 (citing *In re Jevic Holding Corp.*, 2011 WL 4345204, at *1).

[449] This factor goes to show whether the parties had the requisite intent because, if the transactions were interdependent, "[e]ach step of the [collapsed] [t]ransaction would not have occurred on its own, as each relied on additional steps to fulfill the parties' intent." *In re Jevic Holding Corp.*, 2011 WL 4345204, at *5 (quoting *In re Hechinger Inv. Co. of Del.*, 327 B.R. at 546–47).

[450] Bachrach Clothing, 480 B.R. at 856 (citing *In re Jevic Holding Corp.*, 2011 WL 4345204, at *5).

transaction was structured as an LBO.[451] In support of this conclusion, the court pointed to evidence that Sun had offered to purchase BCI without a financing contingency, that BCI was solvent at the time of the sale, and that the purchase price for BCI was below book value.[452] Further, the Defendants[453] had no discussions with Sun about Sun's planned financing and had no role in separately incorporating the buyer, Holdings, or any of the key steps used to implement the LBO.[454] There was no evidence that anyone at Sun disclosed to the Defendants its plan to implement an LBO.[455]

The court rejected BCI's arguments that Ed's actions prior to and during the Sale established a plan to defraud creditors.[456] BCI argued that notes made by Ed concerning the implications of a post-sale bankruptcy as he met with advisors when considering a possible sale of BCI demonstrated fraudulent intent.[457] The court, however, found that Ed's notes evidenced nothing more than diligence in the sale process.[458] Likewise, the court declined to find that the lien on BCI's assets to secure the Note issued by Holdings or Ed's signing of the closing documents were sufficient evidence of the Defendants' intent to defraud BCI's creditors.[459] The court called the lien a "prudent business decision" and pointed out that it was Sun who initially proposed the lien in its letter of intent.[460]

The court also declined to impose on the Defendants constructive fraudulent intent for purposes of the collapsing doctrine, holding that there were no "red flags" to put the Defendants on notice that the Sale to Sun would injure BCI's creditors.[461] In support of this holding, the court pointed to the fact that, prior to

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[451] Bachrach Clothing, 480 B.R. at 856.

[452] Bachrach Clothing, 480 B.R. at 856–57.

[453] The opinion noted that BCI presented no evidence of the sisters' involvement in the alleged scheme so its analysis focused on Ed. Bachrach Clothing, 480 B.R. at 858.

[454] Bachrach Clothing, 480 B.R. at 858.

[455] Bachrach Clothing, 480 B.R. at 858.

[456] Bachrach Clothing, 480 B.R. at 857–58.

[457] Bachrach Clothing, 480 B.R. at 857.

[458] Bachrach Clothing, 480 B.R. at 857.

[459] Bachrach Clothing, 480 B.R. at 858.

[460] Bachrach Clothing, 480 B.R. at 858.

[461] Bachrach Clothing, 480 B.R. at 859. Normally, the existence of "red flags" are used to analyze actual intent to defraud creditors, and not constructive

the Sale, BCI was debt-free and solvent.[462] Further, the court noted, to ensure the financial health of the company, the Defendants agreed to refund a portion of the Cash to the extent that BCI's actual working capital was less than a target amount required to run the company, and did in fact refund over a half million dollars pursuant to that provision.[463]

The court held that no basis existed to collapse the individual transactions that made up the LBO into one transaction. This ended its inquiry into the fraudulent transfer claims, because BCI's expert report opining that the Sale left BCI insolvent and undercapitalized was based on the combined effect of all of the transactions.[464] Thus, the court entered judgment in favor of the Defendants on the fraudulent transfer claims.[465] The court also found in Defendants' favor on the breach of fiduciary duty claim, because the only evidence supporting that claim was contained in BCI's unpersuasive expert report. Finally, the court dismissed the equitable subordination claims on the grounds that Defendants had already withdrawn their claims.[466]

2. *Conclusion*

The court in *Bachrach* declined to impose the collapsing doctrine where, after an extensive review of the facts, it did not find that the defendants had intent to defraud creditors or knowledge of a fraudulent scheme or the company's imminent demise after the LBO. Interestingly, although BCI's complaint alleged constructive fraud, the court's analysis also examined whether the Defendants intended to defraud creditors. The *Bachrach* case differs from many in the LBO context, as the company was financially healthy at the time of the Sale and its former shareholders had limited involvement in the LBO. Because BCI was still a debtor in possession, perhaps potential avoidance claims against other possible defendants were not pursued.

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fraudulent transfer. Indeed, it appears that the collapsing doctrine is most frequently applied only where the relevant players had actual knowledge of the impact of the related transactions on the financial health of the LBO target, thus arguably making the burden for analyzing constructive fraud more difficult in the context of an LBO or similar transaction.

[462]Bachrach Clothing, 480 B.R. at 858.

[463]Bachrach Clothing, 480 B.R. at 858.

[464]Bachrach Clothing, 480 B.R. at 859.

[465]Bachrach Clothing, 480 B.R. at 876.

[466]Bachrach Clothing, 480 B.R. at 876.

D. *Recovery From Subsequent Transferees under Section 550*

Subsequent transferee liability under Section 550 of the Bankruptcy Code was fertile ground for new case law in 2012. In the first case within the Second Circuit to conclusively address the issue, *SIPC v. Bernard L. Madoff Investment Securities LLC* (*In re Bernard L. Madoff Investment Securities LLC*),[467] Judge Burton Lifland of the Bankruptcy Court for the Southern District of New York addressed whether Section 550 of the Bankruptcy Code requires a trustee to formally avoid an initial transfer to permit recovery from a subsequent transferee, or if the mere avoidability of such transfer is sufficient.[468] This decision of first impression is significant and should have an impact on other fraudulent

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[467] *Securities Investor Protection Corporation v. Bernard L. Madoff Inv. Securities LLC*, 480 B.R. 501, 57 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2012) ("*Madoff*").

The liquidation proceedings of Bernard L. Madoff Investment Securities LLC ("BLMIS") are pending in the proceeding styled as *In re Bernard L. Madoff Investment Securities LLC*, Bankr. S.D.N.Y. No. 08-01789 (BRL). BLMIS is being liquidated pursuant to the Securities Investor Protection Act ("SIPA"), 14 U.S.C.A. §§ 78aaa et seq. Congress enacted SIPA in 1970 for the primary purpose of protecting customers from losses caused by the insolvency or financial instability of broker-dealers. See *In re Bernard L. Madoff Inv. Securities LLC*, 424 B.R. 122, 132, 52 Bankr. Ct. Dec. (CRR) 236, Bankr. L. Rep. (CCH) P 81726 (Bankr. S.D. N.Y. 2010), aff'd, 654 F.3d 229, 55 Bankr. Ct. Dec. (CRR) 78, Fed. Sec. L. Rep. (CCH) P 96516 (2d Cir. 2011), cert. dismissed, 132 S. Ct. 2712, 183 L. Ed. 2d 65 (2012) and cert. denied, 133 S. Ct. 24, 183 L. Ed. 2d 675 (2012) and cert. denied, 133 S. Ct. 25, 183 L. Ed. 2d 675 (2012) (citing *Securities and Exchange Commission v. S. J. Salmon & Co., Inc.*, 375 F. Supp. 867, 871, Fed. Sec. L. Rep. (CCH) P 94582 (S.D. N.Y. 1974)). SIPA establishes procedures for liquidating failed broker dealers and provides customers of broker dealers with special protections. Bernard L. Madoff Inv. Sec., 424 B.R. at 132–33. A SIPA liquidation is essentially a bankruptcy liquidation tailored to achieve SIPA's objectives. Bernard L. Madoff Inv. Sec., 424 B.R. at 133 (citing 15 U.S.C.A. § 78fff(b)).

[468] The *Madoff* court noted at the outset of its opinion that Judge Rakoff of the United States District Court for the Southern District of New York, had withdrawn the reference to adjudicate the same issue in certain adversary proceedings in *In re Bernard L. Madoff Inv. Sec. LLC.*, Case No. 12-MC-00115 (JSR). On December 12, 2012, Judge Rakoff entered an order (the "Order") declining to dismiss the proceedings based on the plaintiff's failure to "obtain a fully-litigated, final judgment of avoidance against the relevant initial transferee" or to "obtain[] a judgment against the relevant subsequent transferee avoiding the initial transfer or assert[] a claim against the subsequent transferee to avoid the initial transfer within the period prescribed by 11 U.S.C. § 546(a)." *In re Bernard L. Madoff Inv. Sec. LLC.*, Case No. 12-MC-00115 (JSR), ECF No. 422. The Order states that an opinion explaining the court's reasoning will be issued in due course. *In re Bernard L. Madoff Inv. Sec.*

transfer suits arising out of BLMIS and other Ponzi schemes discovered in the last few years.

1. *In re Madoff*

a. *BLI's Relationship with Fairfield*

The fraudulent transfer action in *Madoff* arose out of the relationship between Fairfield Sentry Limited ("Fairfield"), the largest feeder fund to debtor Bernard L. Madoff Investment Securities ("BLMIS"),[469] and the Taiwanese Bureau of Labor Insurance ("BLI").[470] BLI was one of Fairfield's investors,[471] and party to a subscription agreement with Fairfield in which BLI acknowledged that it was aware that BLMIS held 95% of Fairfield's assets.[472] As a result of this relationship, BLI received redemption payments from Fairfield of approximately $42 million.[473] In May of 2009, the BLMIS SIPA trustee, Irving H. Picard, (the "Trustee"), commenced an action against Fairfield seeking, inter alia, the avoidance of all transfers from BLMIS to Fairfield during the six year period prior to the filing of BLMIS liquidation proceeding, and recovery totaling approximately $3 billion.[474] Shortly after the filing of the complaint, Fairfield began wind-up proceedings in the Eastern Caribbean Supreme Court in the High Court of Justice of the Virgin Islands.[475]

The Trustee subsequently entered into a settlement agreement with Fairfield prior to full adjudication of the avoidability of the

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LLC., Case No. 12-MC-00115 (JSR), ECF No. 422. As of the date of completion of this Article, an opinion had not yet been issued.

[469]For a comprehensive discussion of the facts underlying the SIPA liquidation and Bernard Madoff's notorious Ponzi scheme, see *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. at 125–33.

[470]BLI is a political branch of the Republic of China responsible for labor safety policies and handling investments of the Labor Insurance Fund. BLI is statutorily authorized to invest in any government-authorized projects, which may result to the benefit of their fund, including hedge funds issued by the foreign fund management institutions. Madoff, 480 B.R. at 506–508.

[471]Madoff, 480 B.R. at 507.

[472]Madoff, 480 B.R. at 507.

[473]Madoff, 480 B.R. at 509.

[474]Madoff, 480 B.R. at 518.

[475]Madoff, 480 B.R. at 518. Fairfield was organized under the laws of the British Virgin Islands. See *In re Fairfield Sentry Ltd. Litigation*, 458 B.R. 665, 671 (S.D. N.Y. 2011).

above-referenced transfers from BLMIS to Fairfield.[476] Under the terms of the settlement, Fairfield (i) agreed to pay $70 million to the Trustee; (ii) reduced its customer claim against BLMIS by nearly $730 million; and (iii) entered into a consent judgment in favor of the Trustee for the entire amount of the transfers.[477] The settlement agreement expressly stated that the "judgment" may be used by the Trustee to prosecute a [s]ubsequent [t]ransferee [c]laim, and then for the purpose of establishing the avoidance of the [w]ithdrawals."[478]

Accordingly, in September 2011, the Trustee filed a complaint against BLI as a subsequent transferee seeking to recover the $42 million that BLI received from Fairfield. BLI sought to dismiss the complaint on four separate grounds: (1) the bankruptcy court lacked subject matter jurisdiction over BLI because it is immune from liability under the Foreign Sovereign Immunities Act; (2) the bankruptcy court lacked personal jurisdiction over BLI; (3) the transfers to BLI were not recoverable under Section 550 of the Bankruptcy Code because the Trustee did not first avoid the initial transfers from BLMIS to Fairfield; and (4) the Trustee's claims were barred by the presumption against extraterritoriality.[479] This portion of the Article focuses on point (3), the recoverability of the transfers to BLI under Section 550 of the Bankruptcy Code.

b. *Precedent Examining Recovery Under Section 550 of the Bankruptcy Code*

In examining the question of whether the Trustee could recover from BLI as a subsequent transferee, the court first reviewed the text of Section 550 of the Bankruptcy Code, which provides, in relevant part, "to the extent that a transfer is avoided under [an avoidance provision in the Code], the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from . . . (2) any

[476] Madoff, 480 B.R. at 518.

[477] Madoff, 480 B.R. at 518–19.

[478] Madoff, 480 B.R. at 518–19. The term "withdrawals" refers to funds withdrawn by Fairfield from its BLMIS accounts and transferred to BLI in the form of redemption payments.

[479] Madoff, 480 B.R. at 506. BLI also argued that the settlement was the result of the parties colluding to prosecute the subsequent transferees. The court swiftly dismissed this claim, acknowledging that while part of the value of the settlement was the consent judgment, which allowed the Trustee to prosecute subsequent transferees, but recognizing the difficulty of prosecuting an insolvent entity such as Fairfield. Madoff, 480 B.R. at 519.

immediate or mediate transferee of such initial transferee."[480] Taking into account the express language of the statute, the court addressed BLI's argument that the Trustee was precluded from recovering from BLI because he had not first obtained a "full and final judgment of avoidance" against Fairfield.[481] The court held that the Trustee need not obtain a judgment against Fairfield in order to satisfy the requirement of section 550 that allow recovery of transfers to the extent such transfers are avoided.[482] In so holding, the court examined the only district court case in the Second Circuit to address, but not conclusively decide, the issue—*In re Enron Creditors Recovery Corporation* ("*Enron*").[483]

In *Enron*, the bankruptcy court was confronted with a scenario where the trustee was unable to obtain a judgment against the initial transferee because the entity was no longer in existence and no successor existed, nor had a trustee had been appointed.[484] The court in *Madoff* analogized Fairfield's situation to the initial transferee in *Enron*.[485] The district court in *Enron* acknowledged that while section 550 usually requires actual avoidance of a transfer before permitting recovery from a subsequent transferee, it stated that it was "necessary to leave open the possibility of an exception where . . . it is impossible or impractical to satisfy the precondition of an avoidance."[486] Further, the *Enron* court recognized that to uniformly require actual avoidance of the initial transfer to permit recovery from a subsequent transferee

[480] Madoff, 480 B.R. at 520 (citing 11 U.S.C. § 550).

[481] Madoff, 480 B.R. at 520.

[482] Madoff, 480 B.R. at 520.

[483] Madoff, 480 B.R. at 520–21 (citing *In re Enron Creditors Recovery Corp.*, 388 B.R. 489 (S.D. N.Y. 2008)). The district court in *Enron* reversed the bankruptcy court's decision holding that the initial transfer must be avoided prior to recovery from a subsequent transferee, remanding the case to the bankruptcy court with instructions to grant appellants leave to amend their complaint to show "why, given the circumstances of those transactions, appellants have no practical ability to effect a recovery under 11 U.S.C.A. § 550(a)(2), unless a declaration of avoidance against the initial transferee can be made simultaneously, or prior to, with a declaration authorizing a recovery against a subsequent transferee." In re Enron Creditors Recovery Corp., 388 B.R. at 490.

[484] Madoff, 480 B.R. at 521 (citing *In re Enron Creditors Recovery Corp.*, *Hr'g Tr.* ("*Enron Transcript*"), No. 07-6597, ECF No. 32, Apr. 16, 2008, at p. 17, lines 21–24).

[485] Madoff, 480 B.R. at 520–21.

[486] Madoff, 480 B.R. at 521 (citing Enron Transcript at p. 37, lines 15–25; p. 38, lines 1–10).

would effectively bar recovery of assets that properly belong to the estate's creditors.[487]

The *Madoff* court also cited the Ninth Circuit Bankruptcy Appellate Panel's decision in *In re AVI, Inc.*,[488] which held, in a postpetition transfer avoidance action, that section 550 "should be interpreted to provide flexibility."[489] The *AVI* court examined the circuit split on the issue and rejected the reasoning of the Tenth Circuit Court of Appeals in *Weinman v. Simons* (*In re Slack-Horner Foundries Co.*)[490] and its progeny, which held that a trustee was required to avoid the initial transfer before proceeding against subsequent transferees.[491] In rejecting the Tenth Circuit's approach, the *AVI* court examined precedent from other circuits clarifying section 550(a)'s qualifier "to the extent that a transfer is avoided."[492] The *AVI* court noted that the bankruptcy courts for the Western District of Texas and the Southern District of New York have reached opposite conclusions when dissecting the plain meaning of the statute.[493] On the one hand, the court in *Crafts Plus+, Inc. v. Foothill Capital Corp. (In re Crafts Plus+, Inc.)*[494] reasoned that the phrase "is avoided" was drafted in the present perfect tense, thereby not requiring prior avoidance of the initial transfer.[495] However, the court in *Enron Corp v. International Finance Corp.* (*In re Enron Corp.*)[496] reached the opposite conclusion by construing the word "avoided" as being in

[487]Madoff, 480 B.R. at 521.

[488]Madoff, 480 B.R. at 520 (citing *In re AVI, Inc.*, 389 B.R. 721, 50 Bankr. Ct. Dec. (CRR) 39, 59 Collier Bankr. Cas. 2d (MB) 1753 (B.A.P. 9th Cir. 2008)).

[489]In re AVI, Inc., 389 B.R. at 735.

[490]In re AVI, Inc., 389 B.R. at 732 (citing *In re Slack-Horner Foundries Co.*, 971 F.2d 577, Bankr. L. Rep. (CCH) P 74745 (10th Cir. 1992) (2-1 split decision)).

[491]In re AVI, Inc., 389 B.R. at 732 (citing In re Slack-Horner Foundries Co., 971 F.2d at 577).

[492]In re AVI, Inc., 389 B.R. at 732–33.

[493]In re AVI, Inc., 389 B.R. at 732–33.

[494]In re AVI, Inc., 389 B.R. at 733 (citing *In re Crafts Plus+, Inc.*, 220 B.R. 331, 335–38, 32 Bankr. Ct. Dec. (CRR) 701, 40 Collier Bankr. Cas. 2d (MB) 388 (Bankr. W.D. Tex. 1998)).

[495]In re AVI, Inc., 389 B.R. at 733 (citing In re Crafts Plus+, Inc., 220 B.R. at 335).

[496]In re AVI, Inc., 389 B.R. at 733 (citing *In re Enron Corp.*, 343 B.R. 75, 46 Bankr. Ct. Dec. (CRR) 147, 56 Collier Bankr. Cas. 2d (MB) 195 (Bankr. S.D. N.Y. 2006), rev'd and remanded, 388 B.R. 489 (S.D. N.Y. 2008)).

the past tense.[497] In light of the circuit split and the lack of authority in the Ninth Circuit, the *AVI* court turned to the Eleventh Circuit's decision in *IBT International, Inc. v. Northern* (*In re International Administrative Services, Inc.*),[498] which held that section 550(a) "does not mandate a plaintiff to first pursue recovery against the initial transferee."[499]

The *AVI* court followed the reasoning of the Eleventh Circuit in *International Administrative Services, Inc.*, aligning its interpretation of section 550 with those decisions[500] that endorsed a "construction of section 550 that avoid[ed] absurd results and [was] consistent with the purpose of the statutory framework."[501] The *AVI* court found that "[a] mandate of actual avoidance prior to seeking recovery from a subsequent transferee would [ ] be an exercise in futility."[502] In so holding, the *AVI* court emphasized that if a court were to rely on a strict construction of section 550, a trustee would then be precluded from pursuing subsequent transferees after settling with an initial transferee who does not admit liability.[503] "In turn, trustees would have little incentive to partially settle avoidance actions, thereby running up the costs of litigation and causing further delay."[504] It was the *AVI* court's belief that "Congress could not have contemplated this outcome in enacting section 550."[505] Accordingly, the *AVI* court construed the plain language of section 550 of the Bankruptcy Code and the statutory framework as a whole concluding "that Congress intended avoidance as one remedy and recovery as another."[506] Therefore, the *AVI* court held that "a trustee is not required to

[497]In re AVI, Inc., 389 B.R. at 733 (citing In re Enron Corp., 343 B.R. at 79–80).

[498]In re AVI, Inc., 389 B.R. at 732 (citing *In re International Administrative Services, Inc.*, 408 F.3d 689, 44 Bankr. Ct. Dec. (CRR) 178, Bankr. L. Rep. (CCH) P 80279 (11th Cir. 2005)).

[499]In re AVI, Inc., 389 B.R. at 732 (quoting In re Int'l Admin. Servs., Inc., 408 F.3d at 708).

[500]See *In re National Audit Defense Network*, 332 B.R. 896 (Bankr. D. Nev. 2005); *In re Richmond Produce Co., Inc.*, 195 B.R. 455, 142 A.L.R. Fed. 715 (N.D. Cal. 1996).

[501]In re AVI, Inc., 389 B.R. at 735.

[502]In re AVI, Inc., 389 B.R. at 735.

[503]In re AVI, Inc., 389 B.R. at 735.

[504]In re AVI, Inc., 389 B.R. at 735.

[505]In re AVI, Inc., 389 B.R. at 735.

[506]In re AVI, Inc., 389 B.R. at 735.

avoid the initial transfer from the initial transferee before seeking recovery from subsequent transferees under section 550."[507]

c. *Section 550 Does Not Require Formal Avoidance Against Initial Transferees*

With the *AVI* court's analysis guiding its review, the *Madoff* court held that when a settlement is in play, "rigidly construing section 550 to require formal avoidance against Fairfield before permitting recovery from BLI makes little sense."[508] The *Madoff* court found it "impractical" for the Trustee to obtain such a judgment against Fairfield because "it would have entailed protracted, expensive litigation with an insolvent entity in the midst of a liquidation proceeding with little chance of meaningful recovery."[509] The *Madoff* court further noted that requiring the Trustee to first attain a judgment against Fairfield would "lead to the 'absurd result' of forcing the Trustee to choose between engaging in such burdensome litigation with the insolvent initial transferee on the one hand, or forever forfeiting the right to recover from all subsequent transferees on the other."[510] Following the majority of courts[511] that have addressed this issue, the *Madoff*

[507]In re AVI, Inc., 389 B.R. at 735 (the court further noted that its interpretation of section 550 was "compatible with the avoidance sections" of the Bankruptcy Code to lend another level of support to the court's conclusion).

[508]Madoff, 480 B.R. 501, at 521.

[509]Madoff, 480 B.R. at 521.

[510]Madoff, 480 B.R. at 522.

[511]Madoff, 480 B.R. at 520 (citing 5 Collier on Bankruptcy, ¶ 550.02[1] at 550–6 (Alan N. Resnick and Henry J. Sommer eds., 16th ed. 2011) ("The better view, adopted by the majority of courts is that . . . a recovery may be had from a subsequent transferee without suing the initial transferee."). The court also cited *In re M. Fabrikant & Sons, Inc.*, 394 B.R. 721, 741, 745–46, 50 Bankr. Ct. Dec. (CRR) 192 (Bankr. S.D. N.Y. 2008) ("Avoidable . . . describes a transaction that can be voided . . . but that is valid until annulled . . .. The plaintiff can proceed directly against the [subsequent transferees] and 'avoid' the initial transfer as to them."); *In re International Administrative Services, Inc.*, 408 F.3d 689, 708, 44 Bankr. Ct. Dec. (CRR) 178, Bankr. L. Rep. (CCH) P 80279 (11th Cir. 2005) ("Section 550(a) does not mandate a plaintiff to first pursue recovery against the initial transferee and successfully avoid all prior transfers against a mediate transferee."); *In re Richmond Produce Co., Inc.*, 195 B.R. 455, 463, 142 A.L.R. Fed. 715 (N.D. Cal. 1996) ("[O]nce the trustee proves that a transfer is avoidable under section 548, he may seek to recover against any transferee, initial or immediate, or an entity for whose benefit the transfer is made.") (emphasis added); *In re AVI, Inc.*, 389 B.R. at 735 ("[A] trustee is not required to avoid the initial transfer from the initial transferee before seeking recovery from subsequent transferees under § 550(a)(2)."). Further, the *Madoff* court stated, nothing contained in Section 550 suggests that "recovery from im-

court avoided the "impractical" result and construed section 550 "flexibly to require only *avoidability* to pursue recovery from BLI[,]" the subsequent transferee.[512]

The *Madoff* court's holding, however, did not automatically make BLI liable for the avoidable transactions. The Trustee was still required "to prove that the transfers from BLMIS to Fairfield were fraudulent and improper in connection with it suit against BLI as subsequent transferee."[513] The Trustee's settlement with Fairfield did not involve any determination on the merits as to the initial transfers, and as such, for BLI to be afforded its due process rights, BLI must have the opportunity to challenge the avoidability of the transfers at issue.[514] Accordingly, the *Madoff* court interpreted section 550 to permit a trustee to bring an avoidance action against a subsequent transferee, when the initial transferee has previously settled, but that the trustee must still make a successful showing that the transfers at issue are in fact avoidable.[515]

d. *Section 550(f)'s Statute of Limitations*

As a final effort to avoid potential liability under Section 550 of the Bankruptcy Code, BLI argued that the Trustee's action against BLI was time-barred. Section 550(f) of the Bankruptcy Code states that a trustee must initiate recovery actions against subsequent transferees within "one year after the avoidance of the transfer[.]"[516] BLI argued this provision was inapplicable because the settlement with Fairfield "did not constitute a true

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mediate transferees is in any way dependent upon a prior action or recovery against the initial transferee. . . . On the contrary, avoidability is an attribute of the transfer rather than that of the creditor." Madoff, 480 B.R. at 520 (citing *In re Richmond Produce Co.*, 195 B.R. at 463 (quotation omitted)).

[512] Madoff, 480 B.R. at 522 (emphasis added).

[513] Madoff, 480 B.R. at 522.

[514] Madoff, 480 B.R. at 522 (citing *In re Flashcom, Inc.*, 361 B.R. 519, 525, 47 Bankr. Ct. Dec. (CRR) 220 (Bankr. C.D. Cal. 2007) ("[A] stipulated or default judgment entered in an avoidance action does not preclude the defendants in a recovery action from disputing the avoidability."); *In re Food & Fibre Protection, Ltd.*, 168 B.R. 408, 416, 25 Bankr. Ct. Dec. (CRR) 1019 (Bankr. D. Ariz. 1994) (finding that a default judgment did not preclude defendants from asserting their due process rights to dispute avoidability of the initial transfer and raise whatever defenses were available to the initial transferee)).

[515] Madoff, 480 B.R. at 522.

[516] Madoff, 480 B.R. at 522 (quoting 11 U.S.C. § 550(f)). Section 550(f) of the Bankruptcy Code states:

> (f) An action or proceeding under this section may not be commenced after the earlier of —

avoidance" and therefore the one year statute of limitations under Section 550(f) of the Bankruptcy Code was never triggered.[517] BLI asserted that because section 550(f) was inapplicable, the court should instead apply the two-year statute of limitations contained in Section 546(a)(1)(A) of the Bankruptcy Code which generally applies to all avoidance actions.[518] BLI argued that because the Trustee failed to bring the subject lawsuit until well after the two-year period contained in Section 546(a)(1)(A) of the Bankruptcy Code the action was thus time-barred.[519]

The court found BLI's argument with respect to the statute of limitations "erroneous."[520] The court held that even though the Trustee's settlement with Fairfield did not constitute a formal avoidance of the initial transfers from BLMIS to Fairfield, the settlement "presents the court with finality with respect to Fairfield Sentry. This finality triggers the relevant one-year statute of limitations under section 550(f) of the [Bankruptcy] Code,"[521] and because the Trustee's action was commenced within one year of the Fairfield settlement, the Trustee's action was timely. Accordingly, the court found that the action was not time-barred and the Trustee could seek recovery from a subsequent transferee under Section 550 of the Bankruptcy Code without formally avoiding the initial transfers.

The *Madoff* case is the first decision in the Second Circuit to address the issue of subsequent transferee liability where the initial transfer has not been formally avoided, and, as such, is a

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(1) one year after the avoidance of the transfer on account of which recovery under this section is sought; or

(2) the time the case is closed or dismissed.

11 U.S.C.A. § 550(f).

[517] Madoff, 480 B.R. at 522.

[518] Madoff, 480 B.R. at 522; see also 11 U.S.C.A. § 546(a) (enumerating that avoidance actions under sections 544, 545, 547, 548 or 553 of the Bankruptcy Code must be commenced by the later of "(A) 2 years after the entry of the order for relief; or (B) 1 year after the appointment or election of the first trustee").

[519] Madoff, 480 B.R. at 522.

[520] Madoff, 480 B.R. at 522.

[521] Madoff, 480 B.R. at 522. The court further notes that "[w]ithout such a trigger, the Trustee would be permitted to bring suit against a subsequent transferee for an indefinite amount of time, a highly inequitable result." Madoff, 480 B.R. at 522 (citing *ASARCO LLC v. Shore Terminals LLC*, 2012 WL 2050253, *5 (N.D. Cal. 2012) (finding that a judicially approved settlement triggered the statute of limitations because any other result "would undermine the certainty that statutes of limitations are designated to further," and because otherwise "the statute of limitations would be indefinite because a triggering event might never occur.")).

landmark decision in the area of avoidance action recovery. Importantly, the decision addresses the practical implications faced by trustees who are motivated to settle certain avoidance actions promptly, to avoid expense to the estate, while still preserving the estate's rights to pursue avoidance actions against subsequent transferees.

IV. SUMMARY

The cases discussed above demonstrate the ever-changing landscape of fraudulent transfer law, especially in light of the recent developments in constitutional law brought about by the Supreme Court's ruling in *Stern*. Though *Stern's* full impact on fraudulent transfer claims is still developing, the cases discussed above illustrate that while bankruptcy courts may not have the constitutional authority to finally adjudicate fraudulent transfer claims, litigants often either expressly or impliedly consent to the bankruptcy court's entry of a final judgment. Further, because bankruptcy judges possess significant expertise in fraudulent transfer law, it is likely that most fraudulent transfer claims that find their end in the district court will do so after a bankruptcy court hears the matter and submits findings of fact and conclusions of law to the district court. The *Madoff* decision brings clarity to an issue that had not before been decided within the Second Circuit, and sets a high-stakes precedent within the jurisdiction, the stage for many multi-million-dollar adversary proceedings. With a corresponding decision to be entered by Judge Rakoff in the district court in a case related to *Madoff*, the effect of rulings will likely be far-reaching. The *Verizon* decisions, in the aggregate, provide a window into developments within the Fifth Circuit, while the *Bachrach* ruling takes an in-depth look at the various tests employed within several circuits to determine whether a set of related leveraged transactions should be collapsed in order to demonstrate fraudulent transfer liability. A careful practitioner will take note of these developing areas of law and continue to follow them with interest.