SECTIONS 548 AND 550—DEVELOPMENTS IN THE LAW OF FRAUDULENT TRANSFERS AND RECOVERIES IN 2013

Maryann Gallagher[*]

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 developments and particular cases decided in 2013 that clarified or otherwise relied on these or related provisions.

Decisions of interest from fraudulent transfer actions in 2013, similar to decisions discussed in prior years, address the extent of a bankruptcy court's jurisdiction in the aftermath of *Stern v.*

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[*]Maryann Gallagher is counsel to the law firm Curtis, Mallet-Prevost, Colt & Mosle LLP ("Curtis"). The author gratefully acknowledges Bryan M. Kotliar and Benjamin Butterfield, associates at Curtis who assisted in the research and drafting of this article. The opinions expressed are not necessarily the opinions of Curtis or its Restructuring and Insolvency Group. Nothing contained in this article should be construed as such or as legal advice or legal positions.

[1]Vern 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 (2014) (the "Bankruptcy Code")).

[3]Though this article addresses recent developments in sections 548 and 550 of the Bankruptcy Code, out of necessity it also discusses section 544 and other bankruptcy law provisions relevant to fraudulent transfers, including section 546, a Bankruptcy Code section that places certain limits on a trustee's avoidance powers. *See* 11 U.S.C.A. §§ 544 & 546. This article's use of the term "trustee" should also be read to include a Chapter 11 debtor-in-possession, which possesses all of the rights and abilities of the trustee in bankruptcy. *See* 11 U.S.C.A. § 1107(a).

Marshall,[4] along with continued repercussions from the financial upheaval experienced in the United States starting in 2007. Notably, the Supreme Court agreed to decide an appeal from the decision of the United States Court of Appeals for the Ninth Circuit in the case of *Executive Benefits Insurance Agency v. Arkison* (*In re Bellingham Insurance Agency, Inc.*),[5] which held that although a bankruptcy court lacks constitutional authority to enter final judgment on fraudulent transfer claims asserted against parties who are not creditors of the debtor, it has statutory authority to enter proposed findings of fact and conclusions of law, subject to a district court's de novo review, and that a party can waive its right to a hearing before an Article III judge in actions asserting such claims.[6] In a decision arising out the case of *In re Sentinel Management Group*,[7] the United States Court of Appeals for the Seventh Circuit found that a debtor's transfers of assets from segregated customer accounts to an account that served as collateral for an overnight night loan facility from a large bank were actually fraudulent transfers because the debtor should have known that the effect of its actions was to hinder and delay its

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[4]*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 (2011).

[5]*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, 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013) and aff'd, 134 S. Ct. 2165, 59 Bankr. Ct. Dec. (CRR) 160 (2014).

[6]Bellingham Insurance, 702 F.3d 553. The Ninth Circuit's decision in the *Bellingham* case was discussed at length in the 2013 edition of this article. *See* Maryann Gallagher & Heather E. Saydah, Section 548 and 550 — Developments in the Law of Fraudulent Transfers and Recoveries in 2012, in Norton Annual Survey of Bankruptcy Law 977, 1038 to 1046 (2013). As this Article was being submitted for publication, the Supreme Court issued its opinion in *Bellingham* affirming the Ninth Circuit's decision and holding that in core proceedings for which a bankruptcy court lacks the constitutional authority to enter a final judgment a bankruptcy court may submit proposed findings of fact and conclusions of law subject to de novo review by the district court. *Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 59 Bankr. Ct. Dec. (CRR) 160 (2014). The Supreme Court declined to address the issue of whether a bankruptcy court may enter a final judgment in such proceedings on the basis of litigant consent, "reserv[ing] that question for another day." 2014 WL 2560461, at *4 n.4. A thorough analysis of the Supreme Court's decision is expected in the 2015 edition of this article.

[7]*In re Sentinel Management Group, Inc.*, 728 F.3d 660, 58 Bankr. Ct. Dec. (CRR) 93, 70 Collier Bankr. Cas. 2d (MB) 566, Comm. Fut. L. Rep. (CCH) P 32717 (7th Cir. 2013).

other creditors.[8] The Bankruptcy Court for the Southern District of New York, in an epic opinion, addressed as a matter of first impression the applicability of fraudulent transfer laws to transactions which isolated claims for significant environmental and tort liability, "collapsed" a series of transfers initiated in 2002 and finalized in 2005 and 2006 that were part of an integrated scheme designed to isolate legacy tort and environmental liabilities in order to find that the statute of limitations had not started to run until 2006.[9] It then held that transfers were actually and constructively fraudulent and that the plaintiffs were entitled to damages in excess of $14 billion.[10] As part of that decision, the bankruptcy court also found that the defendants could assert a claim under section 502(h) of the Bankruptcy Code for damages awarded with respect to the fraudulent transfers, subject to dilution in an amount that was to be later determined by the bankruptcy court.[11] In the case of *Official Committee of Unsecured Creditors v. Hancock Park Capital II, L.P.* (*In re Fitness Holdings International, Inc.*),[12] the United States Court of Appeals for the Ninth Circuit, joining several other circuits which have held similarly, ruled that a bankruptcy court has authority to recharacterize debt as equity for purposes of determining whether transfers made in repayment to the debtor's shareholder were constructively fraudulent transfers under section 548(a)(1)(B) of the Bankruptcy Code.[13] Finally, the United States Court of Appeals for the Tenth Circuit, in the case of *Wadsworth v. The Word of Life Christian Center* (*In re McGough*),[14] adopted a "plain language" for its analysis of section 548(a)(2) of the Bankruptcy Code when it held that a trustee may recover the entire amount of a debtor's annual transfers to a qualified charity if the total amount of those transfers exceeds 15% of the debtor's gross

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[8]Sentinel Management, 728 F.3d 660.

[9]*In re Tronox Incorporated*, 503 B.R. 239, 270–71 (Bankr. S.D. N.Y. 2013).

[10]Tronox, 503 B.R. at 291–324.

[11]Tronox, 503 B.R. at 334-37.

[12]*In re Fitness Holdings Intern., Inc.*, 714 F.3d 1141, 57 Bankr. Ct. Dec. (CRR) 243, 69 Collier Bankr. Cas. 2d (MB) 1089, Bankr. L. Rep. (CCH) P 82493 (9th Cir. 2013), for additional opinion, see, 2013 WL 1800978 (9th Cir. 2013), opinion amended and superseded on reh'g, 529 Fed. Appx. 871 (9th Cir. 2013).

[13]Fitness Holdings, 714 F.3d 1141.

[14]*In re McGough*, 737 F.3d 1268, 58 Bankr. Ct. Dec. (CRR) 254, Bankr. L. Rep. (CCH) P 82553 (10th Cir. 2013).

annual income.[15] These and other important fraudulent transfer decisions from 2013 are addressed in Section III below.

II. BACKGROUND

Sections 548 and 550 of the Bankruptcy Code respectively set forth a trustee'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 fraudulent transfers and obligations, underwent certain changes in 1998 as a result of the enactment of the Religious Liberty and Charitable Donation Protection Act of 1998 (the "Charitable Donation Act"),[16] and again in 2005 as a result of the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").[17] As further discussed below, section 550, which sets forth the trustee's power to recover the value of avoided transfers, was also amended under the Bankruptcy Amendments and Federal Judgeship Act of 1984,[18] the Bankruptcy Reform Act of 1994 (the "1994 Reform Act")[19] and BAPCPA.

A. *History and Construction of Section 548*

Section 548 of the Bankruptcy Code 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

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[15]McGough, 737 F.3d 1277.

[16]Pub. L. No. 105-183, 112 Stat. 517 (1998) (codified as amended at 11 U.S.C. §§ 544, 546, 548, 707, 1325).

[17]Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified as amended in various sections of 11 U.S.C.). BAPCPA was enacted on April 20, 2005. With certain exceptions, BAPCPA became effective on October 17, 2005 and was applicable only to cases filed on or after that date.

[18]Pub. L. No. 98-353, 98 Stat. 333 (1984) (codified as amended in various sections of 11 U.S.C. and 28 U.S.C.).

[19]Pub. L. No. 103-394, 108 Stat. 4106 (1994) (codified as amended in various sections of 11 U.S.C., 18 U.S.C., and 28 U.S.C.). The 1994 Reform Act was an attempt to expressly overrule the decision of the United States Court of Appeals for the Seventh Circuit 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).

in 1571.[20] The Statute of Elizabeth was aimed at a practice by which debtors conveyed their assets to friendly parties in order to frustrate creditors' attempts to satisfy their claims.[21] After creditors abandoned their efforts to recover on their claims, the friendly parties would re-convey the property back to the debtor, thus disadvantaging the debtor's creditors.[22]

Similar to the Statute of Elizabeth, the purpose of section 548 is to thwart such a practice by vesting in the trustee the power to avoid transfers that improperly deplete the debtor's estate, the assets of which should be available to all creditors. Section 548(a)(1) of the Bankruptcy Code 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 or became insolvent ("constructively fraudulent" transfers).

Section 548(a)(1) provides:[23]

The trustee may avoid any transfer (including any transfer to or for

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[20]55 Cong. Ch. 541, 30 Stat. 544 (1898) (codified as amended at 11 U.S.C., in various sections of 28 U.S.C., and in scattered sections of other titles) (repealed 1978); *see* S. Rep. No. 95-989 (1978), reprinted in 1978 U.S.C.C.A.N. 5787.

[21]*See 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) of the Bankruptcy Act of 1898 was codified at 11 U.S.C. § 107(d) prior to the enactment of the Bankruptcy Code.

[22]*See* Metro Commc'ns, 945 F.2d at 644–45.

[23]The Bankruptcy Code defines "insolvent" 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). Courts employ a variety of methods to determine whether an entity was solvent at the time of the transfers at issue. *See, e.g.*, *Universal Church v. Geltzer*, 463 F.3d 218, 226, Bankr. L. Rep. (CCH) P 80725, 36 A.L.R. Fed. 2d 649 (2d Cir. 2006) (holding that in the context of a section 548(a)(1)(B) constructive fraudulent conveyance, "insolvency is determined by the 'balance sheet test,' in other words whether the debtor's assets were exceeded by her liabilities at the time of the transfer"); *In re Bayou Group, LLC*, 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 Bachrach Clothing, Inc.*, 480 B.R. 820, 866–67 (Bankr. 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 EBC I, Inc.*, 380 B.R. 348, 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 § 548(a)(2)(B)(i), it is appropriate to take

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:

(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

(B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(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;

(II) was engaged in business or a transaction, or was about 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.

B. *Changes to Section 548(a)(1) Under BAPCPA*

The prefatory sentence of section 548(a)(1) generally receives

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into account intangible assets not carried on the debtor's balance sheet"); *In re Iridium Operating LLC*, 373 B.R. 283, 347 (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." (quoting *In re Longview Aluminum, L.L.C.*, 2005 WL 3021173, *9 (Bankr. N.D. Ill. 2005), decision aff'd, 2007 WL 4287507 (N.D. Ill. 2007), aff'd, 548 F.3d 579, 50 Bankr. Ct. Dec. (CRR) 243, Bankr. L. Rep. (CCH) P 81365 (7th Cir. 2008)). The question as to who bears the burden of solvency versus insolvency has been addressed by one court under unusual circumstances. In *Eerie World Entm't L.L.C. v. Bergrin*, a defendant moved for summary judgment on this issue in a trial that lasted for years. No. 02 Civ. 6513, 2004 WL 2712197, at *2–3 (S.D.N.Y. Nov. 23, 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 found that, while solvency was a question of fact ordinarily reserved for trial, 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. 2004 WL 2712197, at *2–3; *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).

less attention from courts than the subtest provisions of section 548(a)(1)(A) and (B). However, BAPCPA made two notable changes to the prefatory language, which are discussed below.[24]

The first change relates to insider employment contracts.[25] After the term "transfer" in section 548(a)(1), BAPCPA added "including any transfer to or for the benefit of an insider under an employment contract." As "transfer" is already broadly defined in the Bankruptcy Code,[26] the additional language with respect to transfers to insiders arguably does nothing other than indicate that Congress has taken notice of perceived abuse in the realm of executive compensation, something that could have been communicated in legislative history to BAPCPA.

BAPCPA also extended the look-back period contained in the introductory language of section 548(a)(1) from one to two years.[27]

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[24]In addition to these direct changes, BAPCPA changed other Bankruptcy and United States Code provisions governing actions under section 548. One significant change relates to the venue of avoidance actions. *See* 28 U.S.C.A. § 1409(a). Unless de minimus, all such actions may be brought where the bankruptcy case is venued. 28 U.S.C.A. § 1409(a). For de minimus actions, however, 28 U.S.C.A. § 1409(b) 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. Adjusted at three-year intervals, the current dollar amounts became effective on April 1, 2013. The present threshold for property or money judgments is $1,250, the threshold for consumer debts is $18,675 and the threshold, added by BAPCPA, for nonconsumer debts against noninsiders is $12,475.

[25]The Bankruptcy Code does not contain an exhaustive definition of the term "insider." *See* 11 U.S.C.A. § 101(31) (listing entities that are "included" within the scope of the term "insider," based on the debtor's status as an individual, corporation, partnership, or municipality). A court has described the determination of what constitutes an insider under the Bankruptcy Code as "flexible and not amenable to precise formulation." *See In re TSIC, Inc.*, 428 B.R. 103, 111 (Bankr. D. Del. 2010). The question involves both law and fact. *In re Winstar Communications, Inc.*, 554 F.3d 382, 394, 51 Bankr. Ct. Dec. (CRR) 45, Bankr. L. Rep. (CCH) P 81408 (3d Cir. 2009); *see also In re U.S. Medical, Inc.*, 531 F.3d 1272, 1275, 50 Bankr. Ct. Dec. (CRR) 57, 59 Collier Bankr. Cas. 2d (MB) 1900, Bankr. L. Rep. (CCH) P 81275 (10th Cir. 2008).

[26]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 of transfer 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 of title, because possession, custody, and control are interests in property.' " (quoting S. Rep. No. 95-989, at *27 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5811 to 14)). *See generally* 2 Collier on Bankruptcy ¶ 101.54 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013).

[27]*See* 11 U.S.C.A. § 548(a)(1).

The look-back is augmented by the operation of sections 546(a)[28] and 544(b)(1) of the Bankruptcy Code,[29] 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.[30] Courts have "collapsed" a series of related

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[28]Section 546(a) governs the timing for commencing certain actions arising under Chapter 5 of the Bankruptcy Code and provides:

> (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); or
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> (2) the time the case is closed or dismissed.

11 U.S.C.A. § 546(a)(1). The United States Court of Appeals for the Eighth Circuit has examined the two-year period of section 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." *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).

[29]Section 544(b)(1) provides:

> 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 Moore*, 608 F.3d 253, 259–61, 53 Bankr. Ct. Dec. (CRR) 68, Bankr. L. Rep. (CCH) P 81781 (5th Cir. 2010) (explaining that a trustee's successor rights arise under federal law (i.e., section 544), but the extent of those rights depends entirely on applicable law (i.e., the applicable state law fraudulent conveyance statute)). At least one bankruptcy court has concluded that the federal look-back period under section 548(a)(1) does not preempt the applicable state fraudulent transfer look-back period. *See In re Supplement Spot, LLC*, 409 B.R. 187, 197–99 (Bankr. S.D. Tex. 2009).

[30]All but a handful of states have adopted the Uniform Fraudulent Transfer Act of 1984 ("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) (examining both the Maine Uniform Fraudulent Transfer Act and section 548 and determining 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). Constructively fraudulent transfers are also typically subject to the four year look-back. *See* UFTA § 9(b). Alaska, Kentucky, Louisiana, Maryland, New York, South Carolina and Virginia have not adopted the UFTA. *See* Legislative Fact Sheet—Fraudulent Transfer Act, National Conference of Commissioners on Uniform State Laws, www.uniformlaws.org (search for "Find an Act" for "Fraudulent

transactions based on the defendant's knowledge of the structure of the entire transaction and whether its components were part of a single scheme, in finding that a look-back period has not expired.[31]

C. *Tests For Actual And Constructive Fraud: Sections 548(a)(1)(A) and (B)*

1. *Actual Fraud*

As noted above, courts addressing claims arising under section 548(a) typically are asked to focus on the tests for "actual" and "constructive" fraud contained in section 548(a)(1)(A) and section 548(a)(1)(B), respectively.[32] When considering claims asserting actual fraud pursuant to section 548(a)(1)(A), most cases address the so-called "badges of fraud" that parties may present as circumstantial evidence to establish fraudulent intent because of the difficulty in proving actual intent to defraud.[33] In recent years, a presumption of actual intent to defraud creditors has been

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Transfer Act"; click "Fraudulent Transfer Act"; then click "Legislative Fact Sheet") (last visited Jan. 15, 2014). As noted, the State of New York has not adopted the Uniform Fraudulent Transfer Act, and its fraudulent conveyance laws have a six-year look-back period. N.Y. C.P.L.R. 213 (McKinney 2014).

[31]For a discussion of the doctrine that permits a court to "collapse" a series of transactions effectuating a fraudulent transfer for the purposes of fraudulent conveyance analysis, see *In re Tronox Incorporated*, 503 B.R. 239, 269 (Bankr. S.D. N.Y. 2013), discussed at length in Section III.C. of this Article.

[32]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, defenses, and remedies (e.g., with respect to the limitations on avoidance contained in sections 546, 548(c), and 550(a) of the Bankruptcy Code).

[33]*See In re Equipment Acquisition Resources, Inc.*, 502 B.R. 784, 790, 58 Bankr. Ct. Dec. (CRR) 19 (Bankr. N.D. Ill. 2013) ("Direct proof of actual intent to defraud is not required—indeed, it would be hard to come by—and a trustee can prove actual intent by circumstantial evidence. Courts often look to 'badges of fraud' as circumstantial evidence." (quoting *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)). The Uniform Fraudulent Transfer Act identifies eleven specific "badges of fraud." For example, the following are recognized as "badges of fraud" under the Oklahoma UFTA:

> (1) the transfer or obligation was to an insider; (2) the debtor retained possession or control of the property transferred after the transfer; (3) the transfer or obligation was disclosed or concealed; (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit; (5) the transfer was of substantially all the debtor's assets; (6) the debtor absconded; (7) the debtor removed or concealed assets; (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (10) the transfer occurred shortly

recognized by many courts presiding over actions seeking to avoid transfers by debtors who operated Ponzi schemes, particularly where the transfers at issue were made in furtherance of the scheme.[34] Efforts to expand the Ponzi scheme presumption have experienced mixed results.[35]

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before or shortly after a substantial debt was incurred; and, (11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

In re Tronox Inc., 429 B.R. 73, 94 (Bankr. S.D. N.Y. 2010) (quoting OKLA. STAT. tit. 24, § 116(b), in ruling on defendants' motion to dismiss). *See e.g., In re Bayou Group, LLC*, 439 B.R. 284, 307 (S.D. N.Y. 2010) (payments to investors in the fund operated as a Ponzi scheme were accompanied by "badges of fraud" sufficient to imply actual intent to defraud on the part of the fund's principals) (*Bayou* was discussed at length in a previous edition of this Article, *see* Maryann Gallagher, Section 548 and 550—Developments in the Law of Fraudulent Transfers and Recoveries, in Norton Ann. Surv. of Bankr. Law 1119, 1147–58 (2011)); *ASARCO LLC v. Americas Mining Corp.*, 396 B.R. 278, 370–395 (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 Operations NY LLC.*, 490 B.R. 84, 94–95 (Bankr. S.D. N.Y. 2013) (denying motion to dismiss after evaluating several badges of fraud as sufficient circumstantial evidence existed to infer that the debtor did not receive any consideration in connection with the challenged transfers).

[34]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 Schneider v. Barnard*, 508 B.R. 533, 542 (E.D. N.Y. 2014); *In re Bernard L. Madoff Inv. Securities LLC*, 2011 WL 3897970, *4 (S.D. N.Y. 2011); *see also* Bayou, 439 B.R. at 294; *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 section 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).

[35]*See American Cancer Soc. v. Cook*, 675 F.3d 524, 526–29 (5th Cir. 2012) (declining to apply the Ponzi scheme presumption in a state law fraudulent transfer context and holding 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); *In re DBSI, Inc.*, 476 B.R. 413, 56 Bankr. Ct. Dec. (CRR) 240 (Bankr. D. Del. 2012) (holding in the motion to dismiss context that, in addition to demonstrating the existence of a Ponzi scheme, the plaintiff was required to

2. *Constructive Fraud*

Parties seeking to avoid transfers as constructively fraudulent must allege both (a) lack of reasonably equivalent value for the transfer and (b) that the debtor was insolvent or financially harmed as a result of the transfer, as described in section 548(a)(1)(B). Numerous decisions 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.[36] A trio of noteworthy decisions aris-

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plead sufficient facts to show that the disputed transfers were made in furtherance of a fraudulent scheme). *But see In re Sentinel Management Group, Inc.*, 728 F.3d 660, 58 Bankr. Ct. Dec. (CRR) 93, 70 Collier Bankr. Cas. 2d (MB) 566, Comm. Fut. L. Rep. (CCH) P 32717 (7th Cir. 2013) (noting that actions which debtor should have known would result in hindering, delaying or defrauding other creditors can satisfy the intent requirement); *In re Pearlman*, 478 B.R. 448 (M.D. Fla. 2012) (holding 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).

[36]Courts have distilled the concept of "reasonably equivalent value" into a two-step analysis. *See In re David Cutler Industries, Ltd.*, 502 B.R. 58, 73 (Bankr. E.D. Pa. 2013) (employing "a two-step process" involving a determination of "(1) whether any value is received, and (2) whether that value was reasonably equivalent to the transfer made." (citing *In re R.M.L., Inc.*, 92 F.3d 139, 29 Bankr. Ct. Dec. (CRR) 591, 36 Collier Bankr. Cas. 2d (MB) 498 (3d Cir. 1996))); *In re Knippen*, 355 B.R. 710, 726 (Bankr. N.D. Ill. 2006), judgment aff'd, 2007 WL 1498906 (N.D. Ill. 2007) (the determination of "reasonably equivalent value" under section 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). However, the question of whether a transfer was made in exchange for "reasonably equivalent value" remains a fact-heavy determination. *See In re American Housing Foundation*, 544 Fed. Appx. 516, 519–20 (5th Cir. 2013) ("The question of reasonable equivalence is largely a question of fact, as to which considerable latitude must be allowed to the trier of the facts." (quoting *In re TransTexas Gas Corp.*, 597 F.3d 298, 306, 52 Bankr. Ct. Dec. (CRR) 199, Bankr. L. Rep. (CCH) P 81684 (5th Cir. 2010))); *In re Kendall*, 440 B.R. 526, 532–34, 64 Collier Bankr. Cas. 2d (MB) 1404, Bankr. L. Rep. (CCH) P 81898 (B.A.P. 8th Cir. 2010) (holding the question of receipt of reasonably equivalent value is "a factual determination" and finding that 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"). The factual nature of the analysis is evidenced by recent decisions. *See, e.g.*, *In re Northlake Foods, Inc.*, 518 Fed. Appx. 604 (11th Cir. 2013) (dividend payment by subchapter S corporation pursuant to a shareholder agreement whereby the shareholder agreed to pay its share of the corporation's taxes was made in exchange for "reasonably equivalent value" under section 548(a)(1)); *In re Old Carco LLC*, 509 Fed. Appx. 77 (2d Cir. 2013) (holding that a liquidation trust applied implausible values to a subsidiary and ignored other assets that clearly had value, thus failing to plausibly allege that

ing from the bankruptcy cases of TOUSA, Inc. ("TOUSA") and analyzing "reasonably equivalent value," including indirect value, were discussed at length in a previous edition of this Article.[37]

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the debtor received less than reasonably equivalent value under section 548(a)(1)(B)); *In re Perry H. Koplik & Sons, Inc.*, 499 B.R. 276 (S.D. N.Y. 2013), aff'd, 2014 WL 2109064 (2d Cir. 2014) (loan forgiveness for CEO not reasonably equivalent value); *In re TOUSA, Inc.*, 444 B.R. 613, 660 (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) (" a settlement which would avoid default and produce a strong synergy for the enterprise, would suffice to confer ' value' so long as that expectation was legitimate and reasonable"); *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) (finding that 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). Indirect economic benefits can be considered "reasonably equivalent value." *See In re Whyco Finishing Technology, LLC*, 500 B.R. 517, 531 (Bankr. E.D. Mich. 2013) ("[I]ndirect economic benefit can be considered "value" received by the parent company for purposes of determining if the parent company received "reasonably equivalent value" in exchange for making a transfer or incurring an obligation.").

[37] *See* Maryann Gallagher, Section 548 and 550—Recent Developments in the Law of Fraudulent Transfers and Recoveries, in Norton Ann. Surv. of Bankr. Law 1025, 1055–76 (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 financed a settlement of this litigation by causing TOUSA and its subsidiaries to borrow approximately $500 million in new secured debt 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 indebtedness. Although the principles intended 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. Soon after the bankruptcy filing, the official committee of unsecured creditors appointed in the bankruptcy cases commenced an adversary proceeding to avoid, as constructively fraudulent transfers, the liens and guaranties conveyed to finance the settlement, and to recover the proceeds transferred to the Transeastern Lenders. The bankruptcy court ruled for the committee and the district court reversed. *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). On appeal, the Court of Appeals for the Eleventh Circuit reversed the district court and found that the bankruptcy court did not clearly err when it found that the subsidiaries did not receive reasonably equivalent value when they conveyed the liens to finance the settlement. *See* TOUSA, 680 F.3d at 1311–13. The Eleventh Circuit stated that it need not address the question of

In addition to demonstrating lack of reasonably equivalent value for the transfers, the trustee must satisfy one of the four remaining subtests of section 548(a)(1)(B) in order to avoid the transfer as constructively fraudulent for purposes of section 548(a)(1)(B). The first three of the remaining prongs of section look to the debtor's solvency or financial condition as a result of an allegedly constructive fraudulent transfer for less than "reasonably equivalent value." Decisions addressing these prongs related to the debtor's financial condition are fact intensive and often rely heavily on expert testimony.[38]

The last prong of section 548(a)(1)(B) is aimed at extraordinary transfers to insiders under employment contracts. This subclause (IV) was added by BAPCPA,[39] and targets transfers relating to insiders made "under an employment contract and not in the ordinary course of business" as an additional category of constructively fraudulent transfer.[40] Although case law regarding section 548(a)(1)(B)(ii)(IV) is sparse, consistent with a general

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whether the bankruptcy court erred when it adapted a narrow definition of "value," because the record supported the bankruptcy court's conclusion that, regardless of whether avoidance of bankruptcy constituted value to the subsidiaries, any value provided to the subsidiaries was far outweighed by the costs of the transactions at issue. TOUSA, 680 F.3d at 1311.

[38]*See In re Blixseth*, 489 B.R. 154, 186–87 (Bankr. D. Mont. 2013) ("under the plain language of §§ 548(a)(1)(B)(ii)(I) and 101(32), this Court must assign a value to Debtor's assets and liabilities and then determine whether the value of Debtor's assets exceeded her liabilities"); Operations NY, 490 B.R. at 98 ("Under . . . Bankruptcy Code § 548(a)(1)(B)(ii)(II) . . . facts supporting the allegation that at the time of the transfers, the Debtor was engaged in . . . a transaction that would leave it with unreasonably small capital . . . include the transferor's debt to equity ratio, historical capital cushion, and the need for working capital in the transferor's industry."); *see*, *e.g.*, *In re Tronox Incorporated*, 503 B.R. 239, 323 (Bankr. S.D. N.Y. 2013) (consulting a variety of expert testimony analyzing facts relevant to whether a debtor "intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due" under the Oklahoma Uniform Fraudulent Conveyance Act).

[39]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").

[40]*See In re TSIC, Inc.*, 428 B.R. 103, 109–110 (Bankr. D. Del. 2010) (noting that BAPCPA's amendment to section 548 enhanced the "ability to recover avoidable transfers and excessive prepetition compensation, such as loans and bonuses paid to corporate insiders of a debtor.").

wariness of transfers to insiders on the eve of bankruptcy, courts have interpreted the "ordinary course" exception narrowly.[41]

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

Section 548 contains a number of provisions *other than* the actual and constructive fraud tests in section 548(a)(1). Section 548(a)(2), for example, codifies the Charitable Donation Act, which was enacted in 1998 to prevent a bankruptcy trustee from challenging a good faith charitable gift as a constructively fraudulent transfer.[42] Section 548(a)(2) provides:[43]

> (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; or
>
> (B) the contribution made by a debtor exceeded the percentage amount of gross annual income specified in subparagraph (A), if the transfer was consistent with the practices of the debtor in making charitable contributions.

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[41] *See In re M. Davis Management, Inc.*, 55 Bankr. Ct. Dec. (CRR) 87, 2011 WL 3585821 (Bankr. M.D. Fla. 2011) (granting summary judgment in favor of a reorganized debtor who sought to avoid prepetition transfers made pursuant to multiple service contracts from the pre-bankruptcy company to its former CEO); TSIC, 428 B.R. at 109–110 (holding that a severance payment was outside the ordinary course of the debtor's business because the settlement agreement granting the severance was not executed until five years after the corresponding employment agreement and no other director, officer or employee received a severance payment upon termination); *cf. In re Adam Aircraft Industries, Inc.*, 493 B.R. 834 (Bankr. D. Colo. 2013), aff'd, 510 B.R. 342, 59 Bankr. Ct. Dec. (CRR) 142 (B.A.P. 10th Cir. 2014) (by analogy, court held that the "ordinary course" exception should be narrowly construed in a preference action brought under section 547).

[42] *See* 5 Collier on Bankruptcy ¶¶ 548.09[6][a], 548.100–01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013).

[43] 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 section 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) (reviewing various state and federal definitions of "income" and "gross annual income" for purposes of calculating gross annual income under section 548(a)(2)(A)).

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).[44]

Courts reviewing claims alleged under section 548(a)(2)(A) have concluded that the 15% of gross annual income ("GAI") limit in the section is, in essence, a qualifying criterion for a transfer, not a measuring device for propriety.[45] Thus, if a transfer exceeds the 15% mark, even by a cent, the entire transfer will not be afforded the protections of section 548(a)(2)(A).[46]

Another potential issue raised by section 548(a)(2) is that, as

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[44]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 Bankruptcy Appellate Panel for the Ninth Circuit, "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 section 548(a)(2) to provide guidance for a Chapter 13 plan). *See generally In re Meyer*, 467 B.R. 451, 458–59, 67 Collier Bankr. Cas. 2d (MB) 406 (Bankr. E.D. Wis. 2012) (discussing Charitable Donation Act amendments to section 544 and section 548(a)(2) in light of Congressional policy that "religious and social values not be interpreted to the detriment of debtors who practice them" and "provide[] certain protections to donations by debtors to churches and charities."). Courts have found that section 548(a)(2) is constitutional and does not violate the First Amendment. *See In re Witt*, 231 B.R. 92, 97–100, 34 Bankr. Ct. Dec. (CRR) 22 (Bankr. N.D. Okla. 1999) (finding that section 548(a)(2) does not violate the First Amendment); *see also Universal Church v. Geltzer*, 463 F.3d 218, 221, Bankr. L. Rep. (CCH) P 80725, 36 A.L.R. Fed. 2d 649 (2d Cir. 2006) (holding that avoidance of contributions to religious organizations does not violate the Free Exercise and Establishment clauses of the First Amendment).

[45]*In re McGough*, 737 F.3d 1268, 1277, 58 Bankr. Ct. Dec. (CRR) 254, Bankr. L. Rep. (CCH) P 82553 (10th Cir. 2013); *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). For a discussion of the holding in *McGough*, which relied upon a plain language reading of section 548(a)(2), see *infra* Section III.E.

[46]Such a transfer still may be afforded protection under section 548(a)(2)(B), if consistent with the debtor's past practice of giving. *See* McGough, 737 F.3d at 1277 (emphasizing that transfers above 15% of GAI may nevertheless be protected as within the ordinary tithing practices of the debtor under section 548(a)(2)(B)). Furthermore, as an initial matter, the trustee bears the burden of demonstrating that a transfer is avoidable as constructively fraudulent, including that the debtor did not receive reasonably equivalent value in exchange for

drafted, it appears to apply to single transfers.[47] Thus, while a single transfer alone may not exceed the limitation, aggregated transfers by a debtor within a single year may do so. The language of this section calls into question whether they would still be afforded protection.[48]

A court that considered what was required for a charitable contribution to be "consistent with the practices of the debtor" in order to receive shelter under section 548(a)(2)(B) determined that a $20,000 donation was inconsistent with past practices when the debtor's largest previous donation was $2,000, and exceeded annual cumulative donations in past years.[49] One should also note that in order to invoke the protections of the Charitable Donation Act in this regard, the debtor must be a "natural person."[50]

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

Section 548(b) sets forth provisions authorizing the trustee of a partnership debtor to avoid transfers to general partners of the debtor,[51] and is rarely litigated.[52]

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the donation. Based upon the language of section 548(a)(2)(B), it appears that actually fraudulent transfers are not protected by the Charitable Donation Act.

[47]For a discussion of whether a trustee should be permitted to aggregate transfers for the purposes of section 548(a)(2), *see In re Zohdi*, 234 B.R. 371, 380 n.20, 34 Bankr. Ct. Dec. (CRR) 609, 42 Collier Bankr. Cas. 2d (MB) 453 (Bankr. M.D. La. 1999).

[48]Note that in *McGough*, the bankruptcy court aggregated the transfers, but this issue was not appealed by the parties. *See* McGough, 737 F.3d at 1272. *Compare Geltzer*, 463 F.3d at 223–24 (finding the text of section 548(a)(2) to be ambiguous in light of section 102(7) and looking to the legislative history of the Charitable Donation Act to hold that section 548(a)(2) requires "consideration of the debtor's aggregate annual contributions, not each individual contribution"), *cert. denied* 549 U.S. 1113 (2007), *with* Zohdi, 234 B.R. at 380 n.20 (explaining, in dicta, that section 548(a)(2) "probably requires a trustee to make a transfer-by-transfer determination, as opposed to allowing a trustee to aggregate transfers" and that other sections of the Bankruptcy Code use phrases such as "aggregate value of all property . . . affected by such transfer").

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

[50]11 U.S.C.A. § 548(d)(3)(A). *See In re C.F. Foods, L.P.*, 280 B.R. 103, 111 n.17 (Bankr. E.D. Pa. 2002) (explaining that defendant religious organization was unable to assert a section 548(a)(2) defense to an avoidance action brought by a Chapter 7 trustee for a limited partnership).

[51]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

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

Section 548(c) contains a "savings clause" that grants transferees, who take "for value and in good faith" and would otherwise be subject to section 548 avoidance,[53] lien rights, retained interests or enforcement rights, as the case may be, in the interest transferred or obligation incurred to the extent of the value[54]

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or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

11 U.S.C.A. § 548(b).

[52]*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 section 548(b) may retain the payments if the criteria of section 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 section 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).

[53]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).

[54]Value for purposes of section 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); *see also In re Akanmu*, 502 B.R. 124, 131, 70 Collier Bankr. Cas. 2d (MB) 1361 (Bankr. E.D. N.Y. 2013) ("transfers that satisfy, discharge, or secure all or part of an obligation of the transferor are for value"); *In re Waterford Wedgwood USA, Inc.*, 500 B.R. 371, 381, 58 Bankr. Ct. Dec. (CRR) 194 (Bankr. S.D. N.Y. 2013) ("A guaranty is an antecedent debt, and thus courts recognize that payment on account of a pre-existing guaranty constitutes value."). Courts have held that the value requirement of section 548(c) is equivalent to the notion of "reasonably equivalent value" found in section 548(a)(1)(B). *See*, *e.g.*, *In re Rosen Auto Leasing, Inc.*, 346 B.R. 798, 805–06, 46 Bankr. Ct. Dec. (CRR) 235 (B.A.P. 8th Cir. 2006) (holding that where a transferee did not give value for the purposes of section 548(a)(1)(B), the transferee "likewise did not give value for the purposes of asserting a defense under § 548(c)"); *see also In re Petters Co., Inc.*, 499 B.R. 342, 361, 58 Bankr. Ct. Dec. (CRR) 175 (Bankr. D. Minn. 2013) ("The payment of principal constitutes 'value' for the purposes of 11 U.S.C. § 548(c) . . . in the very same way as it does for § 548(a)(1)(B)(i)"). The arm's-length nature of a transaction is regularly cited as evidence of "value," but may not be dispositive. *See In re Vaughan Co., Realtors*, 493 B.R. 597, 58 Bankr. Ct. Dec. (CRR) 11 (Bankr. D. N.M. 2013) (discussing the arm's-length nature of a transaction as one of several factors to

given in exchange for such transfer or obligation.[55] Once the trustee has met its burden of showing a transfer made with the required intent, the defendant-transferee has the burden of demonstrating its good faith and value to gain the protection of the savings clause found in section 548(c).[56] The defense provided by section 548(c) has been the topic of much litigation.[57]

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be considered when determining if a particular transfer was made for "value" for the purposes of section 548(c)); *In re Rothstein Rosenfeldt Adler, P.A.*, 483 B.R. 15, 57 Bankr. Ct. Dec. (CRR) 88 (Bankr. S.D. Fla. 2012) (same); *see also In re e2 Communications, Inc.*, 320 B.R. 849, 858, 43 Bankr. Ct. Dec. (CRR) 277 (Bankr. N.D. Tex. 2004) ("the existence of arm's length negotiations is not dispositive"). *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 transaction with a pawnbroker even though the debtor received less than reasonably equivalent value in exchange for the transfer).

[55]A finding of good faith is generally a question of fact and is subject only to clear-error review on appeal. *See Gold v. Gateway Bank, FSB*, 539 Fed. Appx. 67 (4th Cir. 2013) (upholding lower court's good-faith finding as not "clearly wrong" because the transferee-bank had no actual notice of fraud and followed its own routine business practices within industry standard in its handling of the transfers at issue); *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); *In re Bayou Group, LLC*, 439 B.R. 284, 310–12 (S.D. N.Y. 2010) (collecting cases). The good faith element of section 548(c) relates not to the debtor-transferor's fraudulent intent, but to the defendant-transferee's good faith. *See In re Lydia Cladek, Inc.*, 494 B.R. 555, 561 (Bankr. M.D. Fla. 2013) (holding that a section 548(c) good faith defense relates not to the issue of the debtor-transferor's fraudulent intent, but to the defendant-transferee's good faith, so even if a plaintiff can show that the Ponzi scheme presumption applies, courts must nevertheless assess the good or bad faith of the transferee to determine whether the payments are avoidable).

[56]*See* Bayou, 439 B.R. at 308 (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 generally* 5 Collier on Bankruptcy ¶¶ 548.09[2][c], 548.11[1][b][iii] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013).

[57]*See*, *e.g.*, *In re Taneja*, 743 F.3d 423, 429, 59 Bankr. Ct. Dec. (CRR) 32 (4th Cir. 2014) (utilizing an objective good-faith standard to determine that a bank employee's testimony provided competent objective evidence that satisfied the bank's burden of proving its affirmative defense under section 548(c)); *In re American Housing Foundation*, 544 Fed. Appx. 516, 518 (5th Cir. 2013) (holding section 548(c) inapplicable because the transaction in question was structured so that the appellant could post $15 million in losses and thereby claim $3 million in illegal tax benefits). The savings clause contained in section 548(c) is regularly raised as a defense to fraudulent transfer claims by investors in Ponzi schemes. In the *Madoff* cases, the United States District Court for the District of New York concluded that "it was clear that the principal invested by any of

G. *Section 548(d): Definitions*

Section 548(d) provides guidance regarding when a transfer is deemed to occur, as well as the definitions of "transfer," "value," "charitable contribution," "qualified religious or charitable entity or organization," and certain other terms relating to securities transactions.[58] Except for the safe harbor provision contained in section 548(d)(2),[59] which has been contested on several occasions,[60] section 548(d) is rarely the subject of litigation.[61]

Madoff's customers 'gave value to the debtor' " for the purposes of section 548(c) and that principal invested could not be subject to recovery absent a showing of bad faith on the part of the customers. *Picard v. Katz*, 462 B.R. 447, 453, 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) (quoting 11 U.S.C. § 548(c)). In contrast, with respect to the recovery of "profits" paid to customers, the court concluded that such profits were presumptively in excess of any value provided by the customer, irrespective of a customer's good or bad faith. In re Bernard Madoff Inv. Sec. LLC, 462 B.R. at 453. After granting the trustee's motion for summary judgment with respect to the customer's profits, the court indicated that the "principal issue remaining for trial" was whether the customers had invested their principal in good faith during the two years prior to bankruptcy or whether they had "willfully blinded themselves to Madoff's Ponzi scheme." *Picard v. Katz*, 2012 WL 691551, *2 (S.D. N.Y. 2012); *see also* Lydia Cladek, 494 B.R. at 561 (denying Ponzi scheme investors' motion for summary judgment because genuine disputes of material fact existed as to whether the investors received the transfers for value and in good faith); *In re Dreier LLP*, 462 B.R. 474, 487 (Bankr. S.D. N.Y. 2011) (denying Ponzi scheme investors' motion to dismiss section 548(a) avoidance action because elements of "value" and "good faith" required to assert a valid section 548(c) defense had not been established); *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) (denying Ponzi scheme investors' motion to dismiss a section 548(a) avoidance action because the trustee had sufficiently alleged that the investors " had notice of fraud and were cognizant of the irregularities in their own [investment advisory accounts]. ").

[58]BAPCPA modified section 548(d) in a manner consistent with the changes to section 546 noted below, namely, to add "financial participant" to the list of entities that take "for value" with respect to certain securities transactions, and to add section 548(d)(2)(E) which, in parallel to the addition of section 546(j), includes "master netting agreements" as a type of transfer that is statutorily "for value." *See* 11 U.S.C.A. § 548(d)(2)(B) to (E).

[59]These provisions shelter certain transfers involving commodity brokers, forward contract merchants, stockbrokers, financial institutions, financial participants, repo participants, swap participants, and securities clearing agencies. *See* 11 U.S.C.A. § 548(d)(2)(B) to (D).

[60]*See, e.g.*, *In re National Gas Distributors, LLC*, 556 F.3d 247, 51 Bankr. Ct. Dec. (CRR) 56, 61 Collier Bankr. Cas. 2d (MB) 747, Bankr. L. Rep. (CCH) P 81417 (4th Cir. 2009) (holding that to be included in the definition of "swap agreements" for the purposes of section 548(d)(2)(D), a "commodity forward

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

Section 548(e) addresses transfers to asset protection trusts.[62] The provision was added by BAPCPA and was intended to curb efforts by several states to exempt self-settled trusts from bankruptcy treatment. Under section 548(e), a trustee can avoid a debtor's transfer of an interest in property made within ten years of the bankruptcy filing if the transfer was made to a self-settled trust or similar device by the debtor for the benefit of the debtor

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agreement" need not be traded on an exchange or in a financial market and may involve physical delivery of the commodity to an end user); *In re Paramount Citrus, Inc.*, 268 B.R. 620, 624–26 (M.D. Fla. 2001) (holding that section 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, 44 U.C.C. Rep. Serv. 2d 1125 (S.D. N.Y. 2001) (holding that for the purposes of section 548(d)(2)(A), the term "value" would "exclude future considerations, at least to the extent they remain unperformed.").

[61] *See, e.g.*, *In re Waterford Wedgwood USA, Inc.*, 500 B.R. 371, 381, 58 Bankr. Ct. Dec. (CRR) 194 (Bankr. S.D. N.Y. 2013) (citing to section 548(d)(2)(A) for the definition of "value" in connection with a dispute over the meaning of "reasonably equivalent," which is not defined in the Bankruptcy Code); *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) (citing to section 548(d)(1) to determine when a transfer is deemed to occur, though the issue was not contested by the parties); *Anand v. National Republic Bank of Chicago*, 239 B.R. 511, 517, 42 Collier Bankr. Cas. 2d (MB) 1528 (N.D. Ill. 1999) (citing to section 548(d)(2)(A) for the proposition that collateralization of an antecedent debt may confer value on the debtor).

[62] 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;
>
> (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).

and the transfer was made with the actual intent to hinder, delay or defraud any creditor. This section targets persons who seek to use self-settled trusts to avoid paying creditors. A self-settled trust was commonly referred to as the "millionaire's loophole."[63]

The methodology of section 548(e) stems from the language of section 541 of the Bankruptcy Code, which identifies property of the debtor's estate.[64] Under section 541(c)(2), restrictions on the transfer of beneficial interests in trusts "enforceable under applicable non-bankruptcy law" are made enforceable in a bankruptcy case.[65] At one time, it was feared that the ability to exclude property of this nature from the debtor's estate would permit wealthy individuals to shield substantial assets from creditors, even after filing for bankruptcy.[66] 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 ten years of the filing if the transfer was made by the debtor to a self-settled trust or similar device for the benefit of the debtor and the transfer was made with the actual intent to hinder, delay or defraud any creditor.[67]

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[63]The language in section 548(e) was chosen over competing changes introduced in the House of Representatives under the title of the "Billionaire's Loophole Elimination Act." *See* H.R. 1278, 109th Cong. (2005).

[64]11 U.S.C.A. § 541.

[65]11 U.S.C.A. § 541(c)(2).

[66]Five states (Alaska, Delaware, Nevada, Rhode Island and Utah) enacted such laws between 1997 and the implementation of BAPCPA. *See* Gretchen Morgenson, Proposed Law on Bankruptcy Has Loophole, N.Y. Times, Mar. 2, 2005. Fifteen states have now enacted laws providing for so-called "asset protection trusts." *See* Steven Casselberry, When DAPTs Protect Assets, Lenders Must Be Wary, RMA Journal (Sept. 2013).

[67]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 section 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 section 548(e) has been discussed in several cases. *See In re Huber*, 493 B.R. 798, 814 (Bankr. W.D. Wash. 2013) (permitting a trustee to avoid a transfer into an asset protection trust because, inter alia, the debtor had failed "to present any plausible reason to create a self-settled asset protection trust other than to shield assets from creditors"); *In re Mortensen*, 2011 WL 5025249, *6-8 (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 § 548(e)); *In re Mastro*, 465 B.R. 576, 620 (Bankr.

I. *Protections Against Avoidance for Financial Contracts*

BAPCPA made a number of changes affecting the treatment of financial contracts in the context of avoidance actions under section 548 and related sections of the Bankruptcy Code, and section 546 in particular. With these changes,[68] transfers that are margin or settlement payments 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 made in connection with a repurchase agreement made by or to or for the benefit of a repurchase participant[69] or financial participant; may be avoided only if actually fraudulent under section 548(a)(1)(A), and not if they are merely constructively fraudulent under section 548(a)(1)(B).[70] The same treatment applies to transfers made in connection with any swap agreement by or to

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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 section 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).

[68]BAPCPA added "financial participant" to the list of entities eligible for the protection of the safe harbors provided for certain securities and financial transactions by section 546. *See* 11 U.S.C.A. § 546(e) to (g); *see also* 11 U.S.C.A. § 101(22A) (defining "financial participant").

[69]*See* 11 U.S.C.A. § 546(f) (providing safe harbor relating to transfers to or by (or for the benefit of) a repo participant or financial participant in connection with repurchase agreements). BAPCA added "financial participant" to this group.

[70]*See, e.g.*, *Picard v. Katz*, 462 B.R. 447, 452, 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) (holding that section 546(e) "precludes the Trustee from bringing any action to recover from any of [the transferees of settlement payments] any of the monies paid by [the debtor] to those [transferees] except in the case of actual fraud"); *see also 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) (holding that prepetition payments made to redeem, prior to maturity, commercial paper were "settlement payments" and thus were protected from avoidance under section 546(e)); *In re QSI Holdings, Inc.*, 571 F.3d 545, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009) (holding that nothing in the text of section 546(e) precluded its application to settlement payments involving privately held securities).

or for the benefit of a swap participant or financial participant[71] and transfers made by or to or for the benefit of a master netting participant under or in connection with any master netting agreement or any individual contract covered thereby.[72] As the 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)[73] and the inclusion of "master netting agreements" to the various types of financial contracts that are afforded the same protection.[74]

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.[75] These changes aimed to "reduce systemic risk by providing greater clarity to the rights available to larger participants in markets."[76] 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[77] by making it clear that such netting may be for value under section 548(d)(2).

The treatment of financial contracts under section 548 of the

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[71] *See* 11 U.S.C.A. § 546(g) (providing safe harbor for transfer to or by (or for the benefit of) a swap participant or a financial participant in connection with a swap agreement). BAPCPA added "financial participant" to this group.

[72] *See* 11 U.S.C.A. § 546(j) (providing safe harbor for transfers involving master netting agreements).

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

[74] 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").

[75] 11 U.S.C.A. § 101(22A)(A) (defining "financial participant").

[76] *See* Michael Krimminger, Adjusting the Rules: What Bankruptcy Reform Will Mean for Financial Market Contracts (Dec. 2005), available at http://ssrn.com/abstract=869431 (last visited May 8, 2014).

[77] *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").

Bankruptcy Code was further modified by the passage of the Financial Netting Improvement Act of 2006 (the "2006 Act") 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.[78] The updates and revisions to the descriptions of certain financial transactions were intended to better reflect current market and regulatory industry practice.[79] Notably, in addition 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.[80] The 2006 Act also clarified and expanded the scope of the section 546(e) safe harbor by adding the phrase "or for the benefit of" in connection with the list of protected parties and by including within the scope of the safe harbor transfers made in connection with a "securities contract."[81] Similar expanded protections were made available to repurchase agreement participants, swap participants, and master netting agreement participants.[82] The protec-

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[78] *See* Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5, 120 Stat. 2692, 2695 to 98 (2006). Section 546(e) now 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).

[79] *See* Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, 120 Stat. 2692 (2006). The Financial Netting Improvement Act of 2006 also amends provisions of the Bankruptcy Code to conform to parallel provisions in the Federal Deposit Insurance Act and the Federal Credit Union Act.

[80] *See* Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5, 120 Stat. 2692, 2695 to 98 (2006).

[81] *See* 11 U.S.C.A. § 546(e); *see also* Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5, 120 Stat. 2692, 2695 to 98 (2006).

[82] *See* 11 U.S.C.A. § 546(f), (g); *see also* Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5, 120 Stat. 2692, 2695 to 98 (2006).

tions do not encompass "obligations incurred"[83] and will not preclude avoidance actions alleging actual fraudulent transfers brought under section 548(a)(1)(A).[84]

The purpose of sections 546(e) to (g) of the Bankruptcy Code is to preserve the stability of settled security transactions. To this end, courts have broadly interpreted the definition of "settlement payment" in section 546(e).[85] Courts generally agree that payouts to shareholders in leveraged buyouts typically fall within the ambit of section 546(e), even in cases where the shares were privately held.[86] Although certain courts have interpreted section 546(e) narrowly in cases involving Ponzi-schemes,[87] most have

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[83]*Compare* 11 U.S.C.A. § 548(a) ("The trustee may avoid any transfer . . . of an interest of the debtor in property, or any obligation . . . incurred by the debtor . . .."), *with* 11 U.S.C.A. § 546(e) ("[T]he trustee may not avoid a transfer . . ..").

[84]*See* 11 U.S.C.A. § 546(e) ("Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) . . ..").

[85]*See In re Derivium Capital LLC*, 716 F.3d 355, 364, 57 Bankr. Ct. Dec. (CRR) 277 (4th Cir. 2013) (holding that commissions and fees commonly paid to stockbrokers qualified as "settlement payments" under section 546(e)); *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); *In re Magnesium Corp. of America*, 460 B.R. 360, 372 (Bankr. S.D. N.Y. 2011) (holding that a contract for the future purchase or sale of natural gas, a commodity not subject to rules of a contract market or board of trade, could be a "forward contract" for purposes of the statutory "safe harbor" from the trustee's avoidance powers).

[86]*See Grede v. FCStone, LLC*, 746 F.3d 244, 251–52, 59 Bankr. Ct. Dec. (CRR) 65, 71 Collier Bankr. Cas. 2d (MB) 451 (7th Cir. 2014) (noting that the purpose of section 546(e) is to ensure that "honest investors will not be liable if it turns out that a leveraged buyout (LBO) or other standard business transaction technically rendered a firm insolvent." (citing *Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 748, 58 Bankr. Ct. Dec. (CRR) 114, Bankr. L. Rep. (CCH) P 82548 (7th Cir. 2013))); *In re Plassein Intern. Corp.*, 590 F.3d 252, 52 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 81653 (3d Cir. 2009) (holding that leveraged buyout payments to shareholders of acquired corporations were "settlement payments" protected from avoidance); *In re QSI Holdings, Inc.*, 571 F.3d 545, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009) (same); *Contemporary Industries Corp. v. Frost*, 564 F.3d 981, 51 Bankr. Ct. Dec. (CRR) 157, Bankr. L. Rep. (CCH) P 81473 (8th Cir. 2009) (same). *But see In re MacMenamin's Grill Ltd.*, 450 B.R. 414 (Bankr. S.D. N.Y. 2011) (payments that former shareholders in a closely-held corporation received in connection with a leveraged buyout were not "settlement payments" or such as the trustee was statutorily barred from avoiding).

[87]*See In re Slatkin*, 525 F.3d 805, 49 Bankr. Ct. Dec. (CRR) 267, 76 Fed. R. Evid. Serv. 495 (9th Cir. 2008) (holding that the operators of particular Ponzi schemes were not "stockbrokers" for the purpose of section 546(e)); *Wider v.*

held that section 546(e) is fully applicable to settlement transfers made by debtor entities that engaged in fraud.[88] However, at least one court has recently refused to interpret section 546(e) as applicable to actions brought by individual creditors, rather than merely the trustee.[89] The safe harbors for repurchase and swap transactions are guided by many of the same principals.[90]

J. *The Power of Foreign Representatives*

BAPCPA added a new Chapter 15 to the Bankruptcy Code. Its purpose was to incorporate the UNCITRAL Model Law on Cross-

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Wootton, 907 F.2d 570, 24 Collier Bankr. Cas. 2d (MB) 104, Bankr. L. Rep. (CCH) P 73571 (5th Cir. 1990) (same); *see also In re Arbco Capital Management, LLP*, 498 B.R. 32, 58 Bankr. Ct. Dec. (CRR) 158 (Bankr. S.D. N.Y. 2013) (rejecting a general Ponzi-scheme exception to section 546(e), but holding that a defendant could not raise "safe harbor" provision as a defense to constructive fraudulent transfer claims to the extent that the defendant had participated in alleged fraud); *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC*, 2013 WL 1609154, *9 (S.D. N.Y. 2013) (holding that an initial transferee or subsequent transferee cannot prevail on motion to dismiss on the basis of section 546(e) protections where complaint alleged such transferee had actual knowledge of Ponzi scheme transfers).

[88]*See* Somers Dublin, 729 F.3d at 741 (holding that prepetition redemption payments made to investors by Chapter 7 debtor-hedge funds, which were operated as a second-tier Ponzi scheme, fell within the Bankruptcy Code's "safe harbor" exception to the avoidability of settlement payments or transfers made to financial participants in connection with securities contracts); *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 section 741(8)); *Picard v. Katz*, 462 B.R. 447, 451, 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) ("Because Madoff Securities was a registered stockbrokerage firm, the liabilities of customers like the defendants here are subject to the 'safe harbor' set forth in section 546(e) of the Bankruptcy Code.").

[89]*See In re Tribune Co. Fraudulent Conveyance Litigation*, 499 B.R. 310, 58 Bankr. Ct. Dec. (CRR) 134 (S.D. N.Y. 2013) (holding that section 546(e) applies only to a trustee causes of action and does not preempt individual creditors from bringing state-law claims alleging constructive fraudulent transfers, but noting that individual creditors lack standing to bring these claims until the estate representative has abandoned the claims); *cf. U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 892 F. Supp. 2d 805 (N.D. Tex. 2012) (applying section 546(e) to bar state law claims brought by the litigation trust that was the assignee of the bankruptcy trustee's claims).

[90]*See, e.g.*, *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC*, 505 B.R. 135, 142 (S.D. N.Y. 2013) ("Since the securities and swap agreement safe harbors derive from the same statute, many of the principles that guided the Court's decision with respect to section 546(e) apply to its consideration of section 546(g) as well.")

Border Insolvency. Chapter 15 grants specific and limited powers to foreign representatives to avoid fraudulent transfers under section 548 through the inclusion of sections 1521(a)(7)[91] and 1523(a)[92] of the Bankruptcy Code.[93] 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 provisions broadly.[94]

K. *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 authorizes the avoidance of transfers and obligations pursuant to applicable law and frequently serves as a basis for commencing fraudulent transfer actions under state law, in addition to section 548 actions to avoid fraudulent transfers. Under section 544(b)(1) of the Bank-

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[91] 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—
>
> (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)(7).

[92] Section 1523(a) provides in relevant part:

> 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).

[93] A foreign representative may not use sections 548 and 550 in a stand-alone Chapter 15 case, and "may only do so in a case pending or filed under another chapter." *In re AJW Offshore, Ltd.*, 488 B.R. 551, 557 (Bankr. E.D. N.Y. 2013).

[94] AJW Offshore, 488 B.R. at 560 ("Given the broad scope of relief available under Chapter 15, additional exceptions to § 1521(a)(7) should not be implied"). While the avoidance powers listed in section 1521(a)(7) may be unavailable, courts have permitted foreign representatives to bring avoidance actions under foreign law to reach assets located in the United States. *See In re Condor Ins. Ltd.*, 601 F.3d 319, 52 Bankr. Ct. Dec. (CRR) 256, Bankr. L. Rep. (CCH) P 81712 (5th Cir. 2010) (holding that a bankruptcy court has authority to permit avoidance actions under foreign law seeking relief under foreign avoidance law in a Chapter 15 proceeding, regardless of whether a petition under Chapter 7 or Chapter 11 also has been filed); *In re Fairfield Sentry Ltd. Litigation*, 458 B.R. 665, 691 (S.D. N.Y. 2011) (permitting a foreign representative to bring avoidance actions under foreign law); *see also* Gallagher, *supra* note 33, at Section III.D. (discussing *Condor*). For a detailed discussion of *Condor* and *Fairfield*, see Katelyn Trionfetti, Note, *The Use of Foreign Avoiding Powers under Section 1521(a)(7) in Chapter 15 Cases*, 21 Am. Bankr. Inst. L. Rev. 279 (2013).

ruptcy Code, the trustee is granted standing to avoid transfers under applicable non-bankruptcy law.[95] This standing is based on the rights of an actual unsecured creditor, in existence at the time of the filing of the debtor's bankruptcy petition, with an allowable claim against the debtor.[96] This creditor is often referred to as the "triggering" creditor. However, the trustee need not identify the specific creditor into whose shoes he seeks to step.[97]

The existence of a triggering creditor for the purposes of standing to bring an action under section 544(b) is not often litigated, but the topic was discussed at length in Section III.A.3 of last year's edition of this Article[98] in the context of the United States District Court for the Northern District of Texas' decision in

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[95]11 U.S.C.A. § 544(b)(1). For the full text of section 544(b)(1), see *supra* note 29. A recent decision from the United States District Court for the Southern District of New York noted that "Congress did not conceive of the trustee's avoidance power as a severable commodity that could be sliced up by theory and distributed between the trustee and creditors." *In re Tribune Co. Fraudulent Conveyance Litigation*, 499 B.R. 310, 322–23, 58 Bankr. Ct. Dec. (CRR) 134 (S.D. N.Y. 2013). The court noted that several provisions of the Bankruptcy Code, §§ 362(a)(1) and 546(a) in particular, do not distinguish between trustee avoidance actions brought under sectoin 544(b)(1) and those brought under section 548(a)(1). Ultimately, the court found that the automatic stay deprived creditors of standing to bring fraudulent conveyance claims for as long as the trustee was exercising its avoidance powers targeting the same transactions. Tribune Co., 499 B.R. at 322–23.

[96]*See U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 479 B.R. 405 (N.D. Tex. 2012) (holding that the fact that the triggering creditor was not a beneficiary of the litigation trust was of no import, as the trustee's right to avoid a claim was determined as of the petition date, when the triggering creditor's claim was still outstanding); *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) (explaining that trustee must demonstrate that at least one of the present unsecured creditors of the estate holds an allowable claim, against whom the transfer or obligation was invalid under applicable state or federal law).

[97]*In re Equipment Acquisition Resources, Inc.*, 2012 WL 4754764, *4 (Bankr. N.D. Ill. 2012) ("a trustee need not identify the specific creditor whose rights he seeks to assert" (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))).

[98]*See* Gallagher & Saydah, *supra* note 6, at 1012–31.

United States Bank National Ass'n v. Verizon Communications, Inc.[99] In that case, the defendants argued that: (1) the litigation trustee appointed pursuant to the plan of reorganization (the "Plan") stood in the shoes of a "sophisticated financial institution" and not the estate; (2) any recovery on the fraudulent transfer claims would not be for the benefit of the estate because the estate was extinguished upon confirmation of the Plan; (3) the triggering creditor relied upon for section 544 purposes was not a beneficiary of the litigation trust established by the confirmed Plan; and (4) the trustee's recovery on the fraudulent transfer claims would be a "mockery of justice" because it would allow the debtors' banks and bondholders to benefit from claims that they themselves could not have brought.[100]

The *Verizon* court found that: (1) the trustee was validly designated as the estate's representative under the Plan; (2) confirmation of a plan did not extinguish avoidance claims and holding otherwise would preclude avoidance claims from ever being brought postconfirmation; (3) the fact that the triggering creditor was not a beneficiary of the litigation trust was of no import, because the trustee's right to avoid a claim was determined as of the petition date, when the triggering creditor's claim was still outstanding; and (4) the court could not simply ignore the law to achieve a party's desired result.[101] Thus, the *Verizon* court found that the trustee had satisfied the standing requirements to bring the fraudulent transfer claims under section 544.[102]

As noted earlier, the trustee often relies upon state fraudulent transfer law pursuant to section 544(b)(1) because it affords a longer look-back period than provided by section 548 of the Bankruptcy Code. A detailed discussion of state fraudulent transfer law is beyond the scope of this Article, though it is typically substantially similar to section 548. 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.[103]

L. *History and Construction of Section 550*

In enacting the Bankruptcy Code, Congress took steps to elim-

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

[100] *See* Verizon, 479 B.R. at 413–14.

[101] *See* Verizon, 479 B.R. at 413–14 (citing Mirant, 675 F.3d at 530).

[102] *See* Verizon, 479 B.R. at 414–15.

[103] For a discussion of the Uniform Fraudulent Transfers Act, see *supra* note 30.

inate 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.[104] However, under the Bankruptcy Code, sections 544, 545, 547, 548, and 549 govern avoidance while section 550 "alone governs whether, and to what extent, such avoided transfers may be recovered."[105] Thus, section 550 "enunciates the separation between the concepts of avoiding a transfer and recovering from a transferee."[106]

Since its enactment, section 550 has been subject to a number of challenges. The statute has survived challenges based on the "presumption against extraterritoriality."[107] It also has survived at least one sovereign immunity challenge in which the Supreme

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[104]*See* Bankruptcy Act of 1898, 55 Cong. Ch. 541, 30 Stat. 544 (1898) (codified as amended at 11 U.S.C., in various sections of 28 U.S.C., and in scattered sections of other titles) (repealed 1978).

[105]*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).

[106]H.R. Rep. No. 95-595, at 376 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6332); *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) (noting that it is "clear from both the statute itself and from its legislative history" that avoidance and recovery "are distinct concepts and processes."). 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).

[107]The presumption against extraterritoriality "assumes that, unless Congress indicates otherwise, its legislation applies only within the territorial jurisdiction of the United States." *Securities Investor Protection Corporation v. Bernard L. Madoff Inv. Securities LLC*, 480 B.R. 501, 532, 57 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2012) (citing *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 130 S. Ct. 2869, 177 L. Ed. 2d 535, Fed. Sec. L. Rep. (CCH) P 95776, R.I.C.O. Bus. Disp. Guide (CCH) P 11932, 76 Fed. R. Serv. 3d 1330 (2010)). Courts rejecting the presumption have identified clear Congressional intent to permit the application of the Bankruptcy Code abroad. Madoff, 480 B.R. at 523 ("Congress expressed intent for the application of Section 550 to fraudulently transferred assets located outside the United States and the presumption against extraterritoriality does not apply."); *see also In re French*, 440 F.3d 145, 151, 46 Bankr. Ct. Dec. (CRR) 1, 55 Collier Bankr. Cas. 2d (MB) 806 (4th Cir. 2006) ("several indicia of congressional intent rebut the presumption against extraterritoriality") (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 United States Court of Appeals for the Fourth Circuit distinguished the presumption against the 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

Court of the United States 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[108] and that in "ratifying the Bankruptcy Clause [of the U.S. Constitution], the States acquiesced in a subordination of whatever sovereign immunity they might otherwise have asserted in proceedings necessary to effectuate the *in rem* jurisdiction of the bankruptcy courts."[109]

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

Section 550 consists of six major subsections. Section 550(a) sets forth the trustee's general recovery powers as follows:[110]

> (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:

(1991) by examining the language of section 541, which broadly defines the property of the estate as all property "wherever located," and related legislative history, which states "a trustee in bankruptcy is vested with the title of the bankrupt in property which is located without, as well as within, the United States." French, 440 F.3d at 151 (citing H.R. Rep. No. 82-2320, at 15 (1952), reprinted in 1952 U.S.C.C.A.N. 1960, 1976 (the legislative history corresponding to the first statutory use of the phrase "wherever located" to describe property of the estate)). *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 *French*).

[108]*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 bankruptcy jurisdiction "is principally *in rem* jurisdiction" and "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 section 550(a) are themselves properly characterized as *in rem*," the Court noted that "those who crafted the Bankruptcy Clause [of the U.S. Constitution] 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.

[109]Katz, 546 U.S. at 369–70; *see also In re Diaz*, 647 F.3d 1073, 1079, 66 Collier Bankr. Cas. 2d (MB) 214, Bankr. L. Rep. (CCH) P 82044 (11th Cir. 2011) (sovereign immunity generally not a defense to suits to enforce the automatic stay or for suits for violations of the discharge injunction); *Chasensky v. Walker*, 2012 WL 1287659 (E.D. Wis. 2012) (consent by ratification does not apply to suit for violation of section 525, as such an action is not necessary to effectuate the *in rem* jurisdiction of the Code).

[110]11 U.S.C.A. § 550(a)(1) to (2).

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

Section 550(a) permits a trustee to recover property transferred, or the value of such property,[111] "to the extent that" a transfer is avoided.[112] Legislative history indicates that the phrase "to the extent that" was intended "to incorporate the protection of transferees proposed in section 548(c) and 549(b)."[113] Thus, if the underlying avoidance statute contains defenses,[114] those defenses

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[111]While recovery of the property transferred is somewhat straightforward, what constitutes value for the purposes of section 550 is not as clear. Section 550 of the Bankruptcy Code is intended to "restore the estate to the financial condition it would have enjoyed if the transfer had not occurred." *In re Fine Diamonds, LLC*, 501 B.R. 159, 182 (Bankr. S.D. N.Y. 2013), subsequent determination, 501 B.R. 230, 58 Bankr. Ct. Dec. (CRR) 203 (Bankr. S.D. N.Y. 2013), judgment aff'd, appeal dismissed, 510 B.R. 31 (S.D. N.Y. 2014) and judgment aff'd, appeal dismissed, 510 B.R. 31 (S.D. N.Y. 2014); *see also In re Kingsley*, 518 F.3d 874, 877, 49 Bankr. Ct. Dec. (CRR) 167, Bankr. L. Rep. (CCH) P 81115 (11th Cir. 2008) ("Bankruptcy courts have consistently held that 11 U.S.C. § 550 'is designed to restore the estate to the financial condition that would have existed had the transfer never occurred.' " (quoting *In re Sawran*, 359 B.R. 348, 354 (Bankr. S.D. Fla. 2007)). Accordingly, the determination of "value" is necessarily subjective and may vary depending on the facts of a particular case. *See, e.g.*, *In re EBC I, Inc.*, 380 B.R. 348, 364, 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) ("the term 'value' refers to fair market value") (citing 5 Collier on Bankruptcy ¶ 550.02[3][a] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. 2007)); *see also Active Wear, Inc. v. Parkdale Mills, Inc.*, 331 B.R. 669, 673 (W.D. Va. 2005) ("the value which must be assigned to the [property] in this case is the fair market value that could be obtained for the [property] in a liquidation sale"). Some courts have found that the value of the property cannot readily be determined and that "the correct remedy is to return the property, not award and estimate of the value of the property." *In re Taylor*, 599 F.3d 880, 892 (9th Cir. 2010); *see also In re Trout*, 609 F.3d 1106, 1113, 64 Collier Bankr. Cas. 2d (MB) 257, Bankr. L. Rep. (CCH) P 81797 (10th Cir. 2010) ("the language of § 550(a) suggests that the default rule is the return of the property itself, whereas a monetary recovery is a more unusual remedy to be used only in the court's discretion"). Even if the property is amenable to valuation, "the choice of a § 550 remedy remains in the court's discretion." Trout, 609 F.3d at 1113.

[112]11 U.S.C.A. § 550(a).

[113]*See* H.R. Rep. No. 95-595, at 376 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6332.

[114]*See*, *e.g.*, 11 U.S.C.A. §§ 548(c), 546(e) to (j).

will be effective against a recovery action brought under section 550(a).[115]

To recover under section 550(a), the trustee must "avoid" the transfer. The issue of the requirement that a transfer be "avoided" was litigated in several of the *Madoff* adversary proceedings. In one such case, subsequent transferees of Fairfield Sentry, Ltd. and Kingate Global Fund, Ltd.—two of Madoff Securities' largest feeder funds—argued that the trustee had failed to actually avoid the relevant transfers from Madoff Securities, a prerequisite to recovery under section 550(a).[116] There, the court found that the meaning of "avoided" was ambiguous.[117] Looking to the structure and operation of the Bankruptcy Code, the court sided with the majority of courts in holding that a trustee in a given recovery action need only prove that the transfer he seeks to claw back is avoidable.[118] A minority of courts have held that this provision requires an actual adjudicated judgment of avoidance.[119]

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[115]*See*, *e.g.*, *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC*, 505 B.R. 135, 142 (S.D. N.Y. 2013) ("Even though the initial [transferees] who received the transfers at issue did not raise section 546(g) as a defense, the instant defendants are nonetheless entitled to do so in the context of the Trustee's recovery action against them as subsequent transferees."); *In re M. Fabrikant & Sons, Inc.*, 394 B.R. 721, 744, 50 Bankr. Ct. Dec. (CRR) 192 (Bankr. S.D. N.Y. 2008) ("Fundamental principles of due process require that transferees who claim an interest in real property or its proceeds have a full and fair opportunity to contest claims of fraudulent transfer." (quoting *Tanaka v. Nagata*, 76 Haw. 32, 868 P.2d 450, 455 (1994))).

[116]*Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC*, 501 B.R. 26, 58 Bankr. Ct. Dec. (CRR) 177 (S.D. N.Y. 2013); *see also Securities Investor Protection Corporation v. Bernard L. Madoff Inv. Securities LLC*, 480 B.R. 501, 521, 57 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2012) ("rigidly construing Section 550 to require a formal avoidance against [the initial transferee] before permitting recovery from [a subsequent transferee] makes little sense"); *Picard v. Katz*, 466 B.R. 208, 214, 55 Bankr. Ct. Dec. (CRR) 266 (S.D. N.Y. 2012) (holding that section 550(a) permits avoidance of a subsequent transfer where the initial transfer could have been avoided). A more detailed discussion of this issue can be found in last year's edition of this Article. *See* Gallagher & Saydah, *supra* note 6, at 1066–74.

[117]Madoff, 501 B.R. at 31.

[118]Madoff, 501 B.R. at 31. Other cases have held that section 550(a) merely require a transfer to be avoidable. *See 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) (holding 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); *In re Taylor*, 390 B.R. 654, 667 (B.A.P. 9th Cir. 2008), rev'd on other grounds and remanded, 599 F.3d 880 (9th Cir. 2010)(" Once a right to avoid is established, the bankruptcy

Section 550 permits recovery from transferees, but the Bankruptcy Code does not define the term "transferee."[120] To determine whether a particular entity qualifies as a transferee for the purposes of recovery under section 550, courts typically apply either the "dominion" test or the "control" test.[121] Under the "dominion" test, a transferee is one who has "dominion over the money or other asset," and "the right to put the money to one's own purposes."[122] The "control" test, endorsed primarily by the

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court may properly exercise its discretion to give the trustee the form of recovery that would restore the estate to the position it would have been in if the transfer had not occurred and maximize the value returned to the bankruptcy estate. "); *In re AVI, Inc.*, 389 B.R. 721, 732, 50 Bankr. Ct. Dec. (CRR) 39, 59 Collier Bankr. Cas. 2d (MB) 1753 (B.A.P. 9th Cir. 2008) (holding that 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." (relying on Int'l Admin. Servs., 408 F.3d at 708)); *In re Enron Creditors Recovery Corp.*, 388 B.R. 489, 490 (S.D. N.Y. 2008) (incorporating Tr. of Hr'g at 37-38, No. 07-CV-6597 (S.D.N.Y. Apr. 16, 2008), ECF No. 32 (stating, in dictum, that a requirement of a prior avoidance against the initial transferee should generally be the rule, but holding that it was necessary to carve out "an exception where for legal or practical reasons it is impossible or impractical to satisfy the precondition of an avoidance.")). *See generally* M. Fabrikant & Sons, 394 B.R. at 742–46 (discussing the conflict among the courts 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").

[119] *See In re Slack-Horner Foundries Co.*, 971 F.2d 577, 580, Bankr. L. Rep. (CCH) P 74745 (10th Cir. 1992) ("in order to recover from a subsequent transferee the trustee must first have the transfer of the debtor's interest to the initial transferee avoided"); *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) (holding that "before the trustee may obtain an 'actual recovery' from the [subsequent transferees] under § 550(a), he must first avoid the underlying initial transfers.").

[120] *See In re Derivium Capital LLC*, 716 F.3d 355, 362, 57 Bankr. Ct. Dec. (CRR) 277 (4th Cir. 2013) ("The Bankruptcy Code does not define the term 'initial transferee.' "); *In re Agriprocessors, Inc.*, 490 B.R. 374, 384 (Bankr. N.D. Iowa 2013) (noting that section 550 "does not define the term "initial transferee").

[121] *In re Incomnet, Inc.*, 463 F.3d 1064, 1069, 47 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 80717 (9th Cir. 2006) ("two standards to determine whether a party is an 'initial transferee' have emerged: the 'dominion test' and the 'control test.' ").

[122] *See In re National Consumer Mortg., LLC*, 2013 WL 6844494, *3 (D. Nev. 2013) (quoting *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.

United States Court of Appeals for the Eleventh Circuit, is less restrictive and views the transaction in its entirety in order to determine who actually controlled the funds under the circumstances.[123] Every circuit-level court to consider the issue has held that fraudulent transfers "may not be recovered from a transferee who was a mere conduit in the transfer."[124] The term

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Rep. Serv. 2d 469 (9th Cir. 2002)); *In re Trick Technologies, Inc.*, 2013 WL 3865592, *3 (Bankr. D. Colo. 2013) (quoting *In re First Sec. Mortg. Co.*, 33 F.3d 42, 25 Bankr. Ct. Dec. (CRR) 1683, Bankr. L. Rep. (CCH) P 76046 (10th Cir. 1994)); *see also* Derivium Capital, 716 F.3d at 362 ("Under the dominion and control test, an initial transferee must (1) have legal dominion and control over the property—e.g., the right to use the property for its own purpose—and (2) exercise this legal dominion and control.").

[123]*See In re Harwell*, 628 F.3d 1312, 1322, 54 Bankr. Ct. Dec. (CRR) 12, 64 Collier Bankr. Cas. 2d (MB) 1820, Bankr. L. Rep. (CCH) P 81909 (11th Cir. 2010) ("courts must look beyond the particular transfers in question to the entire circumstance of the transactions" (citing *In re Pony Exp. Delivery Services, Inc.*, 440 F.3d 1296, 1302, 46 Bankr. Ct. Dec. (CRR) 24, Bankr. L. Rep. (CCH) P 80465 (11th Cir. 2006))); *In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1199, Bankr. L. Rep. (CCH) P 72363 (11th Cir. 1988) ("The test articulated by our court is a very flexible, pragmatic one; in deciding whether debtors had controlled property subsequently sought by their trustees, courts must look beyond the particular transfers in question to the entire circumstance of the transactions.") (quotations and citations omitted). Although some courts have combined the names of these tests to produce a "dominion and control" test, they typically apply one of the two approaches when analyzing a particular transaction. *See, e.g.*, Derivium Capital, 716 F.3d at 362; *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).

[124]*In re Lyondell Chemical Company*, 503 B.R. 348, 382 (Bankr. S.D. N.Y. 2014), as corrected, (Jan. 16, 2014) ("[E]very Court of Appeals to consider this issue has squarely rejected a test that equates mere receipt with liability, declining to find 'mere conduits' to be initial transferees." (quoting *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*, 130 F.3d 52, 31 Bankr. Ct. Dec. (CRR) 978, 38 Collier Bankr. Cas. 2d (MB) 1851, Bankr. L. Rep. (CCH) P 77560 (2d Cir. 1997))). *See e.g.*, *In re First Sec. Mortg. Co.*, 33 F.3d 42, 44, 25 Bankr. Ct. Dec. (CRR) 1683, Bankr. L. Rep. (CCH) P 76046 (10th Cir. 1994) ("The bank was obligated to make the funds available to Mr. Hobbs upon demand and, therefore, it acted only as a financial intermediary."); *Matter of Coutee*, 984 F.2d 138, 141, 28 Collier Bankr. Cas. 2d (MB) 762, Bankr. L. Rep. (CCH) P 75112 (5th Cir. 1993) (holding that a firm which held funds in a trust account, rather than a business account, was not an initial transferee of the funds because they were held merely in a fiduciary capacity); *In re Bullion Reserve of North America*, 922 F.2d 544, 21 Bankr. Ct. Dec. (CRR) 326, 24 Collier Bankr. Cas. 2d (MB) 698, Bankr. L. Rep. (CCH) P 73771 (9th Cir. 1991) (holding that a director also did not qualify as "immediate or mediate transferee" of initial transferee because no funds were ever under the dominion and control

"mere conduit" describes not a "transferee," but an entity that receives and holds property, but is unable to use it as he or she sees fit.[125]

Once a transfer has been avoided or determined avoidable, the trustee may recover the avoided property "for the benefit of the estate."[126] Most courts view the "benefit of the estate" requirement "broadly,"[127] interpreting the phrase to encompass both direct benefit and indirect benefits to the estate.[128] A recovery is

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of that director); Chase & Sanborn Corp., 848 F.2d at 1199–1200 (observing that "[w]hen trustees seek recovery of allegedly fraudulent conveyances from banks, the outcome of the case turns on whether the banks actually controlled the funds or merely served as conduits"); *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) (the minimum requirement of status as a "transferee" is dominion over the money or other asset, the right to put the money to one's own purposes).

[125]*See In re National Consumer Mortg., LLC*, 2013 WL 6844494, *3 (D. Nev. 2013); *In re Brooke Corp.*, 2012 WL 1759322, *20 (Bankr. D. Kan. 2012) ("An entity that first received an avoided transfer but that does not satisfy the initial transferee test is deemed to have acted as a conduit and not to be strictly liable under § 550(a)."); *In re Bower*, 462 B.R. 347, Bankr. L. Rep. (CCH) P 82143 (Bankr. D. Mass. 2012) (finding that a nominee who held a mortgage on debtor's property on behalf of a note holder was simply a conduit and not an initial transferee). *But see Paloian v. LaSalle Bank, N.A.*, 619 F.3d 688, 692, 53 Bankr. Ct. Dec. (CRR) 155, Bankr. L. Rep. (CCH) P 81840 (7th Cir. 2010) (holding that "an entity that receives funds for use in paying down a loan, or passing money to investors in a pool, is an 'initial transferee' even though the recipient is obliged by contract to apply the funds according to a formula.").

[126]11 U.S.C.A. § 550(a).

[127]*In re C.W. Min. Co.*, 477 B.R. 176, 189, 56 Bankr. Ct. Dec. (CRR) 276, Bankr. L. Rep. (CCH) P 82342 (B.A.P. 10th Cir. 2012), aff'd, 749 F.3d 895, 59 Bankr. Ct. Dec. (CRR) 98, Bankr. L. Rep. (CCH) P 82629 (10th Cir. 2014) ("There is split of authority concerning how broadly to interpret 'for the benefit of the estate.' However, this Court has already established that the phrase should be construed broadly, rather than narrowly, to include indirect benefits."); *U.S. Bank Nat. Ass'n v. Verizon Communications Inc.*, 479 B.R. 405, 414 (N.D. Tex. 2012) ("the court must read the phrase "estate" broadly, to include those standing in the shoes of the bankruptcy estate."); *In re Tronox Inc.*, 464 B.R. 606, 613–14, 55 Bankr. Ct. Dec. (CRR) 269, Bankr. L. Rep. (CCH) P 82166 (Bankr. S.D. N.Y. 2012) ("Faithful to the language of the statute, the courts have given a very broad construction to the phrase 'benefit of the estate.' ").

[128]*See* C.W. Mining, 477 B.R. at 189; Anadarko Petroleum, 464 B.R. at 614 ("Benefit for purposes of § 550 includes both direct benefits to the estate (*e.g.*, an increased distribution) and indirect ones (*e.g.*, an increase in the probability of a successful reorganization)."); *see, e.g.*, *In re Calpine Corp.*, 377 B.R. 808, 813, 48 Bankr. Ct. Dec. (CRR) 278, 58 Collier Bankr. Cas. 2d (MB) 1212 (Bankr. S.D. N.Y. 2007) ("broadly" construing "benefit of the estate" language in § 550 to en-

deemed to benefit the estate even when the benefit inures exclusively to the benefit of secured creditors.[129] Once a benefit to the estate has been identified, the phrase does not operate as a cap on potential liability—the entire transfer may be recovered.[130]

The interplay between recovery of value for avoided transfers pursuant to section 550(a) and the allowance of claims arising from such recovery pursuant to section 502(h)[131] has been a focus

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able recovery "even in cases where distribution to unsecured creditors [pursuant to a plan of reorganization] . . . in no way varies with recovery of avoidable transfers").

[129]*See In re Kraft, LLC*, 429 B.R. 637, 667 (Bankr. N.D. Ind. 2010) ("It is not required that a benefit resulting from an avoidance action only benefit the unsecured creditors: it can accrue to the exclusive benefit of the secured creditors of the estate as well."); *Mellon Bank, N.A. v. Dick Corp.*, 351 F.3d 290, 42 Bankr. Ct. Dec. (CRR) 68, Bankr. L. Rep. (CCH) P 80011 (7th Cir. 2003) (concluding there was a benefit to the estate even though money recovered would go directly to prepetition lenders where the estate gained the indirect benefit of the continuation of the debtor's business pending a sale); *In re Trans World Airlines, Inc.*, 163 B.R. 964, 25 Bankr. Ct. Dec. (CRR) 373 (Bankr. D. Del. 1994) (finding there would be a benefit to the estate even though substantially all of a recovery would go to the postpetition secured creditor because unsecured creditors would benefit from the enhanced value of the reorganized debtor by becoming shareholders). *But cf. In re Residential Capital, LLC*, 497 B.R. 403, 415 (Bankr. S.D. N.Y. 2013) (holding that, in the section 552 context, "the proceeds of avoidance actions belong to the estate" and are not subject to prepetition liens, even though the property that was transferred was subject to liens at the time of the transfer).

[130]*See In re Acequia, Inc.*, 34 F.3d 800, 811, 31 Collier Bankr. Cas. 2d (MB) 1197, Bankr. L. Rep. (CCH) P 76068, 30 Fed. R. Serv. 3d 170 (9th Cir. 1994) ("Courts construe the 'benefit to the estate' requirement broadly, permitting recovery under section 550(a) even in cases where distribution to unsecured creditors is fixed by a plan of reorganization and in no way varies with recovery of avoidable transfers."); *In re DLC, Ltd.*, 295 B.R. 593, 606–07, 41 Bankr. Ct. Dec. (CRR) 122, 50 Collier Bankr. Cas. 2d (MB) 1012 (B.A.P. 8th Cir. 2003), judgment aff'd, 376 F.3d 819, 43 Bankr. Ct. Dec. (CRR) 79, Bankr. L. Rep. (CCH) P 80132 (8th Cir. 2004) (holding that " the trustee may recover the entire fraudulent transfer under section 550(a) " even if such recovery is in excess of " the amount necessary to satisfy the creditor' s claim"); *see also* Anadarko Petroleum, 464 B.R. at 614 ("the 'for benefit of the estate' clause in § 550 sets a minimum floor for recovery in an avoidance action—at least some benefit to the estate—but does not impose any ceiling on the maximum benefits that can be obtained once that floor has been met").

[131]Section 502(h) provides:

> A claim arising from the recovery of property under section 522, 550, or 553 of this title shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

11 U.S.C.A. § 502(h).

of one recent decision that demonstrates that the stakes can be high and the related issues complex.[132]

Section 550(a)(1) states that an avoided transfer may be recovered from the "initial transferee" or "the entity for whose benefit the transfer was made." Although the Bankruptcy Code does not define either "initial transferee" or an "entity for whose benefit the transfer was made," the concept of recovery from an "entity for whose benefit a transfer was made" predates the enactment of section 550(a) and was "was well known to courts at the time the Bankruptcy Code was drafted."[133] Legislative materials indicate that early drafts of the Bankruptcy Reform Act of 1978 did not provide a trustee with the ability to recover from the "entity for whose benefit such transfer was made."[134] The recovery section originally proposed by the Commission on the Bankruptcy Laws of the United States "imposed liability only on initial and subsequent transferees."[135] Not until the bill emerged from conference committee in its final form did the phrase "entity for whose benefit" appear.[136] In adding this provision, Congress noted: (i) that recovery from the beneficiary "is made in addition to a recovery from the initial transferee" and (ii) that "the trustee is entitled to only a single satisfaction."[137] Courts interpreting this language typically require that the entity actually receive a benefit from the transfer.[138]

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[132]*See In re Tronox Incorporated*, 503 B.R. 239, 330–37 (Bankr. S.D. N.Y. 2013) ("Section 502(h) is based on the principle of fraudulent transfer law that the return of a fraudulent transfer restores the parties to the status quo." (quoting *In re Dreier LLP*, 57 Bankr. Ct. Dec. (CRR) 28, 2012 WL 4867376, *3 (Bankr. S.D. N.Y. 2012) (citing *In re Best Products Co., Inc.*, 168 B.R. 35, 57–58 (Bankr. S.D. N.Y. 1994)))).

[133]*See* Larry Chek & Vernon O. Teofan, The Identity and Liability of the Entity for Whose Benefit A Transfer Is Made Under Section 550(a): An Alternative to the Rorschach Test, 4 J. Bankr. L. & Prac. 145, 149 (1995).

[134]*See* 4 J. Bankr. L. & Prac. at 149 ("the early legislative materials contain no reference whatsoever to recovery from beneficiaries").

[135]*See* 4 J. Bankr. L. & Prac. at 149.

[136]*See* 4 J. Bankr. L. & Prac. at 149.

[137]*See* 124 Cong. Rec. 11089 (statement of Rep. Edwards), reprinted in 1978 U.S.C.C.A.N. 6436, 6457; 124 Cong. Rec. 17406 (statement of Sen. DeConcini), reprinted in 1978 U.S.C.C.A.N. 6505, 6527.

[138]*See In re TOUSA, Inc.*, 680 F.3d 1298, 1313, 56 Bankr. Ct. Dec. (CRR) 135, 67 Collier Bankr. Cas. 2d (MB) 1035, Bankr. L. Rep. (CCH) P 82276 (11th Cir. 2012) ("Finding that that the plain language of section 550(a)(1), combined with the language of documents governing the transaction, supported the conclusion that lenders with rights to the proceeds of loans secured by liens granted

N. *Section 550(b): Protection for Subsequent Transferees*

Section 550(b) provides a safe harbor for subsequent transferees who take for value, in good faith, and without knowledge of the voidability of the transfer:

> (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.[139] However, a subsequent transferee may as-

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by subsidiaries to parent who owed amounts to parties receiving loan proceeds were entities 'for whose benefit' certain conveying subsidiaries transferred the liens and therefore recovery of the proceeds was proper."); *In re Dreier LLP*, 452 B.R. 451, 466 (Bankr. S.D. N.Y. 2011) ("The quintessential example of an entity for whose benefit a transfer is made is a guarantor."); *see also 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 section 550(a)(1) could not be had from her for the transfer). *But see In re Richmond Produce Co., Inc.*, 118 B.R. 753, 759 (Bankr. N.D. Cal. 1990) ("recovery of an avoided transfer may be ordered under 11 U.S.C. § 550(a)(1) even though the entity did not actually receive a benefit as a result of the transfer.").

[139] *In re Trick Technologies, Inc.*, 2013 WL 3865592, *4 (Bankr. D. Colo. 2013) ("Congress has already balanced the equitable considerations under § 550 by distinguishing between initial transferees, who are strictly liable, and subsequent transferees, who are not strictly liable." (quoting *Rupp v. Markgraf*, 95 F.3d 936, 944, 29 Bankr. Ct. Dec. (CRR) 834, 36 Collier Bankr. Cas. 2d (MB) 1312 (10th Cir. 1996))); *see also 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) (explaining that a 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) (holding that section 548(c), not

sert a "good faith" and "for value" defense under section 550(b).[140] The good faith requirement is intended to prevent a transferee from "washing" a transaction by "transferring the recoverable property to an innocent transferee, and receiving a retransfer" in exchange.[141] As discussed above, the recovery provisions of section 550 apply only to the extent a transaction is avoidable.[142]

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

Under section 550(c), recovery for a preference may not be received from a non-insider after the 90-day preference window has expired, even if the transfer was made for the benefit of an insider.[143] This section—added by the 1994 Reform Act[144]—effectively overturned the decision of the United States Court of Appeals for the Seventh Circuit in *In re V.N. Deprizio Construc-*

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section 550(b), is the sole good faith defense for initial transferees of allegedly fraudulent transfers).

[140] *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."); *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 section 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 section 550(b)). Courts are split on which party bears the burden of proof under section 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. 2013).

[141] *See* H.R. Rep. No. 95-595, at 376 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6332.

[142] As discussed in case law and related legislative history, recovery under section 550 is made subject to available defenses, which are effective regardless of the strict liability of initial transferees provided in section 550(a). *See supra* notes 113–15.

[143] 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;

tion Co. and a series of cases adopting that court's rationale.[145] In *Deprizio*, the court considered whether and to what extent a transfer for the benefit of a debtor's insider, but nonetheless to a noninsider, could be recovered as an avoidable preference.[146] The case involved a debtor who made loan payments to non-insider lenders more than 90 days (but less than one year) prior to bankruptcy, on debt guaranteed by insiders.[147] The court held that the trustee could recover the payment from the lender, even though the lender was not an insider, because each payment made to the lenders reduced, on a dollar-for-dollar basis, the liability of the insider guarantors to the lenders.[148] Section 550(c) of the Bankruptcy Code abrogated the result in *Deprizio* and clarified that recovery for preferential transfers cannot be sought from noninsider initial transferees outside of the 90-day preference period set forth in section 547(b)(4)(A) of the Bankruptcy Code.[149]

P. *Section 550(d): Prohibition Against Double Recoveries For Avoided Transfers*

Section 550(d) states: "The trustee is entitled to only a single satisfaction under subsection (a) of this section."[150] Cases examin-

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the trustee may not recover under subsection (a) from a transferee that is not an insider.

11 U.S.C.A. § 550(c).

[144]Pub. L. No. 103-394, 108 Stat. 4106 (1994) (codified as amended in various sections of 11 U.S.C., 18 U.S.C., and 28 U.S.C.).

[145]*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); *In re Crucible Materials Corp.*, 2012 WL 5360945, *6 (Bankr. D. Del. 2012) ("Congress added section 550(c) to overrule the effect of *Deprizio*."); *In re Exide Technologies, Inc.*, 299 B.R. 732, 746 (Bankr. D. Del. 2003) ("The 1994 amendment of § 550, adding subsection (c), overruled [*Deprizio*] and the line of cases adopting its rationale.").

[146]Deprizio, 874 F.2d at 1187–88.

[147]Deprizio, 874 F.2d at 1187–88.

[148]Deprizio, 874 F.2d at 1200–01.

[149]*See* Exide Techs., 299 B.R. at 746 (noting that legislative history indicates that section 550(c) " overrules the *Deprizio* line of cases and clarifies that noninsider transferee should not be subject to the preference provision of the Bankruptcy Code beyond the 90-day statutory period" and citing H.R. Rep. No. 103-835, at 45 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3353); *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) ("However, 11 U.S.C. § 550 was amended by the Bankruptcy Reform Act of 1994 expressly to overrule the results in *Deprizio*.").

[150]11 U.S.C.A. § 550(d).

ing section 550(d) have generally confirmed the plain meaning of the statute.[151] One district 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 postpetition.[152] The district court found that while the strict requirements for recovery under section 550 had been met, the postpetition 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).[153]

Q. *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 on the property recovered, to the extent of the lesser of the cost of any improvement the transferee makes in the transferred prop-

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[151]*See Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC*, 501 B.R. 26, 34, 58 Bankr. Ct. Dec. (CRR) 177 (S.D. N.Y. 2013) ("the Trustee is in any case limited to a single recovery under 550(d), so the defendants' concerns of inequitable treatment are unfounded."); *In re The Russ Companies, Inc.*, 2013 WL 4028098, *5 (Bankr. D. N.J. 2013) ("the limiting nature of section 550(d) ensures only that the trustee's recovery does not exceed the property value or the property transferred"); *see also 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) (recovery of properties and avoidance of bank's lien were not double recovery, as trustee was merely recovering unencumbered title to properties); *In re Skywalkers, Inc.*, 49 F.3d 546, 549, 26 Bankr. Ct. Dec. (CRR) 1006, Bankr. L. Rep. (CCH) P 76394 (9th Cir. 1995) (holding that "recovery of preference payments from Loo under § 547 along with the retention of the license or the proceeds from the sale of the license does not constitute a double satisfaction prohibited by § 550."). Notably, courts have debated whether the exclusion of turnover provisions from the list of prohibited double recoveries in section 550(d) supports a section 542(a) "present possession" requirement. Compare *In re Newman*, 487 B.R. 193, 69 Collier Bankr. Cas. 2d (MB) 519, Bankr. L. Rep. (CCH) P 82425, 111 A.F.T.R.2d 2013-816 (B.A.P. 9th Cir. 2013) (holding that turnover merely requires possession, custody or control of property at any time during the pendency of the bankruptcy case, rather than at the time a demand for turnover is made), *and In re Ruiz*, 455 B.R. 745, 66 Collier Bankr. Cas. 2d (MB) 120 (B.A.P. 10th Cir. 2011) (holding that a party need not be in actual possession of the property at the time of the turnover demand to fall within the scope of section 542(a)), *with In re Pyatt*, 486 F.3d 423, 48 Bankr. Ct. Dec. (CRR) 70, 57 Collier Bankr. Cas. 2d (MB) 136, Bankr. L. Rep. (CCH) P 80936 (8th Cir. 2007) (holding that a trustee could not compel turnover of funds no longer in the debtor's possession).

[152]*In re Cybridge Corp.*, 312 B.R. 262, 264–65, 43 Bankr. Ct. Dec. (CRR) 81, 52 Collier Bankr. Cas. 2d (MB) 615 (D.N.J. 2004).

[153]Cybridge, 312 B.R. at 264–65.

erty and the increase in value of the property as a result of the improvement.[154] 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.[155] Moreover, where a transfer is avoided under section 548 but not recovered under section 550, the protections set forth in section 550(e) do not apply.[156]

R. *Section 550(f): Statute of Limitations For Recovery Actions*

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

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[154]Section 550(e) provides:

(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).

[155]*See supra* notes 139–140 and accompanying text.

[156]*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) (when debtor transferred title to property to third party but retained possession, the transfer was preserved for the benefit of the estate under section 551, no recovery after avoidance was necessary, and the protections of section 550 do not apply); *see also In re Salinitro*, 355 B.R. 15, 18 (Bankr. E.D. Mich. 2006) ("there was no basis for the trustee to resort to the recovery provisions of § 550, and the defenses of § 550(e) were unavailable").

closed or dismissed."[157] The statute runs from the date the transfer was avoided, not the date of the transfer.[158] Even though a settlement may not constitute a formal avoidance of transfers, a bankruptcy court has held that the finality of the settlement triggers the relevant one-year statute of limitations under section 550(f).[159] The statute runs once a case is closed; an action to recover an avoided transfer may not be later brought, even if the case is reopened within one year of the avoidance.[160]

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[157] *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. § 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) (closing of a bankruptcy case terminates many of the trustee's avoiding and recovery powers).

[158] *See* Enron, 343 B.R. at 80 ("Specifically, the limitation in section 550(f) allows one year to pursue recovery, and that 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) ("[A]n action to recover avoided transfers of property must be brought no later than the earlier of one year after the transfer was avoided or the date the case is closed or dismissed. The one year limitations period begins to run once the avoidance action is final.").

[159] *See Securities Investor Protection Corporation v. Bernard L. Madoff Inv. Securities LLC*, 480 B.R. 501, 522, 57 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2012). The *Madoff* court further noted 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." 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")).

[160] *In re Sandoval*, 470 B.R. 195, 201, 67 Collier Bankr. Cas. 2d (MB) 707 (Bankr. D. N.M. 2012) ("Section 550(f)(2) is clear and unambiguous: actions to collect on avoided preferential transfers may not be filed after the case is closed."); *In re Phimmasone*, 249 B.R. 681, 682–83, 44 Collier Bankr. Cas. 2d (MB) 890 (Bankr. W.D. Va. 2000) ("the plain language of the statute prohibits the recovery of an avoidable or avoided transfer once the case is closed"). While there are reported cases that allow actions to be pursued after reopening a case,

III. CASE LAW DEVELOPMENTS IN 2013

This section first provides a brief update on certain cases discussed in last year's Article which addressed the power of bankruptcy courts to determine fraudulent transfer actions in the aftermath of *Stern v. Marshall*[161] and the decision of the Supreme Court of the United States to grant certiorari in the appeal from the decision of the Ninth Circuit Court of Appeals in *Executive Benefits Insurance Agency v. Arkison* (*In re Bellingham Insurance Agency, Inc.*).[162] This discussion is followed by summaries and analyses of certain decisions from 2013 which address issues arising under or relevant to sections 548 and/or 550 of the Bankruptcy Code that the Author believes are 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.

A. *Supreme Court Review of Executive Benefits Insurance Agency v. Arkinson* (*In re Bellingham Insurance Agency, Inc.*): *Whether a Bankruptcy Court Has Authority to Enter a Final Judgment in a Fraudulent Transfer Action*

As discussed in last year's edition of this Article, the United States Court of Appeals for the Ninth Circuit in the landmark case of *Executive Benefits Insurance Agency v. Arkison* (*In re Bellingham Insurance Agency, Inc.*) examined the question of whether a bankruptcy court has the authority to enter a final judgment in a fraudulent transfer action.[163] Citing *Stern*,[164] the Ninth Circuit (i) overruled its earlier decision in *Duck v. G.B.*

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these cases generally involve situations where there are "undisclosed or concealed assets." *See, e.g.*, *In re Mullen*, 337 B.R. 744, 749, 2006 BNH 04 (Bankr. D. N.H. 2006).

[161] *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 (2011). 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 decide the claim as a "core" proceeding under 28 U.S.C.A. § 157.

[162] *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, 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013) and aff'd, 134 S. Ct. 2165, 59 Bankr. Ct. Dec. (CRR) 160 (2014).

[163] *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

Munn (*In re Mankin*),[165] which held that a bankruptcy court had constitutional authority to finally adjudicate fraudulent transfer actions because they were "core proceedings,"[166] which implicated public rights[167] and (ii) declared that while bankruptcy judges, as non-Article III judges,[168] do not have constitutional authority to enter final judgments on fraudulent transfer claims asserted against parties who are not creditors of the bankruptcy estate, despite such proceedings' "core" nature, bankruptcy courts do have statutory authority to hear and enter proposed findings of fact and conclusions of law, subject to a district court's de novo review, in those proceedings.[169] The Ninth Circuit also determined that the noncreditor's right to a hearing before an Article III judge in such an action is waivable.[170] The Supreme Court granted *certiorari* to review these aspects of the Ninth Circuit's decision in *Bellingham*.[171]

In *Bellingham*, the trustee of the bankruptcy estate brought a fraudulent transfer action against noncreditor Executive Benefits

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(9th Cir. 2012), cert. granted, 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013) and aff'd, 134 S. Ct. 2165, 59 Bankr. Ct. Dec. (CRR) 160 (2014). For last year's in-depth discussion of *Bellingham* and a thorough examination of Supreme Court decisions leading up to *Bellingham*, see Gallagher & Saydah, *supra* note 6, at 1031–52.

[164]*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 (2011) (holding that a bankruptcy court could not enter final judgment on a state-law claim for tortious interference with a gift expectancy because the claim could not be deemed a matter of "public right" that could be decided outside the judicial branch).

[165]*Duck v. G.B. Munn* (*In re Mankin*), 823 F.2d 1296 (9th Cir. 1987), *overruled by Bellingham*, 702 F.3d at 561 ("Today, we acknowledge *Mankin's* demise.").

[166]Fraudulent transfer claims are among the types of "core proceedings" which may be heard and determined by a bankruptcy court. 11 U.S.C.A. § 157(b)(1), (2)(H).

[167]11 U.S.C.A. § 157(b)(1), (2)(H).

[168]Article III, § 1, of the Constitution mandates that "[t]he judicial Power of the United States, shall be vested in one Supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish," and provides that the judges of those constitutional courts "shall hold their Offices during good Behaviour" and "receive for their Services[ ] a Compensation[ ] [that] shall not be diminished" during their tenure. U.S. Const. Art. III, § 1.

[169]Bellingham, 702 F.3d at 566.

[170]Bellingham, 702 F.3d at 569–70.

[171]*Executive Benefits Ins. Agency v. Arkison*, 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013) (granting petition for *certiorari* review).

Insurance Agency ("EBIA"), alleging that EBIA was the successor corporation to the debtor Bellingham Insurance Agency ("BIA") and liable for claims as such.[172] Prior to its bankruptcy filing, BIA transferred its business to EBIA, and, as part of the transfer, EBIA received certain insurance commissions from BIA.[173] The trustee sought to recover the transfers of commissions as constructively fraudulent under state law and section 548 of the Bankruptcy Code.[174]

In the adversary proceeding before the bankruptcy court, EBIA demanded a jury trial.[175] The district court treated the jury demand as a motion to withdraw the reference.[176] However, that motion was never heard, because while it was pending EBIA petitioned the district court for a stay to allow the bankruptcy court to rule on the trustee's summary judgment motion, which had been filed in the interim.[177] The bankruptcy court then granted summary judgment in favor of the trustee and entered a final judgment against EBIA, finding that the transfers from BIA to EBIA were avoidable.[178] 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.[179] After reviewing the bankruptcy court's summary judgment determination de novo, the district court affirmed the bankruptcy court's ruling.[180] EBIA further appealed the decision to the Court of Appeals for the Ninth Circuit, 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*.[181]

On appeal, the Ninth Circuit held that a bankruptcy court, as a "legislative court" created by Congress and not authorized to exercise the judicial power of the United States under Article III of the Constitution, does not have authority to enter a final judgment on fraudulent conveyance claims asserted by noncreditors

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

[173]Bellingham, 702 F.3d at 556–57.

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

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

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

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

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

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

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

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

to a bankruptcy estate.[182] The Ninth Circuit found that bankruptcy courts have authority to hear such claims and to prepare proposed findings of fact and conclusions of law for de novo review by the district court.[183] In addition, the Ninth Circuit also found that a litigant could waive its right to a hearing and a judgment by an Article III court in favor of a decision by a bankruptcy court.[184] The Ninth Circuit reasoned that as a "personal right" granted by Article III, the "guarantee of impartial and independent federal adjudication is subject to waiver."[185] Ultimately, the Ninth Circuit found that EBIA had waived its right to an adjudication by an Article III by (i) abandoning its request to withdraw the reference so that the bankruptcy court could decide the summary judgment motion and (ii) failing to object to the bankruptcy court's authority until after briefing to the Ninth Circuit was complete.[186]

The Ninth Circuit's position in *Bellingham* on the issue of consent to bankruptcy court jurisdiction revealed a circuit split with the Courts of Appeals for the Fifth, Sixth, and Seventh Circuits, which each hold that the limitations on bankruptcy court power provided by Article III cannot be waived.[187] The decision of the Court of Appeals for the Sixth Circuit in *Waldman v.*

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

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

[184]Bellingham, 702 F.3d at 567.

[185]Bellingham, 702 F.3d at 567.

[186]Bellingham, 702 F.3d at 568. The Ninth Circuit noted that defendant EBIA was on notice of the Article III question as the Ninth Circuit published its decision in *In re Marshall*, 600 F.3d 1037, 52 Bankr. Ct. Dec. (CRR) 257, Bankr. L. Rep. (CCH) P 81717 (9th Cir. 2010), aff'd, 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 (2011) prior to EBIA's request to the district court to stay its motion to withdraw the reference. Bellingham, 702 F.3d at 569.

[187]*See In re Frazin*, 732 F.3d 313, 320 n.3, 58 Bankr. Ct. Dec. (CRR) 133, 70 Collier Bankr. Cas. 2d (MB) 813 (5th Cir. 2013), cert. denied, 134 S. Ct. 1770, 188 L. Ed. 2d 595 (2014) ("When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect."); *Wellness Intern. Network, Ltd. v. Sharif*, 727 F.3d 751, 773, 58 Bankr. Ct. Dec. (CRR) 116, 70 Collier Bankr. Cas. 2d (MB) 135, 86 Fed. R. Serv. 3d 859 (7th Cir. 2013), petition for certiorari filed, 2014 WL 497634 (U.S. 2014) ("under current law a litigant may not waive an Article III, § 1, objection to a bankruptcy court's entry of final judgment in a core proceeding"); *Waldman v. Stone*, 698 F.3d 910, 918, 57 Bankr. Ct. Dec. (CRR) 45 (6th Cir. 2012), cert. denied, 133 S. Ct. 1604, 185 L. Ed. 2d 581 (2013) (" [creditor-defendant' s] objection thus implicates not only his personal rights, but also the structural principle advanced by Article III. And that principle is not [defendant' s] to waive. ").

Stone,[188] issued prior to *Bellingham*, held that an objection to the power of a bankruptcy court "implicates" the "structural principle advanced by Article III" and thus "is not [the party's] to waive."[189] The issue continued to receive attention from the circuit courts even after the Supreme Court granted certiorari in *Bellingham*. In an opinion issued August 21, 2013 and arguably the subject of an intra-circuit dispute,[190] the Court of Appeals for the Seventh Circuit in *Wellness International Network Ltd. v. Sharif*[191] declared that "a constitutional objection based on *Stern* is not waivable because it implicates separation-of-powers principles."[192] The Court of Appeals for the Fifth Circuit chimed two months later, in the case of *Frazin v. Haynes & Boone, L.L.P* (*In re Frazin*),[193] explaining that when Article III limitations are at issue, "notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect."[194]

In addition, the Ninth Circuit's position on whether a bankruptcy court may submit proposed findings of fact in a fraudulent transfer action in a "core" proceeding is at odds with the Seventh Circuit, and is contradicted in dicta by the Sixth Circuit. The issue is whether section 157(c)(1) of title 28 of the United States

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[188]*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) (vacating bankruptcy court judgment in favor of debtor on non-core state law claims and remanding with instructions to "recast" judgment as proposed findings of fact).

[189]Waldman, 698 F.3d at 918.

[190]The consent issue has led to a possible split within the Seventh Circuit. *See Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 747, 58 Bankr. Ct. Dec. (CRR) 114, Bankr. L. Rep. (CCH) P 82548 (7th Cir. 2013) (Easterbrook, J.) ("The issue in *Wellness International Network* was forfeiture rather than waiver . . .. So we think the effect of an express and mutual waiver open in this circuit.").

[191]*Wellness Intern. Network, Ltd. v. Sharif*, 727 F.3d 751, 58 Bankr. Ct. Dec. (CRR) 116, 70 Collier Bankr. Cas. 2d (MB) 135, 86 Fed. R. Serv. 3d 859 (7th Cir. 2013), petition for certiorari filed, 2014 WL 497634 (U.S. 2014) (holding that bankruptcy judge lacked constitutional authority to enter final judgment on an alter-ego claim and that *Stern* implicates non-waivable separation-of-powers principles).

[192]Wellness Int'l, 727 F.3d at 755.

[193]*In re Frazin*, 732 F.3d 313, 58 Bankr. Ct. Dec. (CRR) 133, 70 Collier Bankr. Cas. 2d (MB) 813 (5th Cir. 2013), cert. denied, 134 S. Ct. 1770, 188 L. Ed. 2d 595 (2014) (holding that bankruptcy court cannot enter a final judgment on state law claims not resolved in the process of ruling on matters rated to the bankruptcy proceeding).

[194]Frazin, 732 F.3d at 320 n.3.

Code,[195] which authorizes the bankruptcy court to propose findings of fact and conclusions of law in "non-core" proceedings, can be interpreted to permit the same in those "core" proceedings which can no longer be finally adjudicated by a bankruptcy court under *Stern*.[196] Unlike the Ninth Circuit, which in *Bellingham* found the entry of such proposed findings to be acceptable, the Seventh Circuit has remarked that "it is difficult to find a statutory basis on which the district court could rely to treat the bankruptcy court's order as proposed findings and conclusions" and, therefore if "the court determines the [claim] to be a core proceeding," the reference must "be withdrawn" and the district court must "conduct fresh discovery proceedings."[197] Likewise, the Sixth Circuit has remarked in dicta that "the statute does not expressly permit" a bankruptcy court "to convert its final judgment" into "proposed findings of fact and conclusions of law" in "core proceedings."[198]

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[195]Section 157(c)(1) of Title 28 of the United States Code provides:

> A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions to which any art has timely and specifically objected.

11 U.S.C.A. § 157(c)(1).

[196]Section 157(b)(1) of Title 28 of the United States Code provides that in "all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11," a bankruptcy judge has the power to "hear and determine" the controversy and "enter appropriate orders and judgments, subject to [appellate] review." *See* 11 U.S.C.A. § 157(b)(1). Section 157(b)(2) of Title 28 of the United States Code provides that core proceedings include, inter alia, the allowance and disallowance of claims against the estate, counter claims against persons filing claims against the estate, orders to turn over property of the estate, and proceedings to avoid and recover preferences and fraudulent transfers. *See* 11 U.S.C.A. § 157(b)(2).

[197]Wellness Int'l, 727 F.3d at 751. While 28 U.S.C.A. § 157(a) permits district courts to refer bankruptcy cases and proceedings to bankruptcy courts, such "reference" may be later withdrawn pursuant to 28 U.S.C.A. § 157(d). The notion of withdrawal "reflects Congress's perception that specialized courts should be limited in their control over matters outside their areas of expertise." *American Tel. & Tel. Co. v. Chateaugay Corp.*, 88 B.R. 581, 583, 27 Env't. Rep. Cas. (BNA) 2108 (S.D. N.Y. 1988).

[198]*Waldman v. Stone*, 698 F.3d 910, 921, 57 Bankr. Ct. Dec. (CRR) 45 (6th Cir. 2012), cert. denied, 133 S. Ct. 1604, 185 L. Ed. 2d 581 (2013); *see also In re Ortiz*, 665 F.3d 906, 915, 55 Bankr. Ct. Dec. (CRR) 255 (7th Cir. 2011) (explaining appellate review of bankruptcy court final orders under 28 U.S.C.A. §§ 157(c)(2) and 158 as opposed to submission of proposed findings of fact and conclusions of law).

These divergent decisions among the various circuits have prompted the Supreme Court to grant certiorari at the request of EBIA on June 24, 2013[199] to resolve the following questions in the wake of *Stern*:[200]

> (1) Whether Article III [of the Constitution] permits the exercise of the judicial power of the United States by bankruptcy courts on the basis of litigant consent, and, if so, whether "implied consent" based on a litigant's conduct, where the statutory scheme provides the litigant no notice that its consent is required, is sufficient to satisfy Article III.
>
> (2) Whether a bankruptcy judge may submit proposed findings of fact and conclusions of law for de novo review by a district court in a "core" proceeding under 28 U.S.C. 157(b).

The parties submitted their briefs[201] and the Supreme Court heard arguments in *Bellingham* on January 14, 2014.[202] As this Article was being submitted for publication, the Supreme Court issued a unanimous opinion affirming the Ninth Circuit's decision and holding that in "core" matters for which a bankruptcy court lacks constitutional authority to enter a final judgment (so-called "*Stern* claims"), a bankruptcy court may treat those matters as "non-core" and submit proposed findings of fact and

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[199] *Executive Benefits Ins. Agency v. Arkison*, 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013) (granting petition for certiorari review).

[200] Petition for a Writ of Certiorari at 1, *Executive Benefits Ins. Agency v. Arkison*, 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013). Respondent EBIA's brief in opposition of the petition for the writ of certiorari is available on Westlaw in the SCT-BRIEF database at 2013 WL 2279702. Petitioner Arkison's reply brief is available at 2013 WL 2405551.

[201] Petitioner Arkison's brief and reply brief is available on Westlaw in the SCT-BRIEF database at 2013 WL 4829341 and 2013 WL 6492302, respectively. Respondent EBIA's brief in opposition is available at 2013 WL 6019314. Sixteen amicus briefs were submitted by parties ranging from a consortium of law school professors to the defendants in the *TOUSA* and *Tronox* cases discussed in this and prior editions of this Article. The full list of amicus briefs and copies of such briefs may be obtained by visiting SCOTUSblog, http://www.scotusblog.com/case-files/cases/executive-benefits-insurance-agency-v-arkison/ (last visited May 8, 2014).

[202] A recording of the oral argument held before the Supreme Court on January 14, 2014 is available online at Executive Benefits Insurance Agency v. Arkinson, The Oyez Project at IIT Chicago-Kent College of Law, http://www.oyez.org/cases/2010-2019/2013/2013__12__1200 (last visited May 8, 2014) and the transcript can be obtained by visiting http://www.supremecourt.gov/oral__arguments/argument__transcripts/12-1200__f29g.pdf (last visited May 8, 2014).

conclusions of law to the district court for review de novo.[203] A thorough examination of the Supreme Court's decision is expected in the 2015 edition of this article.

B. *In re Sentinel Management Group: Seventh Circuit Court of Appeals Reverses Itself and District Court to Find that Transfer of Clients' Funds as Collateral to Bank Demonstrated Actual Invent to Hinder Delay or Defraud*

In a decision that serves as a warning for secured lenders to businesses experiencing financial distress, the United States Court of Appeals for the Seventh Circuit in the case of *In re*

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[203] *See Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2169, 59 Bankr. Ct. Dec. (CRR) 160 (2014). In so holding, the Supreme Court reasoned that *Stern* claims, where the bankruptcy court has statutory authority but not constitutional authority to enter a final judgment, nevertheless qualified under 28 U.S.C.A. § 157(c)(1) as claims that are "not a core proceeding but that [are] otherwise related to a case under title 11." 2014 WL 2560461, at *8. In other words, the Court likened *Stern* claims to non-core claims that arise under or otherwise relate to a proceeding under title 11. Accordingly, the Court explained that the fraudulent conveyance claims at issue in *Bellingham*, which principally sought to retrieve property "that should have been part of the bankruptcy estate and therefore available for distribution to creditors" but was "improperly removed" were " 'related to a case under title 11' under any plausible construction of the statutory text." Thus, the bankruptcy court had authority to submit proposed findings of fact and conclusions of law to the district court, subject to review de novo. 2014 WL 2560461, at *8.

Although that is not precisely what happened in *Bellingham* (the bankruptcy court issued a final judgment, not proposed findings of fact and conclusions of law), the district court nevertheless performed a de novo review of the bankruptcy court's decision on appeal and separately issued its own final judgment. 2014 WL 2560461, at *9. Because defendant EBIA received de novo review by the district court, the Supreme Court determined that it did not need to decide whether Article III of the Constitution was violated. 2014 WL 2560461, at *9 ("EBIA thus received the same review from the District Court that it would have received if the Bankruptcy Court had treated the fraudulent conveyance claims as non-core proceedings under § 157(c)(1). In short, even if EBIA is correct that the Bankruptcy Court's entry of a judgment was invalid, the District Court's *de novo* review and entry of its own final judgment cured any error.") (citations omitted). For this reason, and to the dismay of many who hoped that the Supreme Court would further clarify the scope of bankruptcy court's authority, the Court declined to address the second issue of whether litigants may consent (expressly or impliedly) to having a bankruptcy court enter a final judgment with respect to *Stern* claims. 2014 WL 2560461, at *4 n.4 ("[T]his case does not require us to address whether EBIA in fact consented to the Bankruptcy Court's adjudication of a *Stern* claim and whether Article III permits a bankruptcy court, with the consent of the parties, to enter final judgment on a *Stern* claim. We reserve that question for another day.").

Sentinel Management Group[204] recently held that the failure of investment manager Sentinel Management Group, Inc. ("Sentinel") to keep client funds properly segregated and Sentinel's subsequent pledge of those funds to secure overnight loans from Bank of New York ("BONY") constituted (i) actual fraudulent transfers to BONY and (ii) may have been grounds for equitable subordination of BONY's claims against Sentinel.[205] In so holding, the Seventh Circuit reversed the district court's dismissal of fraudulent transfer and equitable subordination claims brought by the liquidation trustee (the "Trustee") for Sentinel against BONY,[206] noting that Sentinel's pledge of customer funds as collateral for BONY's loan was made with "actual intent to hinder, delay or defraud" creditors under section 548(a)(1)(A) of the Bankruptcy Code because Sentinel knowingly put its other creditors at risk of loss without their knowledge.[207] The Seventh Circuit reversed and remanded the Trustee's equitable subordination claims to the district court due to inconsistencies in both the district court's factual and legal findings.[208] Interestingly, rather than relying on evidence of "badges or fraud," as is typical when analyzing claims alleging actual fraudulent transfer,[209] the Seventh Circuit relied upon decisions from criminal cases addressing the issue of intent to defraud to determine that

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[204]*In re Sentinel Management Group, Inc.*, 728 F.3d 660, 58 Bankr. Ct. Dec. (CRR) 93, 70 Collier Bankr. Cas. 2d (MB) 566, Comm. Fut. L. Rep. (CCH) P 32717 (7th Cir. 2013).

[205]Sentinel, 728 F.3d at 662.

[206]*See Grede v. Bank of New York Mellon*, 441 B.R. 864 (N.D. Ill. 2010). The complaint against BONY was originally filed by the trustee appointed in the Chapter 11 cases, who became the liquidation trustee pursuant to the plan confirmed in the Chapter 11 cases.

[207]Sentinel, 728 F.3d at 662, 667. The Seventh Circuit previously rendered a decision in this dispute on the same set of facts. *In re Sentinel Management Group, Inc.*, 689 F.3d 855, 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) ("Withdrawn Sentinel"). *Withdrawn Sentinel* was withdrawn and vacated on November 30, 2012.

[208]Sentinel, 728 F.3d at 662, 672.

[209]In its first decision on these facts, the Seventh Circuit found that the Trustee had failed to show the presence of sufficient "badges" to support a finding that the transfers to BONY were made with actual intent to delay, hinder of defraud. *See* Withdrawn Sentinel, 689 F.3d at 862–64. The Seventh Circuit acknowledged that badges of fraud are not the exclusive means of establishing circumstantial evidence to prove actual intent to hinder, delay, or defraud creditors, Withdrawn Sentinel, 689 F.3d at 862 (citing *Brandon v. Anesthesia & Pain Management Associates, Ltd.*, 419 F.3d 594, 599–600, 23 I.E.R. Cas. (BNA) 383 (7th Cir. 2005), however, the Trustee's use of only a single badge

Sentinel's transfers to BONY were actually fraudulent, noting that exposing a victim to a substantial risk of loss of which the victim is unaware can satisfy the intent requirement of section 548(a)(1)(A) of the Bankruptcy Code.[210]

1. *Background*

Sentinel was an investment manager and registered futures commission merchant ("FCM") that managed short-term investments for a variety of clients, most of which were other FCMs.[211] Sentinel marketed itself as a safe place for its FCM customers to keep excess capital, while earning solid returns and having ready access to their capital.[212] Sentinel also served other investors and maintained a house account for its own trading activity to benefit Sentinel's insiders.[213] To facilitate certain leveraged transactions and promote liquidity, Sentinel secured an overnight loan from BONY.[214] Pursuant to the Commodity Exchange Act ("CEA"), Sentinel was required to register as an FCM with the Commodity Futures Trading Commission ("CFTC")[215] and to maintain segregated accounts for its FCM customers, so that those accounts would at all times hold assets equal to the amount Sentinel owed its FCM customers.[216]

Sentinel maintained three types of accounts at BONY: the first were clearing accounts that allowed Sentinel to buy and sell securities, and BONY was permitted to place a lien on these accounts; the second was an overnight loan account in connection with Sentinel's secured line of credit, which was subject to

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(insolvency) was insufficient to establish actual intent. Withdrawn Sentinel, 689 F.3d at 862.

[210]Sentinel, 728 F.3d at 667–68.

[211]Sentinel, 728 F.3d at 662.

[212]Sentinel, 728 F.3d at 662.

[213]Sentinel, 728 F.3d at 663.

[214]Sentinel, 728 F.3d at 663–64.

[215]Although registered as a FCM, Sentinel did not function as an FCM (*i.e.* it did not accept or solicit futures contracts) and had an exemption from net-capital requirements applicable to registered FCMs. Sentinel, 728 F.3d at 662–63; *see also Grede v. Bank of New York Mellon*, 441 B.R. 864, 869 (N.D. Ill. 2010).

[216]Sentinel, 728 F.3d at 663 (citing Commodity Exchange Act, 7 U.S.C.A. § 6(d)(a)(2) ("Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, or any customer or person other than the one for whom the same are held . . .")).

BONY's liens; and, the third were segregated accounts for FCM customer assets, which BONY agreed were not subject to its liens.[217] Sentinel had primary responsibility for maintaining accounts at appropriate levels of segregation. BONY's main concern was that Sentinel at all times had sufficient collateral in the lienable accounts to keep the overnight loan fully secured.[218]

Sentinel initially used the BONY secured line to fund its repurchases with non-FCM counterparties.[219] However, as liquidity tightened in 2007 and redemption requests accelerated, instead of maintaining FCM customer assets in segregated accounts as required by the CEA, Sentinel increased the BONY loan balance to as much as $573 million, using FCM customer assets to serve as collateral for the loan.[220] Sentinel ultimately pledged hundreds of millions of dollars in customer assets to secure the overnight loan from BONY, causing a segregation shortfall of nearly a billion dollars.[221] It did this in an effort to stay in business.[222] Evidence presented at trial indicated that certain employees at BONY might have suspected Sentinel's use of customer assets as collateral because Sentinel was not highly capitalized.[223] After Sentinel collapsed in August of 2007 following a summer of redemptions by counterparties who insisted on cash, BONY held a secured claim of $312 million while Sentinel's customers lost millions.[224]

Sentinel filed for protection under Chapter 11 in the Bankruptcy Court for the Northern District of Illinois, Eastern Division on August 17, 2007.[225] BONY asserted a $312 million claim as Sentinel's only secured creditor.[226] The Trustee subsequently commenced an adversary proceeding against BONY in the district court, seeking, inter alia, to (i) avoid BONY's lien on Sentinel's assets as actually fraudulent pursuant to section 548(a)(1)(A) and 550(a) of the Bankruptcy Code and (ii) equitably subordinate BONY's claim pursuant to section 510(c) of the Bankruptcy

[217] Sentinel, 728 F.3d at 663–64.

[218] Sentinel, 728 F.3d at 664.

[219] Sentinel, 728 F.3d at 664.

[220] Sentinel, 728 F.3d at 664–65.

[221] Sentinel, 728 F.3d at 664–65.

[222] Sentinel, 728 F.3d at 667.

[223] Sentinel, 728 F.3d at 665.

[224] Sentinel, 728 F.3d at 665–66.

[225] Sentinel, 728 F.3d at 666.

[226] Sentinel, 728 F.3d at 666.

Code.[227] The Trustee alleged that Sentinel had fraudulently used customer assets to secure BONY's loan to cover its in-house trading activity.[228] The Trustee further alleged that BONY knew about this activity, and, as a result, acted inequitably.[229] After a bench trial that lasted seventeen days, the district court rejected all of the Trustee's claims.[230] The district court found that the Trustee had not proved that Sentinel made the transfers with actual intent to hinder delay or defraud its creditors,[231] noting that (a) the Trustee had "failed to demonstrate the requisite intent through the existence of badges of fraud"[232] or proof of an actual Ponzi scheme[233] and (b) the Trustee's reliance on Ponzi scheme cases was misplaced as there was no evidence presented indicating that Sentinel was engaged in a Ponzi scheme.[234] The district court rejected the Trustee's equitable subordination claim

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[227]Sentinel, 728 F.3d at 666.

[228]Sentinel, 728 F.3d at 666.

[229]Sentinel, 728 F.3d at 666.

[230]Sentinel, 728 F.3d at 666.

[231]Sentinel, 728 F.3d at 666.

[232]*Grede v. Bank of New York Mellon*, 441 B.R. 864, 881 (N.D. Ill. 2010). The district court found that no direct evidence of fraud was presented and that at most one badge of fraud was demonstrated. The district court also distinguished *In re Model Imperial, Inc.*, 250 B.R. 776 (Bankr. S.D. Fla. 2000), a case relied upon by the Trustee (where there was direct evidence of fraud as well the existence of five badges) and which also pointed to several cases holding that the presence of one "badge" is insufficient to establish fraudulent intent. Grede, 441 B.R. at 882 (quoting In re Model Imperial, 250 B.R. at 792 (citing *In re XYZ Options, Inc.*, 154 F.3d 1262, 1271 n.17, 40 Collier Bankr. Cas. 2d (MB) 1288 (11th Cir. 1998); *General Trading Inc. v. Yale Materials Handling Corp.*, 119 F.3d 1485, 1498, 47 Fed. R. Evid. Serv. 670 (11th Cir. 1997); *In re Jeffrey Bigelow Design Group, Inc.*, 956 F.2d 479, 483–84, 26 Collier Bankr. Cas. 2d (MB) 967, Bankr. L. Rep. (CCH) P 74478, 22 Fed. R. Serv. 3d 371 (4th Cir. 1992))).

[233]Grede, 441 B.R. at 881–82.

[234]Grede, 441 B.R. at 882. The district court interpreted the Ponzi scheme presumption narrowly, refusing to presume actual intent to defraud creditors where a debtor has perpetrated a fraudulent scheme involving the misuse of creditor assets. The court noted that unlike Ponzi schemes, which "by nature . . . will eventually collapse" and "perpetrators must know that the investors at the end of the line will lose their investment," in the instant case, the "Ponzi presumption [did] not apply" because the trustee "presented no evidence at trial that [the debtor] was engaged in a Ponzi scheme," and, therefore, the trustee had to prove that the debtors "knew or should have known that their scheme would collapse and that investors would go unpaid" and it had failed to prove such fact. Grede, 441 B.R. at 881–82.

"because it did not believe that [BONY's] conduct was 'egregious or conscience shocking.' "[235]

2. *Seventh Circuit's Reversal of District Court on Fraudulent Transfer Claims*

In *Sentinel*, the Court of Appeals for the Seventh Circuit observed that the Trustee claimed that Sentinel's transfers of customer assets out of segregation and into lienable accounts in June and July 2007 constituted actual fraudulent transfers pursuant to sections 548(a)(1)(A) and 544(b) of the Bankruptcy Code, but the district court did not believe this behavior was sufficient to prove Sentinel possessed the actual intent to hinder, delay or defraud creditors (other than BONY). According to the district court, although these actions were not laudable, Sentinel's behavior was a desperate "attempt to stay in business" and did not rise to the level of fraud sufficient to find avoidance of the specified transfers.[236] The Court of Appeals for the Seventh Circuit, however, disagreed, finding that the district court "too narrowly construes the concept of actual intent hinder, delay or defraud."[237] Rather, the Seventh Circuit found that the Trustee should be able to avoid BONY's lien pursuant to section 548(a)(1)(A) because "even if Sentinel did not intend to harm its FCM clients, Sentinel's actions were hardly innocent."[238] Accordingly, it found that "Sentinel's actions, as determined by the factual findings of the district court, demonstrate actual intent to hinder, delay, or defraud."[239]

While the Seventh Circuit agreed with the district court on Sentinel's desire to save its business as the motivation for pledging customer assets as collateral for BONY, it disagreed that such a motive sheltered those transfers from avoidance because Sentinel should have realized that its actions would result in hindering, delaying or defrauding other creditors.[240] Relying on its decisions from three criminal cases to support this construction

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[235]Grede, 441 B.R. at 901.

[236]Grede, 441 B.R. at 884.

[237]Sentinel, 728 F.3d at 667.

[238]Sentinel, 728 F.3d at 668.

[239]Sentinel, 728 F.3d at 668.

[240]Sentinel, 728 F.3d at 667–668. The Seventh Circuit also noticed that Sentinel falsely reported to both its FCM clients and the CFTC that the fund remained in segregation. Sentinel, 728 F.3d at 667.

of actual fraudulent transfer,[241] the Seventh Circuit observed that "even if we assume that Sentinel had the best intention for its FCM clients when it pledged the segregated funds, the fact remains that Sentinel knowingly exposed its FCM clients to a substantial risk of loss of which they were unaware."[242] Sentinel's "pledge of the segregated funds as collateral for its own loan" became "particularly egregious when viewed in light of the legal requirements imposed . . . by the [CEA]."[243] The Seventh Circuit further explained that "Sentinel did more than just expose its FCM clients to a substantial risk of which they were unaware; Sentinel, *in an unlawful manner*, exposed its FCM clients to a substantial risk of which they were unaware."[244] Thus, the Seventh Circuit concluded, the Trustee should be able to avoid BONY's lien as an actual fraudulent transfer under section 548(a)(1)(A) of the Bankruptcy Code.[245] Significantly, the Seventh Circuit also observed that upon remand BONY may encounter trouble in relying on the defense that it gave value in good faith pursuant to section 548(c) of the Bankruptcy Code, noting that this defense is not available to "any creditor 'who has sufficient

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[241]Sentinel, 728 F.3d at 667–68 (citing *U.S. v. Segal*, 644 F.3d 364, 367 (7th Cir. 2011), cert. denied, 132 S. Ct. 1739, 182 L. Ed. 2d 557 (2012) (explaining that federal mail and wire fraud criminal statutes 18 U.S.C.A. §§ 1341 and 1343 do not require "specific intent" to cause harm); *U.S. v. Davuluri*, 239 F.3d 902, 906, Comm. Fut. L. Rep. (CCH) P 28464 (7th Cir. 2001) ("Exposing the victim to a substantial risk of loss of which the victim is unaware can satisfy the intent requirement [under federal mail and wire fraud statutes]. That [defendant] sincerely intended his scheme to generate a profit is irrelevant.") (citations omitted)); *see also* Sentinel, 728 F.3d at 668 (citing *U.S. v. Hamilton*, 499 F.3d 734, 736 (7th Cir. 2007) ("Fraud is not excused just because you had an honest intention of replacing the money.") (internal quotations omitted)).

[242]Sentinel, 728 F.3d at 668. In *Hamilton*, one of the criminal cases cited in *Sentinel*, the Seventh Circuit explained this distinction using an analogy in the context of fraud and embezzlement:

> If you embezzle from your employer you are not excused just because you had an honest intention of replacing the money, maybe with interest—you embezzled the money to gamble and were honestly convinced that you were on a lucky streak and would win enough to cover the defalcation comfortably. You imposed a risk of loss on the employer—deliberately, fraudulently, and without a shadow of excuse or justification—and that is harm enough to trigger criminal liability even though in the rare case the harm proves harmless because the money is replaced. The same principle that covers embezzlement covers fraud.

Hamilton, 499 F.3d at 736 (internal citations omitted).

[243]Sentinel, 728 F.3d at 668.

[244]Sentinel, 728 F.3d at 668 (emphasis in original).

[245]Sentinel, 728 F.3d at 668.

knowledge to place him on inquiry notice of the debtors' possible insolvency.' "[246]

3. *Seventh Circuit's Reversal and Remand on Issue of Equitable Subordination*

The Seventh Circuit similarly reversed and remanded the district court's determination that BONY's claim were not subject to equitable subordination under section 510(c) of the Bankruptcy Code, determining that the district court had relied upon findings that were "internally inconsistent," and thus clearly erroneous.[247] The Seventh Circuit acknowledged that equitable subordination is an extraordinary result based upon egregious conduct, particularly when analyzing otherwise legally valid transactions with non-insiders, such as BONY.[248] Nonetheless, the Seventh Circuit was dubious of the district court's conclusions and pointed to contradictory findings regarding the extent of BONY's knowledge prior to Sentinel's collapse. For example, the district court had found that, on the one hand, BONY knew that some of Sentinel's insiders were using some loan proceeds for their own purposes, and on the other hand, that BONY's "employees neither kn[e]w nor turned a blind eye to the improper actions of Sentinel."[249] The Seventh Circuit cited additional inconsistencies in the district court's opinion and ultimately requested that the district court clarify on remand, the extent of BONY's knowledge about Sentinel prior to its collapse and whether BONY's failure to investigate Sentinel prior to its collapse was merely negligent, reckless or deliberately indifferent before revisiting the issue of whether BONY's claim merits equitable subordination.[250]

4. *Sentinel: No Mention of Withdrawn Prior Decision Based On Badges Instead of Criminal Fraud Cases*

The decision in *Sentinel* was the second time that the Seventh

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[246]Sentinel, 728 F.3d at 668 n.2 (quoting *In re M & L Business Mach. Co., Inc.*, 84 F.3d 1330, 1336, 29 Bankr. Ct. Dec. (CRR) 188, 36 Collier Bankr. Cas. 2d (MB) 996 (10th Cir. 1996) (quoting *In re Sherman*, 67 F.3d 1348, 1355, 27 Bankr. Ct. Dec. (CRR) 1237, 34 Collier Bankr. Cas. 2d (MB) 655, Bankr. L. Rep. (CCH) P 76671 (8th Cir. 1995))).

[247]Sentinel, 728 F.3d at 670.

[248]Sentinel, 728 F.3d at 669–70.

[249]Sentinel, 728 F.3d at 670.

[250]Sentinel, 728 F.3d at 672. Finally the Seventh Circuit upheld the district court's dismissal pursuant to Rule 12(b)(6) the Trustee's claim that Sentinel's contracts with BONY were inherently illegal, finding that there was nothing in the contract requiring either party to engage in illegal activity or related to an illegal scheme or plan.

Circuit rendered a decision in this dispute on the same set of facts, but the opinion reversing the district court makes no mention of the Seventh Circuit's earlier opinion in *Withdrawn Sentinel*.[251] In *Withdrawn Sentinel*, the Seventh Circuit affirmed the district court's decision that Sentinel's transfers to secure the BONY loan with assets taken from Sentinel's FCM customer accounts was not made with an intent to hinder, delay, or defraud the customers (who became creditors of Sentinel when Sentinel comingled funds subject to segregation), and thus was not an intentional fraudulent transfer under section 548(a)(1)(A) of the Bankruptcy Code.[252] In *Withdrawn Sentinel*, the Seventh Circuit had explained that "fraudulent conveyance law exists for very different purposes that does not include attempts to choose among creditors as contrasted with restitution and preferences."[253] Based on this principle, the *Withdrawn Sentinel* panel held that the debtor's "preference of one set of creditors . . . to another . . . is properly reserved for [the plaintiff's] preferential transfer claims."[254] The *Withdrawn Sentinel* opinion further provided that "a debtor's 'genuine belief that' he could repay all his debts if only he could 'weather a financial storm' won't 'clothe him with a privilege to build up obstructions' against his creditors . . . but that does not mean that actions taken to survive a financial storm require a legal finding that the debtor intended to hinder, delay, or defraud."[255]

Following the Seventh Circuit's decision in *Withdrawn Sentinel*, the Trustee moved for rehearing and rehearing en banc, arguing that the panel's ruling was inconsistent with other Seventh Circuit and Supreme Court precedent holding: (a) the knowing misuse of property held by a fiduciary constitutes fraud; (b) it is not necessary to prove improper motive to void a fraudulent transfer, as a party is presumed to intend the natural consequences of its improper actions; and (c) intent to defraud creditors is not the only ground for avoiding a transfer as fraudulent, as a transfer may be avoided as fraudulent if made with intent to

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[251] *In re Sentinel Management Group, Inc.*, 689 F.3d 855, 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). For the history of the *Sentinel* decisions, see *supra* notes 206–07 and accompanying text.

[252] Withdrawn Sentinel, 689 F.3d at 857.

[253] Withdrawn Sentinel, 689 F.3d at 862–63 (internal citations and quotations omitted).

[254] Withdrawn Sentinel, 689 F.3d at 863 (citations omitted).

[255] Withdrawn Sentinel, 689 F.3d at 863 (citing *Shapiro v. Wilgus*, 287 U.S. 348, 354, 53 S. Ct. 142, 77 L. Ed. 355, 85 A.L.R. 128 (1932)).

delay or hinder creditors.[256] CFTC filed an amicus brief in support of the Trustee's request, arguing that the panel erred in failing to find that Sentinel's grant of a security interest in its FCM customers' assets in violation of the CEA created a presumption that Sentinel acted with actual intent to hinder delay, or defraud its customers.[257] In its amicus brief, CFTC further argued that because Sentinel represented to its FCM clients that their funds would be maintained in accounts that complied with the CEA, and because those clients placed and kept funds at Sentinel in reliance on Sentinel's representations, Sentinel's grant of a security interest necessarily defrauded Sentinel's FCM clients and was intended to delay and hinder them.[258]

BONY opposed the Trustee's request for rehearing, arguing that the Trustee had already failed to prove that the district court's decision was not clearly erroneous, failed to show that Sentinel operated a Ponzi scheme, and that the Trustee impermissibly sought to have the Seventh Circuit impose liability for intentional fraudulent transfers in reliance upon presumptions not previously recognized as exceptions for proof of actual fraud and in reliance on cases involving criminal statutes which were not cited in any of his earlier briefs.[259] The Seventh Circuit did not rule on the Trustee's petition for rehearing and rehearing en

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[256]*See* Plaintiff-Appellant's Petition for Rehearing and Rehearing En Banc, Grede v. Bank of N.Y. Mellon Corp., No. 10-3787 (7th Cir. Sept. 7, 2012), ECF No. 58 [hereinafter "Sentinel Court of Appeals Docket"].

[257]*See* Brief of Amicus Curiae Commodity Future Trading Commission in Support of Appellant's Petition for Rehearing and Rehearing En Banc, Sentinel Court of Appeals Docket, ECF No. 59.

[258]Brief of Amicus Curiae Commodity Future Trading Commission in Support of Appellant's Petition for Rehearing and Rehearing En Banc, Sentinel Court of Appeals Docket, ECF No. 59, at 6–7. The CFTC further argued that the Seventh Circuit's *Withdrawn Sentinel* opinion presented an issue of exceptional importance because misuse or misappropriate of FCM customer assets threatens both customers and the financial integrity of the futures market. Brief of Amicus Curiae Commodity Future Trading Commission in Support of Appellant's Petition for Rehearing and Rehearing En Banc, Sentinel Court of Appeals Docket, ECF No. 59, at 8–9. Noting that segregation of customer funds and restrictions on the use of such funds under the CEA are the primary legal protection for commodity customers, the CFTC further argued that the *Withdrawn Sentinel* decision weakened critical commodity customer protection because it failed to recognize the special status of commodity customers relative to general customers. Brief of Amicus Curiae Commodity Future Trading Commission in Support of Appellant's Petition for Rehearing and Rehearing En Banc, Sentinel Court of Appeals Docket, ECF No. 59, at 9.

[259]Answer to the Petition for Rehearing and Petition for Rehearing En Banc at 3–5, 9–10, Sentinel Court of Appeals Docket, ECF No. 64. BONY also argued

banc; rather it withdrew and vacated its decision on November 30, 2012.[260]

5. *Significance of Sentinel: A New Presumption for Actual Intent?*

The Seventh Circuit obviously struggled with the circumstances, applicable law and somewhat inconsistent facts presented in *In re Sentinel Management Group*, but ultimately rendered a decision which arguably: (a) makes it easier for trustees to prove claims asserting actual fraudulent transfer under section 548(a)(1)(A) of the Bankruptcy Code by creating a presumption of actual intent where a debtor should have known that its actions would put at risk the recoveries of creditors without their knowledge; and (b) potentially more difficult for lenders to defend against claims for equitable subordination if they have some knowledge or suspicion of borrower's illegal behavior. *Sentinel*'s reliance on decisions from criminal cases is a departure from the traditional analysis of actual fraudulent transfer claims, which typically look to "badges of fraud" as opposed to actual fraud or criminal actions to establish a debtor's intent to delay, hinder or defraud other creditors.

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that the CFTC's amicus brief raised no issue worthy of rehearing, that CFTC's position was inconsistent with its knowledge of Sentinel's leveraged investment strategy, and that the CFTC's pleas are more appropriately addressed to Congress. Answer to the Petition for Rehearing and Petition for Rehearing En Banc at 12–13.

[260] *See In re Sentinel Management Group, Inc.*, 704 F.3d 1009 (7th Cir. 2012) (vacating *Withdrawn Sentinel* and stating that the appeal remains under consideration by the panel). Following the Seventh Circuit's decision in *Sentinel*, BONY sought a rehearing en banc. *See* Petition for Rehearing and a Petition for Rehearing En Banc, Sentinel Court of Appeals Docket, ECF Nos. 68, 69. That petition was denied. *See* Order, Sentinel Court of Appeals Docket, ECF No.70.

With respect to the Seventh Circuit's reversal of the district court on the fraudulent transfer and equitable subordination claims, the Seventh Circuit remanded the case to the district court for further proceedings on these two claims. Sentinel, 728 F.3d at 672. On November 26, 2013, the Trustee submitted proposed supplemental findings of fact and sought entry of a judgment in its favor on these claims. *See* Trustee's Proposed Supplemental Findings of Fact, Grede, No. 1:08-cv-02582 (N.D. Ill. Nov. 26, 2013), ECF Nos. 448, 449 [hereinafter "Sentinel District Court Docket"]. Thereafter, BONY sought entry of a judgment in its favor and opposed the Trustee's proposed findings, but did not submit its own proposed findings of fact, arguing that such a submission was not necessary in light of the district court's extensive findings after the trial and the court's directive to the parties. *See* Sentinel District Court Docket, ECF No. 452. In early 2014, the parties submitted cross-replies, and a hearing was held on May 14, 2014. *See* Sentinel District Court Docket, ECF Nos. 455, 456. As of the writing of this Article, the district court had not issued a decision.

C. *Tronox Inc. v. Kerr-McGee Corp.* (*In re Tronox, Inc.*): *Bankruptcy Court Avoids as Fraudulent Transfer Spinoff and IPO Transaction Imposing Liability on Former Parent for Environmental Liabilities and Determines That Defendant's Claim Under Section 502(h) of the Bankruptcy Code Would Offset Portion of Damages Awarded*

In a decision that captured the attention of the bankruptcy and restructuring world, the Bankruptcy Court for the Southern District of New York in *Tronox Inc. v. Kerr-McGee Corp.,* (*In re Tronox Inc.*),[261] (a) collapsed a series of related transactions initiated in 2002 in order to determine that the statute of limitations for fraudulent transfers had not started to run until 2006[262] and (b) ruled that, the defendants' claims under section 502(h) of the Bankruptcy Code for damages owed with respect to the transfers avoided might exceed the consideration provided for the avoided transfers, and could, under the circumstances of the case, limit a trustee's recovery for avoided transfers under section 550 of the Bankruptcy Code.[263] After collapsing the transactions, the bankruptcy court found that the transfers at issue were actually and constructively fraudulent and that the plaintiffs were, as a result, entitled to damages in the amount of $14.459 billion (subject to offset and dilution for the defendants' claim under section 502(h) in an amount to be later determined by the bankruptcy court following additional briefing by the parties).[264] According to the bankruptcy court, the *Tronox* action also raised issues of first impression regarding the applicability of fraudulent transfer laws to address claims of substantial environmental and tort liability.[265] As this Article was nearing its completion, the bankruptcy court issued findings of fact and conclusions of law recommending that the district court approve a settlement agreed to by the parties involving a payment to the plaintiffs of $5.15 billion (plus interest), obviating likely appeals of several issues which

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[261] *In re Tronox Incorporated*, 503 B.R. 239 (Bankr. S.D. N.Y. 2013).

[262] Tronox, 503 B.R. at 270–71.

[263] Tronox, 503 B.R. at 334–35.

[264] In addition, the bankruptcy court held that the transfers were not sheltered by the safe harbor contained in section 546(e) of the Bankruptcy Code (Tronox, 503 B.R. at 340–42) and that it had authority to finally decide the fraudulent transfer claims because the defendants had not only consented to jurisdiction, but had also filed proofs of claim in the bankruptcy case that were related to the fraudulent transfer actions. Tronox, 503 B.R. at 343–47.

[265] Tronox, 503 B.R. at 249.

could have taken many years and millions of dollars to prosecute.[266]

1. *Background*

Kerr-McGee was founded in 1929 as an oil and gas exploration company.[267] It purchased its first oil refinery in 1945, and—in the years that followed—acquired a variety of other businesses, including 800 retail oil and gas outlets, fifteen wood treating plants, a uranium mine, a rare earth facility that produced radioactive thorium, and a titanium dioxide pigment plant.[268] Along the way, the Kerr-McGee group incurred enormous environmental and tort liabilities: the company by 2005 had become responsible for more than 2,700 environmental sites in 47 states, seven of

[266]*See* Findings of Fact and Conclusions of Law on Joint Motion for a Report and Recommendation to the District Court Recommending Approval of Settlement Agreement Resolving the Adversary Proceeding and Issuance of an Injunction in Support Thereof, Tronox v. Kerr-McGee Corp. (In re Tronox, Inc.), No. 09-10156 (ALG), Adv. No. 09-1198 (ALG) (Bankr. S.D.N.Y. Apr. 9, 2014), ECF No. 661 (the "Bankruptcy Court Report"). A copy of the settlement agreement is attached as Exhibit A to the Bankruptcy Court Report (the "Settlement Agreement"). As of the writing of this Article, the Settlement Agreement remains subject to approval by the district court.

Regarding approval of the Settlement Agreement, the parties jointly filed a motion seeking that the bankruptcy court issue a report and recommendation requesting that the district court (i) approve the Settlement Agreement pursuant to Bankruptcy Rule 9019 and (ii) issue a narrowly tailored injunction preventing the assertion of derivative, estate claims against certain released parties under the Settlement Agreement. *See* Bankruptcy Court Report at 2–4. The United States, as plaintiff-intervenor in the adversary proceeding and on behalf of several federal agencies, joined the motion and separately requested that the bankruptcy court include certain findings in its recommendation to the district court that the Settlement Agreement should also be approved as fair, reasonable, and consistent with environmental law. Bankruptcy Court Report at 2–4. The parties agreed that the bankruptcy court should treat the motions to approve the settlement as a "related matter" for purposes of 28 U.S.C. § 157, and the bankruptcy court found that it was a related matter. Bankruptcy Court Report, at Conclusions of Law ¶ 3. In doing so, the parties appeared to agree that requesting the bankruptcy court to submit proposed findings of fact and conclusions of law for final entry and adjudication by the district court would be the safest route procedurally in light of the uncertainty created by the Supreme Court's anticipated decision in *Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 59 Bankr. Ct. Dec. (CRR) 160 (2014), which was issued after the Bankruptcy Court Report was submitted, but prior to the district court entering a final judgment. For a discussion of the jurisdictional arguments addressed by the bankruptcy court in *Tronox*, see *infra* Section III.C.5 and for a discussion of the issues before the Supreme Court in *Bellingham*, see *supra* Section III.A.

[267]*In re Tronox Incorporated*, 503 B.R. 239 (Bankr. S.D. N.Y. 2013).

[268]Tronox, 503 B.R. at 249–51.

which were categorized as federal Superfund sites, even though by that time it had discontinued all but two of its historical businesses.[269] By the date Tronox (a successor of Kerr-McGee) filed for bankruptcy protection in 2009, the company was spending an average of $160 million annually on environmental remediation.[270]

Kerr-McGee began to plan an internal restructuring in 2000 that would separate its profitable oil and gas exploration and production (the "E&P Business") from its portfolio of legacy liabilities, having concluded that the E&P Business would perform better as an independent player in the U.S. market and with hopes of transforming it into an attractive merger candidate.[271] The initial transactions ultimately took place in 2002, when Kerr-McGee transferred the assets of the E&P Business into newly formed Kerr-McGee Worldwide Corporation ("New Kerr-McGee") and then merged what remained of the company, including a titanium dioxide business (the "Chemical Business"), into Kerr-McGee Chemical Worldwide LLC ("Old Kerr-McGee").[272] At this stage, all operating costs and liabilities, including the costs associated with Kerr-McGee's legacy liabilities continued to be paid out of a central cash management system used for both Old Kerr-McGee and New Kerr-McGee without regard to a subsidiary's ability to pay expenses.[273] While both businesses were profitable, the E&P Business was dominant: it generated operating profits of approximately $1.8 billion in 2005, compared with $106 million from the Chemical Business.[274]

The separation of the E&P Business first implemented in 2002 was completed in 2005–06. In 2005, New Kerr-McGee and Old Kerr-McGee agreed on a formal split of their properties.[275] In this series of transactions, Old Kerr-McGee became solely responsible for all of the legacy liabilities of the terminated businesses of

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[269]Tronox, 503 B.R. at 249–50.

[270]Tronox, 503 B.R. at 249–50. In addition, the company had settled approximately 15,000 claims of creosote tort liability for $72 million and faced an additional 9,450 pending claims. Tronox, 503 B.R. at 250.

[271]Tronox, 503 B.R. at 250–51.

[272]Tronox, 503 B.R. at 252–53 & n.8.

[273]Tronox, 503 B.R. at 253, 268.

[274]Tronox, 503 B.R. at 249.

[275]Tronox, 503 B.R. at 254.

Kerr-McGee.[276] The only liabilities assumed by New Kerr-McGee would be those "directly associated" with the "currently conducted" E&P Business.[277] One of the agreements contained terms forbidding Old Kerr-McGee for seven years from changing the policies that Kerr-McGee had followed with respect to environmental remediation and administration.[278] The final step of the separation, a spinoff of Old Kerr-McGee accomplished by an initial public offering ("IPO") of Old Kerr-McGee's stock in November 2005, was completed when Old Kerr-McGee's shares were distributed to the public in March 2006.[279] As a result of these transactions, Old Kerr-McGee, which later became known as Tronox Worldwide LLC, became indebted for $800 million, $450 million of which was secured debt, including a revolver in the amount of $250 million. Following the IPO and related financings, Tronox was left with $40 million in cash and $761.8 million was paid over to New Kerr-McGee, consisting of $224.7 million from the IPO and $537.1 million from the new debt on Tronox.[280]

Tronox began to struggle immediately after the IPO because it lacked sufficient cash to continue to fund the legacy liabilities left behind.[281] Due to low titanium dioxide prices, Tronox was forced to begin cutting costs and, in June 2006, began to draw on its revolving line of credit—a process that would continue until its January 2009 bankruptcy filing, when more than $212.8 million was outstanding under the revolver.[282] Tronox continued to fund and suffer from the legacy liabilities.[283] In 2007 and 2008, Tronox was forced to obtain waivers of the covenants in its secured loan agreements to avoid default and experienced great difficulty obtaining funding to finance the bankruptcy case.[284] Nonetheless, by November 2010, Tronox had a confirmed a Chapter 11 plan (the "Tronox Plan"), which allotted to a liquidating trust for the benefit of environmental claimants and tort plaintiffs of the proceeds of the fraudulent transfer action discussed in this

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[276]Tronox, 503 B.R. at 254.

[277]Tronox, 503 B.R. at 254.

[278]Tronox, 503 B.R. at 254–55.

[279]Tronox, 503 B.R. at 258–59.

[280]Tronox, 503 B.R. at 259.

[281]Tronox, 503 B.R. at 259–261 (describing the state of Tronox's "one-product" Chemical Business post-spinoff).

[282]Tronox, 503 B.R. at 261.

[283]Tronox, 503 B.R. at 261–62.

[284]Tronox, 503 B.R. at 262.

Article, plus certain cash consideration for their claims.[285] Pursuant to the disclosure statement approved in connection with the Tronox Plan, the commercial creditors of Tronox anticipated a cash recovery of 58% to 78%, or 78% to 100% if they participated in a proposed rights offering.[286] Also, pursuant to the Tronox Plan, the defendants agreed that they would not participate in the initial distribution under the Tronox Plan, and the Tronox Plan would become effective without a determination of the fraudulent transfer action.[287]

2. *Fraudulent Transfer Action*

The Tronox debtors commenced an adversary proceeding in 2009, seeking to, among other things, avoid the transactions that separated the E&P Business from the legacy environmental and tort liabilities, both as actual and constructive fraudulent transfers.[288] In order to avoid those transactions, the plaintiffs had to rely on section 544(b) and "applicable law"[289] because the two-year statute of limitations found in section 548(a)(1) of the Bankruptcy Code would not have allowed the plaintiffs to seek to avoid the conveyances that took place in 2002 or the subsequent spinoff and IPO in 2005–2006.[290] The parties agreed that the Uniform Fraudulent Transfer Act ("UFTA") as adopted by Oklahoma was "applicable law" for the purposes of section 544(b), and consequently a four-year statute of limitations applied to the fraudulent transfer action.[291]

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[285]Tronox, 503 B.R. at 248, 262–63. The litigation trust formed pursuant to the Tronox Plan. Tronox, 503 B.R. at 248.

[286]Tronox, 503 B.R. at 263.

[287]Tronox, 503 B.R. at 265.

[288]Tronox, 503 B.R. at 264. The adversary proceeding was commenced by three of the debtors. Tronox, 503 B.R. at 248. Upon confirmation of the Tronox Plan, the litigation trust created by that plan assumed the litigation for the benefit of the trust beneficiaries. The trust beneficiaries include the United States, eleven states, the Navajo Nation, four environmental response trusts and a trust for the benefit of tort plaintiffs. Tronox, 503 B.R. at 248.

[289]Tronox, 503 B.R. at 266.

[290]Tronox, 503 B.R. at 264 n.26, 266.

[291]Tronox, 503 B.R. at 266–67. The UFTA, as adopted by Oklahoma, OKLA STAT tit. 24, §§ 112–23 is substantially similar to §§ 548 and 550 of the Bankruptcy Code, but provides for the avoidance of transfers that take place within four years prior to the date of the filing of the bankruptcy petition. *See supra* note 33. The Bankruptcy Code's two-year statute would permit the Plaintiffs only to avoid, at most, a very few transfers that took place after Janu-

a. Collapsing Transaction Doctrine Permitted 2002 Transfers To Be Avoided

The defendants argued that a four year look-back from January 2009—when Tronox filed its Chapter 11 petition—would encompass the IPO in 2005 and the distribution of shares in 2006, but not the transfer of the E&P Business from Kerr-McGee to New Kerr-McGee in 2002.[292] The bankruptcy court disagreed and "collapsed" into a single transaction the series of transfers beginning in 2002 and culminating in the 2006 distribution of shares to find that the statute of limitations did not begin to run until 2006.[293] The bankruptcy court stated several reasons for its decision on this issue. First, the bankruptcy court noted that the agreements transferring the E&P Business—although backdated to 2002—were not finalized or executed until the spring of 2005, and therefore became operative within four years of Tronox's January 2009 Chapter 11 filing.[294] In so holding, the court observed that back-dating may not be used for an improper purpose, such as compromising rights of third parties.[295] Moreover, the court noted that the terms of the separation of the businesses were not finalized until 2005.[296]

The bankruptcy court next determined that the statute of limitations did not begin to run in 2002 because the legacy creditors suffered no immediate injury from the 2002 transfers.[297] For a legacy creditor to have recourse to the E&P Business transferred in 2002, that creditor would have needed to obtain and serve a judgment against Old Kerr-McGee, have it be returned unsatisfied, and then execute on the stock of the E&P Business

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ary 12, 2007, or two years before the filing of Tronox's Chapter 11 petition. Tronox, 503 B.R. at 266.

[292]Tronox, 503 B.R. at 267.

[293]Tronox, 503 B.R. at 270 (finding clear and convincing evidence that the asset transfers in 2002 were part of a "single integrated scheme" known to the defendants).

[294]Tronox, 503 B.R. at 267. The court held that for a backdating to be valid, it must document an agreement that was final and conclusive at the earlier date.

[295]Tronox, 503 B.R. at 267 (citing *In re Tronox Inc.*, 429 B.R. 73, 99 (Bankr. S.D. N.Y. 2010) (citing *Debreceni v. Outlet Co.*, 784 F.2d 13, 18–19, 7 Employee Benefits Cas. (BNA) 1118 (1st Cir. 1986)); *S.E.C. v. Solucorp Industries, Ltd.*, 197 F. Supp. 2d 4, 11, Fed. Sec. L. Rep. (CCH) P 91788 (S.D. N.Y. 2002); Jeffrey Kwall & Stuart Duhl, *Backdating*, 63 Bus. Law. 1153, 1159, 1169–71 (2008)).

[296]Tronox, 503 B.R. at 268.

[297]Tronox, 503 B.R. at 268.

subsidiaries.[298] However, following the 2002 transfers, the environmental expenses and liabilities of Kerr-McGee continued to be paid out of a centralized cash management system—funded by New Kerr-McGee—until the date of the IPO in November 2005.[299] Not until Old Kerr-McGee was finally separated from New Kerr-McGee and ceased payment of legacy liabilities would it have been possible for a creditor to access the assets of the E&P Business subsidiaries.[300]

The bankruptcy court also observed that the law made clear that for statute of limitations purposes fraudulent transfers must be examined for their substance and not their form.[301] In light of the its findings that Kerr-McGee management had knowledge of and intended to devise a process to free the E&P Business from the legacy liabilities, the bankruptcy court rejected testimony from certain executives espousing the business reasons for the transfers and denying such knowledge and intent. The court explained that the question was not whether a good business reason existed for the spinoff of Old Kerr-McGee, but rather, whether the 2002 transfers were a part of a single integrated transaction.[302] The court found that the various transactions separating New Kerr-McGee from Old Kerr-McGee constituted a single integrated scheme undertaken for the purpose of cleansing the E&P Business of legacy liabilities; a scheme that included

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[298]Tronox, 503 B.R. at 268.

[299]Tronox, 503 B.R. at 268.

[300]Tronox, 503 B.R. at 268. The court noted that the Oklahoma UFTA recognizes that a fraudulent transfer takes place when there is an actual effect on creditors and their rights, Tronox, 503 B.R. at 268 & n.34 (citing OKLA. STAT. tit. 24, § 118(5)(b)), and that for statute of limitations purposes, fraudulent transfers are examined for their substance and not their form, 503 B.R. at 276 (citing *Orr v. Kinderhill Corp.*, 991 F.2d 31, 35 (2d Cir. 1993); *MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Services Co.*, 910 F. Supp. 913 (S.D. N.Y. 1995)).

[301]Tronox, 503 B.R. at 268–69 (citing *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 638, 31 Fed. R. Serv. 3d 1422 (2d Cir. 1995); *In re Best Products Co., Inc.*, 168 B.R. 35, 56–57 (Bankr. S.D. N.Y. 1994); *Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787, 793, 52 Bankr. Ct. Dec. (CRR) 101, Bankr. L. Rep. (CCH) P 81628 (7th Cir. 2009); *In re Sunbeam Corp.*, 284 B.R. 355, 370, 40 Bankr. Ct. Dec. (CRR) 101 (Bankr. S.D. N.Y. 2002); *In re M. Fabrikant & Sons, Inc.*, 447 B.R. 170, 186 (Bankr. S.D. N.Y. 2011), aff'd, 480 B.R. 480 (S.D. N.Y. 2012), judgment aff'd, 541 Fed. Appx. 55 (2d Cir. 2013)).

[302]Tronox, 503 B.R. at 270–71.

the structural separation of the legacy liabilities in 2002 and was completed after the spinoff in 2006.[303]

The final and "conclusive" reason for collapsing the transactions was one based in public policy.[304] The bankruptcy court observed that the environmental laws of the United States and many of the States are founded on principles of strict liability.[305] It then noted that the defendants' scheme would permit a business with substantial environmental liabilities to divest itself of its most valuable assets while continuing to satisfy environmental liabilities from the cash flow of the combined entity until the statute of limitations period had expired.[306] Once the statute had expired, the business could simply complete its divesture and leave the bad assets behind.[307] The court held that if the statute of limitations had started to run from the first step of this integrated scheme, businesses of this nature "would have free reign to hinder and delay creditors so long as they could do it in two steps several years apart."[308] Additionally, since there was only minimal disclosure of the initial steps of Kerr-McGee's corporate reorganization, there would be no recourse for the legacy creditors if the transfers were not collapsed.[309] To preclude such manipulation of the statute of limitations, the bankruptcy court ruled that the separation of the legacy liabilities, which began in 2002, was completed for the purposes of the statute of limitations when the shares of Old Kerr-McGee were distributed in 2006.[310]

b. The Transfers Separating the E&P Business were Actual Fraudulent Transfers

The court next examined the transfers separating the businesses to determine if they were actually or constructively

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[303]Tronox, 503 B.R. at 271.

[304]Tronox, 503 B.R. at 271.

[305]Tronox, 503 B.R. at 271 (citing *U.S. v. Atlantic Research Corp.*, 551 U.S. 128, 136, 127 S. Ct. 2331, 168 L. Ed. 2d 28, 64 Env't. Rep. Cas. (BNA) 1385, 22 A.L.R. Fed. 2d 735 (2007) (quoting *U.S. v. Alcan Aluminum Corp.*, 315 F.3d 179, 184, 55 Env't. Rep. Cas. (BNA) 1705, 33 Envtl. L. Rep. 20145 (2d Cir. 2003))).

[306]Tronox, 503 B.R. at 271.

[307]Tronox, 503 B.R. at 271.

[308]Tronox, 503 B.R. at 271.

[309]Tronox, 503 B.R. at 271.

[310]Tronox, 503 B.R. at 271.

fraudulent.[311] It noted that the basic issue presented was one of first impression: "under what circumstances can an enterprise rid itself of its legacy environmental and tort liabilities by spinning off substantially all of its assets and leaving behind property incapable of supporting the liabilities."[312]

The bankruptcy court first considered whether the transfers were actually fraudulent transfers. Like section 548(a)(1)(A) of the Bankruptcy Code, under the UFTA adopted by Oklahoma, a transfer is actually fraudulent if it was made with "actual intent to hinder, delay, or defraud" creditors.[313] The defendants argued that the legacy creditors had the burden of proving that the "main or only purpose" for the transactions separating the E&P Business from the other assets and liabilities of Kerr-McGee was the actual intent to prevent creditor from collecting debts.[314] Observing that liability may be imposed for actual fraudulent transfer when creditors knew about the fact of a transfer and its purpose in whole or part if the transferor intended to delay or hinder creditors,[315] the bankruptcy court relied on the recent decision by the Court of Appeals for the Seventh Circuit in the case of *In re Sentinel Management Group* to support a broader view of actual intent.[316] As described in more detail in Section III.B. of this Article, in *Sentinel*, a debtor had pledged client funds to secure short-term loans supporting trading activity for its own account in violation of its agreements with its clients and the Commodities Exchange Act, all in an effort to survive a financial crisis.[317] The Seventh Circuit held that the lower court had "too narrowly construe[d] the concept of actual intent" and even if the debtor had not intended "to render the funds permanently unavailable" to creditors, it "should have seen this result as a natural consequence of its actions" and is presumed to have intended the con-

[311]Tronox, 503 B.R. at 276–77.

[312]Tronox, 503 B.R. at 277.

[313]Tronox, 503 B.R. at 277.

[314]Tronox, 503 B.R. at 279.

[315]Tronox, 503 B.R. at 278.

[316]Tronox, 503 B.R. at 279 (citing *In re Sentinel Management Group, Inc.*, 728 F.3d 660, 58 Bankr. Ct. Dec. (CRR) 93, 70 Collier Bankr. Cas. 2d (MB) 566, Comm. Fut. L. Rep. (CCH) P 32717 (7th Cir. 2013)). The defendants relied on a decision in the *Sentinel* case that has since been withdrawn by the Court of Appeals for the Seventh Circuit. For an in-depth discussion of the Seventh Circuit's decisions in the *Sentinel* cases, see *supra* Section III.B.

[317]Sentinel, 728 F.3d at 660.

sequences of its actions, which was to delay or hinder creditors.[318] Following this reasoning, the bankruptcy court in *Tronox* concluded that actual intent could be found even where a debtor's scheme was not undertaken for nefarious or malicious purposes, but simply with the purpose of hindering or delaying creditors.[319]

Turning to the facts of *Tronox*, the bankruptcy court considered documentary evidence from the company's investment bankers and the testimony of key management figures indicating that the environmental liabilities being assigned to Tronox were abnormally large when compared against the liabilities of comparable companies.[320] The bankruptcy court also focused on attempts by Kerr-McGee to cleanse references to the legacy liabilities as a motivation for the transactions as those transactions were approved by board of directors.[321] The bankruptcy court determined that the record supported a finding that the principal goal of the transactions separating the E&P Business and Chemical Businesses was to free the E&P Business of liabilities resulting from the 85 year history of the Kerr-McGee and to make it a more attractive target for acquisition.[322] Even with a business justification for the transaction, the bankruptcy court held that, as a natural consequence of the transfers, legacy creditors were "hindered or delayed" because these creditors were left with claims against entities having a minimal asset base, and one that did not include the much more profitable E&P Business.[323] Thus, even without the consideration of the "badges of fraud," the court found that the plaintiffs established by clear and convincing evidence that

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[318]Sentinel, 728 F.3d at 667. The *Tronox* court also relied upon *ASARCO LLC v. Americas Mining Corp.*, 396 B.R. 278, 386 (S.D. Tex. 2008) (observing that a transfer may be made with fraudulent intent if not made with the intent to harm creditors, but where the debtor knew the transfer would inevitably delay or hinder creditors).

[319]*See* Tronox, 503 B.R. at 279. On this point, the court emphasized that the intent to delay or hinder creditors is penalized the same as the intent to defraud. Tronox, 503 B.R. at 278 (citing *In re Duncan & Forbes Development, Inc.*, 368 B.R. 27, 34 (Bankr. C.D. Cal. 2006)). The court explained that "[t]he intent to defraud is something distinct from the mere intent to delay or hinder", Tronox, 503 B.R. at 278 (quoting *In re Braus*, 248 F. 55, 64 (C.C.A. 2d Cir. 1917)), and that "[a] conveyance is illegal if made with an intent to defraud the creditors of the grantor, but equally it is illegal if made with an intent to hinder and delay them." Tronox, 503 B.R. at 278 (quoting *Shapiro v. Wilgus*, 287 U.S. 348, 354, 53 S. Ct. 142, 77 L. Ed. 355, 85 A.L.R. 128 (1932)).

[320]Tronox, 503 B.R. at 280.

[321]Tronox, 503 B.R. at 280–81.

[322]Tronox, 503 B.R. at 280–81.

[323]Tronox, 503 B.R. at 280–81.

the defendants acted to delay or hinder creditors when all of the legacy liabilities were imposed upon Tronox.[324]

The defendants attempted to rebut the evidence by offering three defenses, including that there existed a "legitimate supervening purpose"[325] for the transactions. They first argued that they believed that Tronox would be a successful standalone company, capable of paying its creditors.[326] In rejecting this argument, the bankruptcy court pointed to (1) the "compelling" fact that that defendants had apparently neglected to conduct a contemporaneous analysis of Tronox's ability to support its legacy liabilities postspinoff and (2) the fact that the defendants had spun off Tronox with a capital structure that included $550 million in debt, $40 million in cash and environmental liabilities which had in the past cost Kerr-McGee billions of dollars.[327] Next, the defendants claimed that the transactions unlocked the value of the E&P and Chemical Businesses and thus immunized the transfers from attack as fraudulent conveyances.[328] Although the court recognized a potential legitimate business purpose for the separation of the E&P Business, it found no business justification

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[324]Tronox, 503 B.R. at 282. The bankruptcy court also found that the plaintiffs provided evidence which supported five of the seven "badges of fraud" which would be relevant on the facts of this case, more than necessary to "stamp" a transaction as actually fraudulent under Oklahoma law. Tronox, 503 B.R. at 283–84 (citations omitted). The following five badges were present: The transfer or obligation was to an insider, as the 2002 transfers and IPO transfers were to insiders. Tronox, 503 B.R. at 283. The debtor retained possession or control after the transfer, as Kerr-McGee retained control after the 2002 transfers and the IPO and spinoff. Tronox, 503 B.R. at 283–84. The transfer or obligation was disclosed or concealed, as although the 2005–06 transfers were disclosed, disclosure of the 2002 transfers was ineffective and insubstantial. Tronox, 503 B.R. at 284. Before the transfer was made or obligations incurred, the debtor had been sued or threatened with suit, as Kerr-McGee had been litigating its environmental liabilities for years. The transfer was of substantially all the debtor's assets, as Kerr-McGee represented that the 2002 transfers represented substantially all of its assets, in any event the 2002 transfers represented more than 80% of its assets. Tronox, 503 B.R. at 284.

[325]Courts interpreting the Oklahoma UFTA have found that sufficient "badges of fraud" create only an inference of intent—i.e., a presumption that the defendant may rebut. Tronox, 503 B.R. at 284 (collecting cases). One of the ways of rebutting this presumption is by demonstrating some "legitimate supervening purpose" for the transfers. Tronox, 503 B.R. at 284 (citations omitted).

[326]Tronox, 503 B.R. at 284–85.

[327]Tronox, 503 B.R. at 285.

[328]Tronox, 503 B.R. at 288–89.

for imposing the totality of the legacy liabilities upon Tronox.[329] Finally, the defendants argued that they had merely attempted to limit the overall environmental liability of the Kerr-McGee group.[330] The court rejected this argument largely on policy grounds, noting that if this were an acceptable alternative, "all enterprises with substantial existing environmental liability would be encouraged to do exactly what [defendants] did."[331] The court relied upon the decision in *ASARCO LLC v. Americas Mining Corp.* which held, among other things that the defendants had the burden to prove a legitimate supervening purpose for "the 'manner in which the transfer was structured'" to conclude that the defendants failed to prove (i) a legitimate supervening purpose for the transfers and (ii) that their efforts to limit their liability were not intended to hinder or delay creditors.[332]

c. Constructive Fraudulent Transfer

After having found that the questioned transfers were actually fraudulent, the bankruptcy court next turned to the allegations that the transfers of the E&P Business were constructively fraudulent.[333] There was no dispute among the parties that the transfers constituted a conveyance of an interest in property and that the burden of proof is a preponderance of the evidence standard.[334] Therefore, the court considered whether: (1) reasonably equivalent value was paid in exchange for the E&P Business and related transfers, and (2) the result was insolvency, inadequate capitalization, or inability to pay debts as they came due.[335]

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[329]Tronox, 503 B.R. at 289.

[330]Tronox, 503 B.R. at 289.

[331]Tronox, 503 B.R. at 290.

[332]Tronox, 503 B.R. at 289 (citing *ASARCO LLC v. Americas Mining Corp.*, 396 B.R. 278, 392 (S.D. Tex. 2008) (holding, inter alia, that paying creditors with a security interest in stock, upon which they might foreclose, was a legitimate purpose for the transfer, but not sufficient to overcome the presumption of fraud)); *see also* Tronox, 503 B.R. at 291 (citing ASARCO, 396 B.R. at 375 (holding, inter alia, that a parent had acted with actual fraudulent intent to hinder, delay or defraud creditors even though it had paid reasonably equivalent value for the transferred assets)).

[333]Tronox, 503 B.R. at 289.

[334]Tronox, 503 B.R. at 289.

[335]Tronox, 503 B.R. at 289. Again, Oklahoma law applied, but the relevant provisions of the UFTA adopted by Oklahoma were substantially the same as section 548(a)(1)(B). Tronox, 503 B.R. at 289 (citing Okla. Stat. tit. 24, §§ 116(A)(2), 117(A)).

i. *Tronox Did Not Receive Reasonably Equivalent Value*

The parties disagreed as to whether Tronox had received "reasonably equivalent value" for the spinoff of the E&P Business.[336] The plaintiffs' expert explained that Old-Kerr McGee conveyed property worth approximately $17 billion and received in return property worth $2.6 billion: a $14.5 billion reduction in value.[337] Although the defendants did not quarrel with these calculations, they made several arguments including: (1) the "reasonably equivalent value" analysis could not include the transfer of the E&P Business, because that transfer took place outside of the statute of limitations in 2002; (2) the conversion of intercompany debt to equity in connection with the transfers counted as a contribution from Kerr-McGee to Tronox, and (3) reasonably equivalent value should be calculated on an entity-by-entity basis instead of on a consolidated basis, as proposed by the plaintiffs.[338]

The bankruptcy court rejected the defendants' three arguments that Tronox had received reasonably equivalent value in turn. The court initially noted that the 2002 transactions, which first separated the E&P Business from the remainder of Kerr-McGee's assets and liabilities was the first step in a single plan, and thus could be collapsed and analyzed for constructive fraud.[339] Next, the court refused to treat the forgiveness of intercompany debt as a contribution from New Kerr-McGee to Old Kerr-McGee, because the original balance should have been viewed as an equity investment in the first instance, as Kerr-McGee's general practice was to convert intercompany balances to equity if the subsidiary was unable to pay.[340] Finally, the court refused to conduct its constructive fraud analysis on an entity-by-entity basis, because Kerr-McGee had historically treated its environmental liabilities on a consolidated basis. Further, the defendants marketed Tronox as a consolidated entity in the IPO, with each of the Tronox entities liable on the debt issued in connection with the IPO as either a borrower or a guarantor.[341] Therefore, the court held that the plaintiffs had satisfied their burden of proving a lack of reasonably equivalent value "easily and without substantial dispute"

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[336]Tronox, 503 B.R. at 291–92.

[337]Tronox, 503 B.R. at 292.

[338]Tronox, 503 B.R. at 292–93.

[339]Tronox, 503 B.R. at 293.

[340]Tronox, 503 B.R. at 293.

[341]Tronox, 503 B.R. at 294.

when they demonstrated that, at the conclusion of the IPO, the value of Tronox had been reduced by $14.5 billion.[342]

ii. *The Transfers Resulted in Tronox's Insolvency, Inadequate Capitalization, or Inability to Pay Debts As They Became Due*

The more hotly contested issue was whether Tronox was, as a result of the transfers, made insolvent, left without sufficient capital, or unable to pay its debts as they became due.[343] On the issue of solvency, the defendants primarily relied upon two market defenses: (1) Tronox had issued $450 in secured debt, $350 million in unsecured bond debt and $224.7 million in stock in the IPO in 2005; and (2) a private equity firm had submitted a signed, fully financed offer to purchase the Chemical Business for $1.3 billion based on due diligence taking six months at a cost of millions of dollars.[344] Plaintiffs' response was twofold: the financial statements upon which the financial markets had relied for the IPO were false and misleading and the private equity bid was not "final and binding."[345]

The bankruptcy court agreed with the plaintiffs. The ability to issue $450 in secured debt did not deserve any weight in the solvency analysis because that debt was secured by all of the assets and the lenders knew they would come first in in a bankruptcy or liquidation.[346] The bankruptcy court noted, however, that while Tronox's ability to issue $350 million in unsecured bond debt and $224.7 million in stock was the defendants' strongest indication of solvency, those facts were unavailing

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[342]Tronox, 503 B.R. at 295.

[343]Tronox, 503 B.R. at 295. The bankruptcy court observed that the definition of insolvency contained in the Oklahoma UFTA was nearly identical to the definition of insolvency contained in section 101(32) of the Bankruptcy Code. Tronox, 503 B.R. at 295–96. In addition, the bankruptcy court observed that the definitions for "debt" and "claim" under the Bankruptcy Code are substantially identical to those in the Oklahoma UFTA. Tronox, 503 B.R. at 296.

[344]Tronox, 503 B.R. at 297, 304–05. Apollo Investors had placed a bid to purchase Tronox for $1.3 billion, but the court did not find the offer to be "final and binding" because critical parts of the contract remained to be negotiated. Tronox, 503 B.R. at 304. Furthermore, the court noted that Apollo Investors had re-negotiated and failed to honor positions taken earlier in the negotiations, leading management to testify that the company "didn't have a real opportunity there." Tronox, 503 B.R. at 305.

[345]Tronox, 503 B.R. at 304.

[346]Tronox, 503 B.R. at 297–98.

under the circumstances.[347] The bankruptcy court found that the financial statements were "false and misleading" because the projections contained inflated sell-side projections with key numbers imposed by Kerr-McGee's chief financial officer.[348] In addition, the evidence showed that the relevant financial statements for Tronox had "omitted certain critical contingencies and potential liabilities," including information about a federal Superfund site.[349] The court noted that financial statements use generally accepted accounting principles, which require reserves only for claims that are "probable and reasonably estimable" and thereby understate environmental liabilities.[350] In addition, the court questioned whether the private equity fund, which had previously failed to honor commitments with regards to Kerr-McGee, had made a "final and binding offer" for Tronox and was ever a serious bidder.[351] For that and a variety of other reasons, the court found that the private equity bid did not even provide "probative evidence" of Tronox's solvency at the time of the IPO.[352]

The bankruptcy court next examined evidence offered by both sides as to the amount of Tronox's various debts on the date of the IPO.[353] With respect to this issue, the single substantial dispute was over the amount of Tronox's environmental and tort liabilities.[354] The only comprehensive valuation of the environmental liabilities in the case was performed by the plaintiffs, which the court noted was a "major failure of proof" on the part of the defendants.[355] Although the defendants did submit a report, it was prepared only as a rebuttal to the plaintiffs' valuation and did not purport to be a comprehensive analysis.[356] The disagreement between the two sides primarily involved whether the plaintiffs' expert should have applied a "gating" analysis to

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[347]Tronox, 503 B.R. at 298.

[348]Tronox, 503 B.R. at 298–99.

[349]Tronox, 503 B.R. at 299.

[350]Tronox, 503 B.R. at 301.

[351]Tronox, 503 B.R. at 305.

[352]Tronox, 503 B.R. at 307. The bankruptcy court also rejected the defendants' argument that the confidence of Tronox's officers directors in its future was evidence of Tronox's solvency, noting that "the optimism of some of Tronox's management is no better proof of solvency than the despair of others." Tronox, 503 B.R. at 308.

[353]Tronox, 503 B.R. at 309.

[354]Tronox, 503 B.R. at 309.

[355]Tronox, 503 B.R. at 310–11.

[356]Tronox, 503 B.R. at 310–11.

determine the likelihood that Tronox would incur any cost at a particular remediation site.[357] In siding against the defendants, the court noted that the object of solvency analysis is to assign a "fair valuation" to all debts, defined in the "broadest possible sense" to include contingent, unmatured and unliquidated claims.[358] The court recognized the potential need to discount contingent claims by the possibility that the contingencies will never occur, but noted that environmental liabilities are not contingent because, like asbestos claimants, creditors with environmental claims are aware that their claims are accelerated by a bankruptcy filing.[359] Relying primarily in the plaintiff's witnesses, the bankruptcy court found that the fair value of Tronox's liabilities at the time of the IPO was $2,073,000,000.[360] Similarly, the bankruptcy court found that the fair value of Tronox's assets at the time of the IPO was $1.232 billion, and determined that Tronox's insolvency at the time of the IPO was $850,000.[361] While the court found that the record did not establish that Tronox could not pay its debts as they came due after the IPO, it nonetheless held that the plaintiffs had proved that the defendants should have known[362] that Tronox, as structured after the IPO, was insolvent, left without access to the capital markets due to its legacy environmental liabilities,[363] and likely to incur debts

[357]Tronox, 503 B.R. at 313.

[358]Tronox, 503 B.R. at 313.

[359]Tronox, 503 B.R. at 313.

[360]Tronox, 503 B.R. at 315.

[361]Tronox, 503 B.R. at 319.

[362]Tronox, 503 B.R. at 333–34. The second prong of the test for constructive fraud in the Oklahoma UFTA is that the debtor "intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due." Okla. Stat. tit. 24, § 116(A)(2)(b). The test has a subjective and objective element: either the debtor must have been objectively unable to pay its debts or reasonably should have come to that conclusion. Tronox, 503 B.R. at 333–34 (citing *ASARCO LLC v. Americas Mining Corp.*, 396 B.R. 278, 392, 399 (S.D. Tex. 2008)). The bankruptcy court found that while it was not clear that the plaintiffs had proved that Tronox had insufficient funds to pay its debts as of the IPO, at least in the short run, the plaintiff's had proved the subjective prong because they established that the defendants should have been aware that Tronox could not satisfy the legacy liabilities after the IPO. Tronox, 503 B.R. at 324.

[363]Tronox, 503 B.R. at 322.

beyond its ability to pay, even if the liabilities could have been "managed" in the short term.[364]

3. *Damages—The Interplay Between Sections 550 and 502(h)*

The most complex issue in the case—according to the bankruptcy court—was the measure of damages resulting from the fraudulent transfer claims.[365] Based on the record, the court found that plaintiffs had established that Tronox on a consolidated basis suffered a diminution in value of $14.459 billion as of the IPO.[366] The plaintiffs argued that pursuant to the language of section 550(a) of the Bankruptcy Code, they were entitled to recover the value of the property transferred.[367] However, the defendants asserted several bases for limiting recovery to the actual value of the legacy liability claims, arguing that to find otherwise would result in a windfall to the plaintiffs.[368]

a. Post-Trial Issue: Limits on Plaintiff's Recovery

In an earlier decision in the case determining motions for summary judgment addressing issues related to recovery under section 550(a) of the Bankruptcy Code, the defendants had argued that the "for the benefit of the estate" clause in section 550(a)[369] imposed a "cap" on the plaintiffs' recovery for fraudulently

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[364]Tronox, 503 B.R. at 324.

[365]Tronox, 503 B.R. at 327.

[366]Tronox, 503 B.R. at 327–28. The court was persuaded by the calculation of damages proffered by the plaintiffs' expert, who used a fair market value approach and the so-called Guideline Publicly Traded Company Method to calculate a value of approximately $6.6 billion as of the 2002 transfer and $12.5 billion as of the IPO date in 2005, the increase being attributable to the growth of the value of the assets in the interim. Tronox, 503 B.R. at 327. He then applied a 30% control premium and concluded that the value of the E&P Business was $15.9 billion as of the date of the IPO, an amount validated by the fact that Anadarko acquired the same assets for $15.8 billion a few months after the spinoff when it acquired New Kerr-McGee. Tronox, 503 B.R. at 327–28. The court arrived at $14.459 billion by adding to the value of the E&P Business other outbound transfers and then subtracting $2.55 billion in inbound consideration, such as certain debts assumed by New Kerr-McGee. Tronox, 503 B.R. at 328.

[367]Tronox, 503 B.R. at 328. The court also observed that there was never a question that the remedy in this case there would be recovery of value and not a reconveyance. Tronox, 503 B.R. at 266 n.29.

[368]Tronox, 503 B.R. at 329.

[369]Section 550(a) of the Bankruptcy Code provides:

> 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

transferred property at the amount of Tronox's unpaid creditor claims.[370] The bankruptcy court rejected defendants' arguments in favor of a recovery cap and found that such a ceiling would unfairly value the plaintiffs' agreement in the Tronox Plan confirmed in the case to give up their rights to a pro-rata distribution of estate property and instead receive a limited cash distribution and an uncertain litigation recovery. In ruling for the plaintiffs, the bankruptcy stated that "[o]nce some benefit to the estate is established, the cases do not use the 'benefit of the estate clause' in § 550(a) to impose a cap on recovery."[371]

The bankruptcy court noted that its previous decision had left open the possibility that other provisions of section 550, other sections of the Bankruptcy Code, and the bankruptcy court's equitable powers may mitigate the liability of the defendant in an avoidance action.[372] Turning first to the provisions limiting recovery contained in the Bankruptcy Code, the court dismissed as inapplicable limitations on liability based on sections 550(b) and 550(e) of the Bankruptcy Code, presumably because, respectively, the defendants did not improve the property transferred, nor were they subsequent transferees.[373] The court next refrained from conducting an analysis of the safe harbor for "good faith transferees" to the extent of "value give" provided under section 548(c) of the Bankruptcy Code and the analogous provision of the Oklahoma UFTA, because the plaintiffs in their calculation of damages had already given defendants full credit for the inbound consideration received primarily in the form of

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recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from: (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee.

11 U.S.C.A. § 550(a). For a discussion of section 550(a), see *supra* notes 110–37 and accompanying text.

[370]Tronox, 503 B.R. at 328 (citing *In re Tronox*, 464 B.R. 606, 609 (Bankr. S.D.N.Y 2012) ("Anadarko")).

[371]Tronox, 503 B.R. at 328 (citing Anadarko, 464 B.R. at 613–14). The plaintiffs, in connection with negotiating their recovery under the Tronox Plan confirmed in the bankruptcy cases, agreed that their recovery was limited to the distribution of the proceeds of this fraudulent transfer action, plus certain cash consideration for their claims. Tronox, 503 B.R. at 263. The commercial creditors of Tronox received a recovery of 58% to 78% (or 78% to 100% if they participated in a proposed rights offering). Tronox, 503 B.R. at 263.

[372]Tronox, 503 B.R. at 329 (citing *Anadarko*, 464 B.R. at 617–18).

[373]Tronox, 503 B.R. at 329, n.119. For the text and background of sections 550(b) and 550(e) of the Bankruptcy Code, see *supra* Section II.N, II.Q and note 154.

assumed debt.[374] Finally, the court recognized that, while section 502(d) of the Bankruptcy Code[375] bars recovery on the claims of a transferee who has not paid or turned over fraudulently transferred property, it does not create a claim and, in any case, the parties in connection with the Tronox Plan had agreed to offset any recovery to which the defendants would be entitled on their proofs of claim against their liability for damages as a result of the litigation.[376]

b. Post-Trial Issue: "Restorative Principle" of Section 502(h)

The bankruptcy court next addressed the potential impact on recovery of damages resulting from any claims that the defendants might be able to assert under section 502(h) of the Bankruptcy Code.[377] Section 502(h) provides that "[a] claim arising from the recovery of property under [section 550] shall be determined, and shall be allowed . . . or disallowed . . . the same as if such claim had arisen before the date of the filing of the petition."[378] The court observed that little authority exists for the application of section 502(h) in the context of fraudulent transfer recoveries, but noted that recipients of fraudulent transfers, including actually fraudulent transfers, have been permitted to share on parity with other creditors after surrendering the transferred assets.[379] In surveying the case law on this topic, the court explained that in "virtually all" of the few cases brought under section 502(h), the transferee has been awarded a claim for the consideration given for such property.[380] The plaintiffs proffered this construction of section 502(h) and argued that—

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[374]Tronox, 503 B.R. at 329.

[375]Section 502(d) of the Bankruptcy Code provides in relevant part:

> [T]he court shall disallow any claim of an entity from which property is recoverable under section . . . 550 . . . of this title or that is a transferee of a transfer avoidable under section . . . 544 . . . [or] 550 of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section . . . of this title.

11 U.S.C.A. § 502(d).

[376]Tronox, 503 B.R. at 329–330.

[377]Tronox, 503 B.R. at 330.

[378]11 U.S.C.A. § 502(h).

[379]Tronox, 503 B.R. at 330.

[380]Tronox, 503 B.R. at 331 (citing *In re Calpine Corp.*, 377 B.R. 808, 815, 48 Bankr. Ct. Dec. (CRR) 278, 58 Collier Bankr. Cas. 2d (MB) 1212 (Bankr. S.D. N.Y. 2007); *In re Best Products Co., Inc.*, 168 B.R. 35, 58 (Bankr. S.D. N.Y. 1994)). The bankruptcy court also cited *In re Dreier LLP*, 57 Bankr. Ct. Dec.

since their calculated damages of $14.459 billion were net of inbound consideration received from New Kerr-McGee—the defendants had no 502(h) claim.[381]

The defendants construed section 502(h) broadly, arguing that: (a) their claim should not be limited to the consideration paid for the property conveyed; and that (b) section 502(h) should restore the parties to the positions they would have had if the 2002 transactions been avoided at that time.[382] The latter point—identified by the defendants as "the restorative principle"—would entitle the defendants to the residual value of Kerr-McGee after all outstanding legacy liabilities had been satisfied.[383] The defendants based this notion on the Supreme Court's 1974 decision in *Bangor Punta Operations, Inc. v. Bangor & A. R. Co*.[384] A non-bankruptcy case, *Bangor Punta* involved a group of shareholders who purchased a corporation at what they conceded was a "fair price" and then asserted standing to bring an action for corporate waste against the former shareholders from whom they acquired their shares.[385] The Supreme Court held that to permit the new shareholders to recover from the former shareholders would be an unwarranted profit, because the price for the company paid by the new shareholders already reflected the diminution in value attributable to the corporate waste.[386]

In their posttrial briefing on the section 502(h) issue, the defendants distinguished *Bangor Punta's* "restorative principal" from the "creditor cap" argument made under section 550(a) and rejected by the bankruptcy court earlier in the case,[387] arguing that the "restorative principle" applies only to a subset of fraudulent transfer actions in which a purchaser is attempting to re-

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(CRR) 28, 2012 WL 4867376, *3 (Bankr. S.D. N.Y. 2012), where the court held that if a transferee did not give any consideration for the fraudulent transfer, there is nothing to reinstate and the return of the fraudulently transferred funds does not give rise to an allowable claim under section 502(h). Tronox, 503 B.R. at 331.

[381]Tronox, 503 B.R. at 331.

[382]Tronox, 503 B.R. at 332.

[383]Tronox, 503 B.R. at 332.

[384]Tronox, 503 B.R. at 332 (citing *Bangor Punta Operations, Inc. v. Bangor & A. R. Co.*, 417 U.S. 703, 94 S. Ct. 2578, 41 L. Ed. 2d 418, Fed. Sec. L. Rep. (CCH) P 94598 (1974)).

[385]Bangor Punta, 417 U.S. at 704.

[386]Bangor Punta, 417 U.S. at 712.

[387]Defendants' Post-Trial Brief at 261, Tronox Inc. v. Kerr-McGee Corp. (In re Tronox Inc.), No. 09-10156 (ALG), Adv. No. 09-1198 (ALG) (Bankr. S.D.N.Y. Nov. 21, 2013), ECF No. 594.

cover value from the seller in excess of that transferred in the original transaction.[388] The defendants asserted that since Old Kerr-McGee had acquired the Chemical Business—legacy liabilities and all—from New Kerr-McGee for a mix of cash and assumed liabilities, the "restorative principle" would limit the plaintiffs' recovery to the value of the cash and assumed liabilities—to the purchase price, essentially—and that any further recovery would be an unjustified windfall.[389]

In contrast, the plaintiffs had argued that the "restorative principle" was just another version of the defendants' argument under section 550(a) of the Bankruptcy Code that plaintiffs' claims should be limited to the value of the legacy liabilities—an argument rejected by the bankruptcy court on summary judgment.[390]

In analyzing the parties' disparate arguments made with respect to section 502(h) of the Bankruptcy Code, the bankruptcy court recognized that some cases have construed section 502(h) more broadly and found that claims arising under that section can include more than just the consideration paid by the defendant for the transferred assets and that a defendant should be able to prove whatever claim it would have in the absence of its fraudulent behavior.[391] The bankruptcy court observed the absence of authority providing direct support for the application of the *Bangor Punta* principal, which relates to shareholder standing to limit damages in a fraudulent conveyance action

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[388]Defendants' Post-Trial Brief at 259, In re Tronox.

[389]Defendants' Post-Trial Brief at 259, In re Tronox. Defendant New Kerr-McGee argued that the recovery limitation articulated in *Bangor Punta* applied to any recovery under section 550(a) because "[c]hanging the statutory context out of which a windfall recovery arises does not change the fact that it is a windfall." Defendants' Post-Trial Brief at 260, In re Tronox (citing *In re REA Exp., Inc.*, 412 F. Supp. 1239, 1253, 1976-2 Trade Cas. (CCH) ¶ 61166 (E.D. Pa. 1976)).

[390]*In re Tronox Incorporated*, 503 B.R. 239, 332 (Bankr. S.D. N.Y. 2013).

[391]Tronox, 503 B.R. at 331 (citing *In re Verco Indus.*, 704 F.2d 1134, 1138 (9th Cir. 1983) (section 502(h) claim was for losses defendant suffered when the transfer (the purchase of the portion of the debtor's business operations) was set aside); *Misty Management Corp. v. Lockwood*, 539 F.2d 1205, 1215 (9th Cir. 1976) (damages awarded for consideration paid by defendant for fraudulent transferred property and whatever other claim it would have in the absence of the fraudulent behavior); and *ASARCO LLC v. Americas Mining Corp.*, 404 B.R. 150, 181–82 (S.D. Tex. 2009) (defendant entitled to an offset of the fraudulent transfer judgment for the amount of the consideration ultimately paid for the stock)).

under section 550(a) of the Bankruptcy Code.[392] However, the court noted that section 502(h) was "fundamentally based on a type of restorative principle" and quoted *In re Best Products Co.* for the proposition that "when a fraudulent transfer is avoided, the parties are restored to their previous positions."[393] The court also quoted *In re Dreier*, which recognized that "[s]ection 502(h) is based on the principle of fraudulent transfer law that the return of a fraudulent transfer restores the parties to the *status quo*."[394] Ultimately, the *Tronox* court explained that "if the parties are to be restored to the positions they held before the transfers, [d]efendants would be entitled to the residual value of the [E&P Business] after their debts, including the legacy liabilities, were paid in full."[395]

c. Post-Trial Issue: Calculation of Defendants' Section 502(h) Claim

The bankruptcy court observed that "the measurement of damages under 502(h), so as to provide the defendants with a claim for the value of the E&P assets to which they would have been entitled after payment of the legacy liabilities," was "not an easy task."[396] This was in part due to the fact that all distributions from the Tronox Chapter 11 cases are governed by the Tronox Plan confirmed in the Chapter 11 cases.[397] Pursuant to the Tronox Plan, the plaintiffs had given up their rights to a *pro rata* distribution from the estate with other unsecured creditors in exchange for the damages in this fraudulent conveyance action.[398] The Tronox Plan also provided that the defendant's 502(h) claim, if any, would be treated as an offset against any judgment for the plaintiffs—"a concession" between the defendants and the

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[392]Tronox, 503 B.R. at 332. In a footnote the bankruptcy court noted that it could only use its equitable powers pursuant to limit damages in this case by application of § 502(h) "especially in light of those cases that find no limitation on damages in the plain words of the fraudulent conveyance statutes." Tronox, 503 B.R. at 332 n.121.

[393]Tronox, 503 B.R. at 332–33 (citing *In re Best Products Co., Inc.*, 168 B.R. 35, 58 (Bankr. S.D. N.Y. 1994)).

[394]Tronox, 503 B.R. at 333 (citing to fraudulent transfer action in *In re Dreier LLP*, 57 Bankr. Ct. Dec. (CRR) 28, 2012 WL 4867376, *3 (Bankr. S.D. N.Y. 2012)).

[395]Tronox, 503 B.R. at 333.

[396]Tronox, 503 B.R. at 333.

[397]Tronox, 503 B.R. at 333.

[398]Tronox, 503 B.R. at 333.

plaintiffs.[399] This concession was not a waiver of the defendant's right to recover on their claims; although the 502(h) claim was to be treated as an offset, the defendants were to be provided with a distribution comparable to that received by other creditors upon confirmation of the Tronox Plan.[400]

The bankruptcy noted that the defendants had reserved their rights to file claims under section 502(h) in the event of an adverse judgment in the case.[401] Because the court's decision had been long awaited and the damages issues had been extensively briefed, the bankruptcy court provided provisional findings on the subject of damages.[402] The court noted that since the parties had agreed in connection with the Tronox Plan that defendants' claim under section 502(h)—if allowed—would be multiplied by "the percentage recovery" of general unsecured creditors, it would be logical to calculate the claim in the same manner as if it were a claim allowed under the Tronox Plan.[403] When the Tronox Plan and its disclosure statement were disseminated in October 2010, the plaintiffs had estimated a mid-point value for the legacy liabilities of approximately $4 billion.[404] Therefore, the court indicated that if it were to accept the plaintiffs' valuation of the liabilities, the residual value of the E&P Business after satisfaction of those liabilities—and the amount of the defendants claim under section 502(h)—would be $10.459 billion: the $14.459 billion diminution in value suffered as of the IPO less the $4 billion value of the legacy liabilities.[405] The court, reconstructing the state of affairs as of confirmation, indicated that $10.459 billion represented the sum that would have been available to New Kerr-McGee as equity after payment of the legacy liabilities and stated that the defendants should provisionally have an allowed claim under section 502(h) for that amount.[406]

Pursuant to the Tronox Plan, the parties had agreed that the bankruptcy court would determine the percentage recovery on

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[399]Tronox, 503 B.R. at 335 n.126.

[400]Tronox, 503 B.R. at 333–34.

[401]Tronox, 503 B.R. at 335.

[402]Tronox, 503 B.R. at 335.

[403]Tronox, 503 B.R. at 335.

[404]Tronox, 503 B.R. at 335.

[405]Tronox, 503 B.R. at 335.

[406]Tronox, 503 B.R. at 335.

defendants' section 502(h) claim.[407] The court determined it could rely upon the recoveries projected in the disclosure statement approved in connection with the Tronox Plan. The plaintiffs had agreed that the defendants would be entitled to be treated as if they had participated in the rights offering contemplated by the Tronox Plan. The anticipated mean percentage of recovery for participants in the rights offering based upon the Tronox disclosure statement was 89%. Thus, if the defendants' recovery on their section 502(h) claim were valued at 89% of the $10.459 billion, the defendants would be entitled to an offset of $9,308,510,000 from the recovery of $14,459,000,000, resulting in a net damages award of $5,150,490,000.[408]

d. Post-Trial Issue: Dilutive Effect of Section 502(h) Claim on Creditor Recovery

The final issue related to damages was the question of the dilutive effect of the defendants' 502(h) claim on their ability to reduce any judgment in the litigation.[409] Although this issue was to be deferred until supplemental briefing could be completed by the parties, the bankruptcy court again provided some initial guidance. The disclosure statement for the Tronox Plan had estimated the recovery of the general unsecured creditors who participated in the rights offering at between 78% and 100%. This range of recovery was based upon general unsecured claims totaling $445.6 million and stock allocated to general unsecured creditors valued at $302,855,000, with a mean percentage recovery of 89%.[410] The claims of general unsecured creditors, however, would be dwarfed by the defendants' allowed section

[407]Tronox, 503 B.R. at 335.

[408]Tronox, 503 B.R. at 336. The bankruptcy court rejected defendants' argument—based on the postconfirmation record—that the total actual percentage recovery for the general unsecured creditors was 337%, an argument which relied on the fact that Tronox common stock had appreciated between the confirmation date and the effective date of the Tronox Plan. Tronox, 503 B.R. at 337. In denying this argument, the bankruptcy court refused to consider a recovery to general unsecured creditors that could not have been anticipated as of the confirmation. In any case, the court noted that such a recovery would have violated the absolute priority rule that creditors cannot receive more than 100% of the value of their claims. Interestingly, the $5.15 billion potential net damage award is nearly identical to the amount of the defendants' settlement payment in the Settlement Agreement proposed by the parties. *See supra* note 266.

[409]Tronox, 503 B.R. at 336.

[410]Tronox, 503 B.R. at 336.

502(h) claim for $10.459 billion.[411] If the defendants' claims under section 502(h) were included in the total amount of claims of general unsecured creditors, the total recovery to that class would have been diluted from 89% to roughly 2.8%.[412] Thus, if the offset were calculated based on the general unsecured creditors' diluted recovery instead of the recovery estimated by the disclosure statement, defendants would be entitled to a section 502(h) offset of roughly $293 million (instead of $9,308,510,000), resulting in a damages award for the plaintiffs of roughly $14.166 billion.[413]

The bankruptcy court noted that before making its final determination on damages, it would (i) allow the defendants to file a section 502(h) claim and brief the issue of the dilutive effect of the defendants' claim and (ii) give the plaintiffs an opportunity to respond.[414] Had the matter not been settled following the submission of briefing on this issue, the remaining issue to be determined by the bankruptcy court was whether the defendants should be liable for damages in the amount of $14,166,148,000 or $5,150,490,000.[415]

4. *Safe Harbor—The Section 546*(*e*) *Issue*

As trial approached and after the parties had spent millions of dollars preparing for it, the defendants moved to amend their answer to include the defense that the transfers at issue in the case were "settlement payments" or payments made or to or for the benefit of a "financial participant" in connection with a "securities contract" within the meaning of section 546(e) of the Bankruptcy Code.[416] The bankruptcy court denied the motion on the

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[411]Tronox, 503 B.R. at 336.

[412]Tronox, 503 B.R. at 336.

[413]Tronox, 503 B.R. at 336. Subject to approval of the district court, the parties have agreed to settle this dispute in exchange for payment by the defendants in this amount. *See supra* note 266.

[414]Tronox, 503 B.R. at 337.

[415]Tronox, 503 B.R. at 337.

[416]Tronox, 503 B.R. at 339. The defendants also asserted that the bankruptcy court lacked jurisdiction to enter a final judgment in the adversary proceeding, but the bankruptcy court held that not only had the defendants consented to the court's jurisdiction in their answer, but also that the claims in the adversary proceeding fell within the jurisdiction preserved by *Stern v. Marshall* because the process of adjudicating the defendants' proofs of claim required resolving the fraudulent conveyance and other claims against the defendants. Tronox, 503 B.R. at 343–47.

grounds of timeliness and waiver and on the ground that the amendment would—in any event—be futile.[417]

The bankruptcy court explained that Rule 8(c)(1) of the Federal Rules of Civil Procedure provides that a party responding to a pleading must affirmatively state any avoidance or affirmative defense.[418] The court noted that the defendants' section 546(e) safe harbor defense was a "classic affirmative defense" which would intervene to shield the transfers from avoidance even if the plaintiffs successfully prove the elements of the claims. The defense had been waived, since it had not been asserted earlier in the case despite several opportunities, and could not be preserved by a general pleading under Rule 12(b)(6) of the Federal Rules of Civil Procedure of "failure to state a claim upon which relief may be granted" or by Rule 12(h)(2), which provides that certain defenses may be asserted "at trial."[419] This outcome was necessary to "protect the plaintiff from being ambushed with an affirmative defense."[420]

Regardless of whether the section 546(e) defense had been waived, the bankruptcy court remarked that such a defense was futile, because the transactions at issue were not "settlement

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[417]Tronox, 503 B.R. at 340.

[418]Tronox, 503 B.R. at 339. Rule 8(c)(1) of the Federal Rules of Civil Procedure provides:

> In responding to a pleading, a party must affirmatively state any avoidance or affirmative defense, including: accord and satisfaction; arbitration and award; assumption of risk; contributory negligence; duress; estoppel; failure of consideration; fraud; illegality; injury by fellow servant; laches; license; payment; release; res judicata; statute of frauds; statute of limitations; and waiver.

Fed. R. Civ. P. 8(c)(1).

[419]Tronox, 503 B.R. at 339. Rule 12(b) of the Federal Rules of Civil Procedure provides:

> Every defense to a claim for relief in any pleading must be asserted in the responsive pleading if one is required. But a party may assert the following defenses by motion: (1) lack of subject-matter jurisdiction; (2) lack of personal jurisdiction; (3) improper venue; (4) insufficient process; (5) insufficient service of process; (6) failure to state a claim upon which relief can be granted; (7) and failure to join a party under Rule 19.

Fed. R. Civ. P. 12(b). Rule 12(h)(2) of the Federal Rules of Civil Procedure provides:

> Failure to state a claim upon which relief can be granted, to join a person required by Rule 19(b), or to state a legal defense to a claim may be raised: (A) in any pleading allowed or ordered under Rule 7(a); (B) by a motion under Rule 12(c); or (C) at trial.

Fed. R. Civ. P. 12(h)(2).

[420]Tronox, 503 B.R. at 339 (citations omitted).

payments" in the context of a securities trade,[421] nor were the challenged transfers made to financial participants in connection with a "securities contract."[422] With respect to whether the transactions at issue were settlement payments in connection with a securities trade, the bankruptcy court emphasized that the defendants presented no evidence that the changes of ownership of the stock of the E&P Business from Old Kerr-McGee to New Kerr-McGee constituted a settlement payment.[423] For example, the court noted that even the defendants referred to this transaction as a "reorganization" in their financial statements. Moreover, the court noted that a " 'one-way payment' is not a 'settlement payment.' "[424] The bankruptcy court also rejected the defendants' claims that Kerr-McGee was a "financial participant" within the meaning of sections 546(e) and 101(22A) of the Bankruptcy Code and that the transfers of ownership were made in connection with a "securities contract," as defined in section 741(7) of the Bankruptcy Code, noting that the defendants failed to identify a "securities contract" or any other contact that would fall within the provisions of section 741(7).[425] Instead, the

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[421]Tronox, 503 B.R. at 341 (citing *In re Appleseed's Intermediate Holdings, LLC*, 470 B.R. 289, 302 (D. Del. 2012)). The term "settlement payment" is defined in section 741(8) of the Bankruptcy Code as "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 in the securities trade." 11 U.S.C.A. § 741(8). Although the bankruptcy court admitted that a definition of "settlement payment" "defies plain meaning," *see* Tronox, 503 B.R. at 341 (citing *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 675 (D.R.I. 1998)), the court indicated that the term must be interpreted "as it is plainly understood within the securities industry," *see* Tronox, 503 B.R. at 341 (citing *In re Kaiser Steel Corp.*, 952 F.2d 1230, 1237, 26 Collier Bankr. Cas. 2d (MB) 443, Bankr. L. Rep. (CCH) P 74387 (10th Cir. 1991)), and ultimately found that the change in ownership of the stock of the E&P Business from Old Kerr-McGee to New Kerr-McGee constituted a "one-way payment" made in a reorganization, and not a "settlement payment." Tronox, 503 B.R. at 341.

[422]Tronox, 503 B.R. at 343.

[423]Tronox, 503 B.R. at 341–43.

[424]Tronox, 503 B.R. at 341–43 (citing Appleseed's Holdings, 470 B.R. at 302; *In re Integra Realty Resources, Inc.*, 198 B.R. 352, 360, 29 Bankr. Ct. Dec. (CRR) 353 (Bankr. D. Colo. 1996), subsequently aff'd, 354 F.3d 1246, 42 Bankr. Ct. Dec. (CRR) 111 (10th Cir. 2004)).

[425]Tronox, 503 B.R. at 342. The definition of "securities contract" contained in section 741(7) of the Bankruptcy Code is lengthy, but it includes:

> (i) a contract for the purchase, sale, or loan of a security . . . (ii) any option entered into on a national securities exchange . . . (iii) the guarantee (including by novation) by or to any securities clearing agency of a settlement of cash, securities, certificates

court concluded that the various agreements separating the businesses entered into by the defendants in 2005 were not "contracts for the purchase, sale or loan of a security,"[426] but rather were merely contracts confirming the allocation of assets and liabilities between the subsidiaries of Kerr-McGee.[427]

5. *The Defendants' Belated Jurisdiction Argument Based on Stern v. Marshall*

Finally, the bankruptcy court rejected the defendants' belated effort to assert that the bankruptcy court lacked authority to enter final orders or a judgment in the plaintiffs' action in light of the Supreme Court's decision in *Stern v. Marshall*. This attempt was predicated upon the defendants' alleged lack of informed consent to jurisdiction due to their inability to "contemplate 'a new class of claims that, although statutory 'core,' were deemed to be outside the constitutional authority of the bankruptcy court to adjudicate to a final determination—absent the consent of the parties.' "[428] The defendants argued that their earlier consent to jurisdiction, even though expressly given, could not be presumed because their consent was given before the Supreme Court rendered its decision in *Stern*.[429] However, the bankruptcy court noted that the defendants were unlike the defendant in *Stern*, where the estate's counterclaim was unrelated to the proof of claim filed by the defendant there.[430] In *Tronox*, the defendants had not only consented to the bankruptcy court's authority in their answer to the second amended complaint, they had also filed proofs of claims against the debtors for damages now valued by them in the billions of dollars that were related to the very transactions that were subject of the plaintiffs' "core" fraudulent

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of deposit, mortgage loans or interests therein . . . (iv) any margin loan . . . (v) any extension of credit for the clearance or settlement of securities transactions . . . (vi) any loan transaction coupled with a securities collar transaction . . . (vii) any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph . . . (viii) any combination of the agreements or transactions referred to in this subparagraph . . . (ix) any option to enter into any agreement or transaction referred to in this subparagraph . . . (x) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), (iv), (v), (vi), (vii), (viii), or (ix) . . . (xi) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this subparagraph.

11 U.S.C.A. § 741(7).

[426]Tronox, 503 B.R. at 343.

[427]Tronox, 503 B.R. at 343.

[428]Tronox, 503 B.R. at 344.

[429]Tronox, 503 B.R. at 344.

[430]Tronox, 503 B.R. at 344.

transfer claims. In other words, the defendants consented to the bankruptcy court's jurisdiction by filing their related proofs of claim.[431]

The bankruptcy court also noted that defendants could have preserved the issue about the subset of "core" claims potentially outside of the bankruptcy court's authority to finally resolve, as the Supreme Court had already granted certiorari in *Stern* and its decision was expected in 2011 while *Tronox* was in its earlier stages.[432] In addition, the bankruptcy court distinguished the facts present in *Tronox* from those present in the decisions involving consent to jurisdiction that are expected to be clarified by the Supreme Court in its review of the Ninth Circuit's decision in the *Bellingham* case.[433] None of the decisions under review in *Bellingham* "involved defendants who had filed proofs of claim, and all involved one form or another of implied consent based upon the

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[431]Tronox, 503 B.R. at 344–45 ("Although the parties were eventually able to agree on a treatment of Defendants' claims (other than its § 502(h) claim) that permitted Tronox to confirm a plan without first resolving this adversary proceeding, there was no question that 'the process of adjudicating' Defendants' proofs of claim required resolution of Plaintiff's fraudulent conveyance and other claims against the Defendants.") (citing, among other cases, *Stern v. Marshall*, 131 S. Ct. 2594, 2616, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011); *Langenkamp v. Culp*, 498 U.S. 42, 111 S. Ct. 330, 112 L. Ed. 2d 343, 20 Bankr. Ct. Dec. (CRR) 1953, 23 Collier Bankr. Cas. 2d (MB) 973, Bankr. L. Rep. (CCH) P 73668, 18 Fed. R. Serv. 3d 586 (1990); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S. Ct. 2782, 106 L. Ed. 2d 26, 19 Bankr. Ct. Dec. (CRR) 493, 20 Collier Bankr. Cas. 2d (MB) 1216, Bankr. L. Rep. (CCH) P 72855, 18 Fed. R. Serv. 3d 435 (1989); *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); *In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 562 n.7, 57 Bankr. Ct. Dec. (CRR) 89, 68 Collier Bankr. Cas. 2d (MB) 1429, Bankr. L. Rep. (CCH) P 82404 (9th Cir. 2012), cert. granted, 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013) and aff'd, 134 S. Ct. 2165, 59 Bankr. Ct. Dec. (CRR) 160 (2014); *In re Global Technovations Inc.*, 694 F.3d 705, 722, 56 Bankr. Ct. Dec. (CRR) 266, 77 A.L.R. Fed. 2d 581 (6th Cir. 2012)).

Though the question of whether parties may consent to having a bankruptcy court finally adjudicate certain claims was certified for appeal by the Supreme Court in *Bellingham*, the Court ultimately declined to rule on this issue. *See*) *Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2169 n.4, 59 Bankr. Ct. Dec. (CRR) 160 (2014). Accordingly, circuit law regarding litigant consent as a basis for a bankruptcy court's authority to finally adjudicate claims remains good law after *Bellingham*.

[432]Tronox, 503 B.R. at 345–56.

[433]Tronox, 503 B.R. at 346. For a discussion of *Bellingham*, see *supra* Section III.A.

defendant's participation in litigation, default or other form of action or inaction."[434]

6. *Significance of Tronox*

Although it appears that the decision in *In re Tronox* will not be reviewed by an appellate court, the decision illustrates the difficulties and conflicts which can arise when a business seeks to isolate significant liabilities in transactions outside of a bankruptcy case. In addition, the *Tronox* decision highlights complications associated to the application of section 502(h) in fraudulent transfer cases in which recovery is ordered and the related and possibly unforeseen consequences when provisions in a plan of reorganization override operation of the Bankruptcy Code. In light of the continuing uncertainty about the extent and applicability of section 502(h) to amounts recovered in fraudulent transfer actions, it is not surprising that the parties in *Tronox* decided to settle; they seemingly used the bankruptcy court's analysis as a roadmap arriving at the amount of the damages to be paid by the defendants.

D. *In re Fitness Holdings International Inc.: Ninth Circuit Court of Appeals Holds that a Court May Recharacterize Debt as Equity in Fitness Holdings Fraudulent Transfer Case*

The United States Court of Appeals for the Ninth Circuit in the case of *Official Committee of Unsecured Creditors v. Hancock Park Capital, L.P.* (*In re Fitness Holdings International Inc.*)[435] recently ruled: (a) that the bankruptcy court has authority to recharacterize a purported loan from the debtor's shareholder as an equity investment for purposes of determining whether transfers in repayment to the shareholder were constructively

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[434]Tronox, 503 B.R. at 346. The bankruptcy court held it had jurisdiction to enter final judgment in the adversary proceeding, but, if an appellate court should disagree, it requested that its decision be deemed proposed findings of fact and conclusions of law for final entry by the district court. Tronox, 503 B.R. at 347. This outcome would be consistent with the standing order in place in the Southern District of New York allowing district courts to 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 court could not have properly entered a final order in that proceeding. *See 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).

[435]*In re Fitness Holdings Intern., Inc.*, 714 F.3d 1141, 57 Bankr. Ct. Dec. (CRR) 243, 69 Collier Bankr. Cas. 2d (MB) 1089, Bankr. L. Rep. (CCH) P 82493 (9th Cir. 2013), for additional opinion, see, 2013 WL 1800978 (9th Cir. 2013), opinion amended and superseded on reh'g, 529 Fed. Appx. 871 (9th Cir. 2013).

fraudulent under section 548(a)(1)(B) of the Bankruptcy Code if the complaint plausibly alleges that the interests created by the debtor constituted equity rather than debt; and (b) that a transaction creates a debt if it creates a right to payment under state law.[436] In so doing, the Ninth Circuit overruled a long-standing decision of the Bankruptcy Appellate Panel for the Ninth Circuit in *In re Pacific Express, Inc.*, which held that the " 'characterization of claims as equity or debt' is governed by [section] 510(c),"—the Bankruptcy Code section providing for equitable subordination.[437] As a result of this decision, the Ninth Circuit joins several other circuits which permit a claim to be challenged on the grounds that it should be recharacterized as equity instead of debt,[438] and that such a challenge can be made separate from an equitable subordination action. The risk of recharacterization of debt as equity is now an issue for consideration by stakeholders and constituents in bankruptcy cases in the Ninth Circuit.

1. *Background*

Fitness Holdings International, Inc. ("FHI") was a California-based fitness corporation that sold exercise machines for homes. It was funded primarily by its sole shareholder, Hancock Park Capital II, L.P. ("Hancock Park"), and a traditional lender, Pacific

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[436]Fitness Holdings, 714 F.3d at 1143.

[437]Fitness Holdings, 714 F.3d at 1147 (quoting *In re Pacific Exp., Inc.*, 69 B.R. 112, 115, 15 Bankr. Ct. Dec. (CRR) 629, 16 Collier Bankr. Cas. 2d (MB) 286 (B.A.P. 9th Cir. 1986)). Section 510(c) of the Bankruptcy Code provides, in relevant part, that a court may "under principles of subordination, subordinate for purposes of distribution, all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest." 11 U.S.C.A. § 510(c).

[438]In holding that the court had the authority to recharacterize claims as equity in bankruptcy proceedings, the Ninth Circuit joined the Third, Fourth, Fifth, Sixth, and Tenth Circuits. Fitness Holdings, 714 F.3d at 1148. *See In re Lothian Oil Inc.*, 650 F.3d 539, 542–43, 55 Bankr. Ct. Dec. (CRR) 67, 66 Collier Bankr. Cas. 2d (MB) 69, Bankr. L. Rep. (CCH) P 82055 (5th Cir. 2011), cert. denied, 132 S. Ct. 1573, 182 L. Ed. 2d 170 (2012); *In re Official Committee Of Unsecured Creditors for Dornier Aviation (North America), Inc*, 453 F.3d 225, 231, 46 Bankr. Ct. Dec. (CRR) 189, Bankr. L. Rep. (CCH) P 80636 (4th Cir. 2006); *In re SubMicron Systems Corp.*, 432 F.3d 448, 454, 45 Bankr. Ct. Dec. (CRR) 232, 55 Collier Bankr. Cas. 2d (MB) 1077, Bankr. L. Rep. (CCH) P 80436 (3d Cir. 2006); *In re Hedged-Investments Associates, Inc.*, 380 F.3d 1292, 1298, 43 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 80151 (10th Cir. 2004); *In re AutoStyle Plastics, Inc.*, 269 F.3d 726, 748, 45 U.C.C. Rep. Serv. 2d 964, 2001 FED App. 0378P (6th Cir. 2001).

Western Bank.[439] The funding from Hancock Park took the form of eleven separate subordinated promissory notes, issued between 2003 and 2006 with stated maturity dates and bearing interest at 10% annually. This financing totaled about $24 million.[440] In July 2004, Pacific Western Bank provided additional financing of $13 million, which consisted of a revolving loan and an installment loan, both secured by the assets of FHI and guaranteed by Hancock Park.[441] Due to FHI's financial difficulties, the loan agreements between FHI and Pacific Western Bank were amended on several occasions to extend certain maturity dates and to waive past breaches. Finally, in June 2007, FHI and Pacific Western Bank agreed to a refinancing arrangement by which Pacific Western Bank made two loans to FHI totaling $17 million that were secured by all of FHI's assets. The loans: (1) effectively released Hancock Park from its guarantee obligations; and (2) paid off the promissory notes held by Hancock Park.[442]

The 2007 refinancing proved unsuccessful and FHI filed for Chapter 11 protection in October 2008.[443] Shortly thereafter, the official committee of unsecured creditors of FHI filed a complaint to avoid and recover the transfer made by FHI to pay off the unsecured notes held by Hancock Park.[444] The complaint also sought declaratory relief.[445] Because transfers made to satisfy antecedent debt are considered made for "reasonably equivalent value" and not subject to avoidance under section 548(a) of the Bankruptcy Code, in order to attempt to avoid the repayment of the unsecured notes as constructively fraudulent, the committee requested that the court recharacterize the original Hancock Park investment as an equity investment in FHI, rather than an extension of credit.[446] The bankruptcy court granted Hancock Park's motion to dismiss all of the claims with prejudice.[447]

Following conversion of FHI's bankruptcy case to a Chapter 7

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[439]Fitness Holdings, 714 F.3d at 1143.

[440]Fitness Holdings, 714 F.3d at 1143.

[441]Fitness Holdings, 714 F.3d at 1143.

[442]Fitness Holdings, 714 F.3d at 1143–44.

[443]Fitness Holdings, 714 F.3d at 1144.

[444]Fitness Holdings, 714 F.3d at 1144.

[445]Fitness Holdings, 714 F.3d at 1144. The Ninth Circuit's decision under discussion in this Article addresses the trustee's request for declaratory relief with respect to his constructive fraudulent transfer claims.

[446]Fitness Holdings, 714 F.3d at 1144.

[447]Fitness Holdings, 714 F.3d at 1144.

case, the court-appointed trustee appealed the bankruptcy court's ruling to the district court.[448] Although several other circuits had permitted the recharacterization of claims as equity or debt, the district court held that recharacterization in the Ninth Circuit had been barred by a bankruptcy appellate panel decision in *In re Pacific Express*, *Inc*., which declared that the Bankruptcy Code does "not provide for the characterization of claims as equity or debt."[449] For this reason, the district court refused to consider the question of whether, and under what circumstances, Hancock Park's contributions to the debtor might be recharacterized as equity and affirmed the bankruptcy court's dismissal of the claims. The Chapter 7 trustee appealed the district court's decision to the Ninth Circuit.[450]

2. *Ninth Circuit Approves Recharacterization Pursuant To State Law*

On appeal, the Ninth Circuit began its fraudulent transfer analysis by examining the language of section 548(a) of the Bankruptcy Code and a number of related definitions.[451] As background, the Ninth Circuit explained that a transfer can be avoided as constructively fraudulent by the trustee under section 548 of the Bankruptcy Code if made for "less than a reasonably equivalent value" and, broadly speaking, the transfer resulted in the deb-

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[448]*In re Fitness Holdings Intern., Inc.*, 2011 WL 7763674 (C.D. Cal. 2011), vacated and remanded, 714 F.3d 1141, 57 Bankr. Ct. Dec. (CRR) 243, 69 Collier Bankr. Cas. 2d (MB) 1089, Bankr. L. Rep. (CCH) P 82493 (9th Cir. 2013), for additional opinion, see, 2013 WL 1800978 (9th Cir. 2013), opinion amended and superseded on reh'g, 529 Fed. Appx. 871 (9th Cir. 2013) and aff'd in part, vacated in part, rev'd in part, 529 Fed. Appx. 871 (9th Cir. 2013).

[449]*In re Fitness Holdings Intern., Inc.*, 2011 WL 7763674, *5 (C.D. Cal. 2011), vacated and remanded, 714 F.3d 1141, 57 Bankr. Ct. Dec. (CRR) 243, 69 Collier Bankr. Cas. 2d (MB) 1089, Bankr. L. Rep. (CCH) P 82493 (9th Cir. 2013), for additional opinion, see, 2013 WL 1800978 (9th Cir. 2013), opinion amended and superseded on reh'g, 529 Fed. Appx. 871 (9th Cir. 2013) and aff'd in part, vacated in part, rev'd in part, 529 Fed. Appx. 871 (9th Cir. 2013) (quoting *In re Pacific Exp., Inc.*, 69 B.R. 112, 15 Bankr. Ct. Dec. (CRR) 629, 16 Collier Bankr. Cas. 2d (MB) 286 (B.A.P. 9th Cir. 1986)).

[450]Fitness Holdings, 714 F.3d at 1144. Because the district court dismissed the trustee's complaint for failure to state a claim, the Ninth Circuit reviewed the decision de novo. Fitness Holdings, 714 F.3d at 1144 (citations omitted).

[451]Fitness Holdings, 714 F.3d at 1145–46. The Ninth Circuit observed that the trustee brought a "recharacterization" claim as a separate cause of action, and interpreted this claim as a request for a determination that FHI's transfer to Hancock Park was not in repayment of a "debt" as that term is defined by section 101(12) of the Bankruptcy Code. Fitness Holdings, 714 F.3d at 1145 n.4.

tor's insolvency.[452] The Ninth Circuit noted that a determination that the transfer was made for "reasonably equivalent value" precludes a finding that it was constructively fraudulent under section 548.[453]

In determining under section 548(a)(1)(B) whether a debtor has received "reasonably equivalent value" in exchange for a transfer, the Ninth Circuit observed that the Bankruptcy Code's definition of "value" includes the "satisfaction or securing of a present or antecedent debt of the debtor."[454] Debt is defined as "liability on a claim,"[455] and a "claim," in turn, is defined in relevant part to mean "a right to payment."[456] Therefore, the Ninth Circuit concluded that "to the extent a transfer is made in satisfaction of a 'claim' (*i.e.*, a 'right to payment'), that transfer is made for 'reasonably equivalent value' for purposes of § 548(a)(1) . . . [which] precludes a determination that it was constructively fraudulent under § 548(a)(1)(B)."[457] The court observed that since the term "right to payment" is not defined in the Bankruptcy Code, the "nature and scope of the term must be determined through the application of state law principles," unless Congress has provided otherwise.[458]

In holding that a court may recharacterize a debtor's obligation in order to determine whether the purported debt constituted a right to payment under state law, the Ninth Circuit (i) expressly disagreed with the decision of the Bankruptcy Appellate Panel for the Ninth Circuit *In re Pacific Express, Inc.*, which limited courts to the statutory remedy of equitable subordination under section 510(c) of the Bankruptcy Code, and (ii) noted that recharacterization and equitable subordination under section

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[452]Fitness Holdings, 714 F.3d at 1145–46.

[453]Fitness Holdings, 714 F.3d at 1145–46.

[454]Fitness Holdings, 714 F.3d at 1145 (quoting 11 U.S.C. § 548(d)(2)(A)).

[455]Fitness Holdings, 714 F.3d at 1146 (quoting 11 U.S.C. § 101(12)).

[456]Fitness Holdings, 714 F.3d at 1146 (quoting 11 U.S.C. § 101(5)(A)).

[457]Fitness Holdings, 714 F.3d at 1146 (citing *In re United Energy Corp.*, 944 F.2d 589, 595–96, 22 Bankr. Ct. Dec. (CRR) 143, 25 Collier Bankr. Cas. 2d (MB) 740, Bankr. L. Rep. (CCH) P 74294 (9th Cir. 1991)).

[458]Fitness Holdings, 714 F.3d at 1146 (citing *Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co.*, 549 U.S. 443, 127 S. Ct. 1199, 167 L. Ed. 2d 178, 47 Bankr. Ct. Dec. (CRR) 265, 57 Collier Bankr. Cas. 2d (MB) 314, Bankr. L. Rep. (CCH) P 80880 (2007); *Butner v. U.S.*, 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979)).

510(c) address distinct concerns.[459] The Ninth Circuit observed that equitable subordination is a remedy which allows a court to rely upon equitable principles to subordinate claims, whereas when considering avoidance of transfers under section 548(a)(1)(B), a court "must determine whether the transfer is for the repayment of a 'claim' at all."[460]

The Ninth Circuit recognized that several other circuit courts of appeal have also concluded that the Bankruptcy Code authorizes courts to recharacterize claims in bankruptcy proceedings.[461] After reviewing these circuits, the Ninth Circuit expressly adopted the approach taken by the Fifth Circuit in *In re Lothian Oil*, finding that it is more consistent with Supreme Court precedent than those of circuits which fashioned recharacterization in reliance on the general equitable authority provided by section 105(a) of the Bankruptcy Code.[462] This is because the Supreme Court has indicated that such an approach is inconsistent with the Court's precedent requiring courts to determine whether a party has a right to payment by reference to state law.[463] In aligning itself with the Fifth Circuit, which had relied on Texas law to distinguish between debt and equity, the Ninth Circuit in *Fitness Holdings* ruled that state rather than federal law provides the appropriate test for determining when to recharacterize a debt as equity.

Looking to the facts of *Fitness Holdings*, the Ninth Circuit held that the district court had erred because it concluded wrongly

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[459]Fitness Holdings, 714 F.3d at 1143, 1147.

[460]Fitness Holdings, 714 F.3d at 1147.

[461]Fitness Holdings, 714 F.3d at 1148 (citing *In re Lothian Oil Inc.*, 650 F.3d 539, 542–43, 55 Bankr. Ct. Dec. (CRR) 67, 66 Collier Bankr. Cas. 2d (MB) 69, Bankr. L. Rep. (CCH) P 82055 (5th Cir. 2011), cert. denied, 132 S. Ct. 1573, 182 L. Ed. 2d 170 (2012); *In re SubMicron Systems Corp.*, 432 F.3d 448, 454, 45 Bankr. Ct. Dec. (CRR) 232, 55 Collier Bankr. Cas. 2d (MB) 1077, Bankr. L. Rep. (CCH) P 80436 (3d Cir. 2006); *In re Official Committee Of Unsecured Creditors for Dornier Aviation (North America), Inc*, 453 F.3d 225, 231, 46 Bankr. Ct. Dec. (CRR) 189, Bankr. L. Rep. (CCH) P 80636 (4th Cir. 2006); *In re Hedged-Investments Associates, Inc.*, 380 F.3d 1292, 1298, 43 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 80151 (10th Cir. 2004); and *In re AutoStyle Plastics, Inc.*, 269 F.3d 726, 748, 45 U.C.C. Rep. Serv. 2d 964, 2001 FED App. 0378P (6th Cir. 2001)).

[462]Fitness Holdings, 714 F.3d at 1148. In determining a request to recharacterize certain loan agreements as equity for purposes of claims disallowance under section 502 of the Bankruptcy Code, the Ninth Circuit looked to *Lothian Oil*, which examined Texas law to distinguish between debt and equity. Fitness Holdings, 714 F.3d at 1148 (citing Lothian Oil, 650 F.3d at 432).

[463]Fitness Holdings, 714 F.3d at 1148–49 (citing Butner, 440 U.S. at 48).

that, under the precedent set by the Bankruptcy Appellate Panel for the Ninth Circuit in *Pacific Express*, it was barred from considering whether the complaint plausibly alleged that the Hancock Notes could be "recharacterized as creating equity interests, rather than debt" under applicable state law principles.[464] As a result, the district court failed to apply the correct standard when considering the trustee's allegation that FHI did not receive reasonably equivalent value in exchange for its transfers to Hancock Park. Rather than rule on these issues in the first instance, the Ninth Circuit vacated the district court's dismissal of the trustee's constructive fraudulent transfer claim and remanded the case for further proceedings consistent with its opinion.[465]

3. *Fitness Holdings On Remand*

On remand from the Ninth Circuit, the district court remanded the matter to the bankruptcy court for further proceedings.[466] In a subsequent hearing before the bankruptcy court on the recharacterization claim, the parties disagreed as to whether the original Hancock Park investment truly constituted a right to

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[464]Fitness Holdings, 714 F.3d at 1149. The Ninth Circuit criticized the district court for failing to recognize that decisions of the Bankruptcy Appellate Panel have no precedential value for a district court. Fitness Holdings, 714 F.3d at 1144 n.3 (quoting *Bank of Maui v. Estate Analysis, Inc.*, 904 F.2d 470, 472, 20 Bankr. Ct. Dec. (CRR) 919, 23 Collier Bankr. Cas. 2d (MB) 848, Bankr. L. Rep. (CCH) P 73411 (9th Cir. 1990) (" 'As Article III courts, the district courts must always be free to decline to follow BAP decisions and to formulate their own rules within their jurisdiction' ")).

[465]Fitness Holdings, 714 F.3d at 1150. The Ninth Circuit did not address the bankruptcy court's authority to enter a final judgment on this issue. As noted above, in late 2012, the Ninth Circuit held, in light of the Supreme Court's opinion in *Stern v. Marshall*, that fraudulent conveyance claims cannot be adjudicated by non-Article III judges absent the parties' express or implied consent, at least where the defendant has not filed a proof of claim. *See In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 561, 57 Bankr. Ct. Dec. (CRR) 89, 68 Collier Bankr. Cas. 2d (MB) 1429, Bankr. L. Rep. (CCH) P 82404 (9th Cir. 2012), cert. granted, 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013) and aff'd, 134 S. Ct. 2165, 59 Bankr. Ct. Dec. (CRR) 160 (2014). Because the issue of litigant consent as a basis for a bankruptcy court's authority to decide a matter was not resolved by the Supreme Court in *Bellingham*, circuit law regarding litigant consent (including the Ninth Circuit's holding in *Bellingham* on this issue) remains good law. This issue apparently was not raised in *Fitness Holdings*.

[466]Order Remanding Case to Bankruptcy Court for Further Proceedings, Official Comm. of Unsecured Creditors v. Hancock Park Capital II, L.P. (In re Fitness Holdings Int'l, Inc.), No. 10-00647 (AG), (C.D. Ca. June 26, 2013), ECF No. 38.

payment under state law.[467] The bankruptcy court dismissed the remanded claims with prejudice on state law grounds, finding "nothing unusual" about the Hancock Park investment under state law and no indication that the unsecured promissory notes were "anything other than a debt."[468] The parties ultimately agreed to settle the other remaining issues in the case.[469]

As another circuit recognizes the authority of bankruptcy courts to decide recharacterization issues, it becomes increasingly important for parties in interest to understand the nature of transactions in which they become involved. Recharacterization can significantly affect parties' rights and recoveries in bankruptcy, sometimes transforming seemingly secure loans into unprotected equity interests. Further complicating the analysis is the fact that different circuits and different states apply different tests to determine if recharacterization is appropriate.

E. *Wadsworth v. The Word of Life Christian Center (In re McGough): Tenth Circuit Holds Entire Amount of Debtor's Donations to Charity Avoided if They Exceed 15% of GAI*

In *Wadsworth v. The Word of Life Christian Center* (*In re McGough*),[470] the United States Court of Appeals for the Tenth Circuit, in a case of first impression for that circuit, addressed the narrow issue of whether a trustee may avoid the entire amount of a debtor's annual transfers to a charity or only that portion which exceeds 15% of the debtor's gross annual income ("GAI") if a debtor transfers more than 15% of his GAI to a qualified religious or charitable organization.[471] The Tenth Circuit held that a trustee may recover the entire amount of the debtor's annual contributions to a charity as a fraudulent transfer if the amount of those transfers exceeds 15% of the debtor's GAI.[472] In so doing, the Tenth Circuit reversed the bankruptcy court and

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[467]Tr. of Hr'g, at 7:15–18, Fitness Holdings, No. 08-27527, Adv. No. 09-01610 (BR) (Bankr. C.D. Ca. Dec. 04, 2013), ECF No. 137 [hereinafter "Fitness Holdings Bankruptcy Court Docket"].

[468]Tr. of Hr'g, at 28:18–29:7, Fitness Holdings, No. 08-27527.

[469]*See* Stipulation for Dismissal of Claim for Equitable Subordination, Fitness Holdings Bankruptcy Court Docket, ECF No. 142; Order Dismissing Claims Against Defendant Hancock Park Capital II L.P. and Michael J. Fourticq Sr., Fitness Holdings Bankruptcy Court Docket, ECF No. 146.

[470]*In re McGough*, 737 F.3d 1268, 58 Bankr. Ct. Dec. (CRR) 254, Bankr. L. Rep. (CCH) P 82553 (10th Cir. 2013).

[471]McGough, 737 F.3d at 1271.

[472]McGough, 737 F.3d at 1277.

the bankruptcy panel and enforced a plain language reading of section 548(a)(2)(A), finding further that it would not be an "absurd" result for the entirety of charitable donations to be avoided where they exceed the 15% of GAI limitation imposed by the statute.[473]

1. *Background*

The debtors in *McGough* filed for relief under Chapter 7 of the Bankruptcy Code on December 31, 2009.[474] During 2008, the debtors made 25 contributions to the Word of Life Christian Center (the "Center"), totaling $3,478.[475] During 2009, they made seven contributions to the Center totaling $1,280.[476] Their taxable income for 2008 and 2009 was $6,800 and $7,487, respectively, and the debtors also received social security benefits in 2008 and 2009 totaling $22,036 and $23,164 respectively.[477]

The Chapter 7 trustee commenced an adversary proceeding against the Center seeking to avoid and recover the debtors' contributions made in 2008 and 2009 under sections 548(a)(1)(B) and 550 of the Bankruptcy Code. Both parties filed for summary judgment.[478] The Center alleged that: (1) because the individual amounts of each contribution made by the debtors did not exceed 15% of their GAI, none were avoidable under the safe harbor provision of section 548(a)(2);[479] and (2) even if the contributions were considered in their annual aggregate, the trustee could only

[473]McGough, 737 F.3d at 1277 ("We see no absurdity here. The statute establishes a bright line rule—donations not exceeding 15% of GAI are protected; donations exceeding 15% are not.").

[474]McGough, 737 F.3d at 1271.

[475]McGough, 737 F.3d at 1271.

[476]McGough, 737 F.3d at 1271.

[477]McGough, 737 F.3d at 1271.

[478]McGough, 737 F.3d at 1271.

[479]In 1998, Congress passed the Religious Liberty and Charitable Donation Protection Act, Pub. L. 105-183, § 3, 11 Stat. 517 (1998), which amended section 548 of the Bankruptcy Code by adding a "safe harbor" provision exempting transfers of charitable contributions to qualified religious or charitable organizations from section 548(a)(1)(B) so long as (1) "the amount of that contribution does not exceed 15% of the gross annual income of the debtor for the year in which the transfer of the contribution is made" or (2) even if the contribution exceeds 15% of GAI, "the transfer was consistent with the practices of the debtor in making charitable contributions." 11 U.S.C.A. § 548(a)(2). For an in-depth discussion of the Religious Liberty and Charitable Donation Protection Act, see *supra* Section II.D.

avoid the amount of the contributions exceeding 15% of GAI.[480] In contrast, the trustee argued that the debtors' contributions must be considered in the aggregate and because those aggregate contributions exceeded 15% of the debtors' GAI in those years, he could recover them in their entirety.[481]

The bankruptcy court agreed with the trustee in part.[482] For the purposes of applying the safe harbor provisions of section 548(a)(2), the bankruptcy court held that a debtor's contributions must be considered in their annual aggregate.[483] However, it agreed with the Center that only the portions of the contributions exceeding 15% of the debtors' GAI were subject to avoidance.[484] Therefore, the trustee's recovery was limited to the amount of the contributions exceeding 15% of the debtors' GAI in 2008 and 2009.[485] The trustee appealed the latter issue to the Bankruptcy Appellate Panel for the Tenth Circuit, which affirmed the bankruptcy court's decision that the trustee could only avoid and recover that portion exceeding the statutory "cap."[486] The Center did not appeal the bankruptcy court's ruling that the debtors' contributions could be considered in the aggregate for purposes of determining whether they exceeded 15% of the debtor's GAI under section 548(a)(2)(A) of the Bankruptcy Code.[487]

2. *Transfers of More Than 15% of GAI May Be Avoided Entirely*

The trustee further appealed to the Court of Appeals for the Tenth Circuit.[488] The Tenth Circuit reversed, holding that the plain language of section 548(a)(2) clearly and unambiguously only protects transfers of 15% of GAI or less.[489] The Tenth Circuit endorsed the trustee's plain language reading of the statute and held that section 548(a)(2) provides a safe harbor from avoidance only if the "transfer" does not exceed 15% of GAI, and thus, conversely, if the "transfer" exceeds 15% of GAI, then the

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[480] McGough, 737 F.3d at 1271.

[481] McGough, 737 F.3d at 1271–72.

[482] McGough, 737 F.3d at 1272.

[483] McGough, 737 F.3d at 1272.

[484] McGough, 737 F.3d at 1272.

[485] McGough, 737 F.3d at 1272.

[486] McGough, 737 F.3d at 1272.

[487] McGough, 737 F.3d at 1272.

[488] McGough, 737 F.3d at 1272.

[489] McGough, 737 F.3d at 1277.

"transfer"—i.e., the entire transfer—is subject to avoidance. Because the Tenth Circuit found the statute unambiguous, it determined that there was no need to examine its legislative history.[490]

The Center urged the Tenth Circuit to interpret the meaning of the phrase "in any case which" the same as the phrase "to the extent."[491] The Tenth Circuit rejected the Center's interpretation that the phrase "in any case in which" expands the scope of the statute to protect portions of transfers that do not exceed 15% of GAI.[492] In other words, the Tenth Circuit rejected the notion that the phrase "in any case in which" acted as both an "avoidable threshold" and established the amount of the transfer subject to avoidance in the event the threshold is exceeded.[493] Citing to examples in other statutes where the phrase is often used in place of "if" or "when," the Tenth Circuit explained that the Center's interpretation of this phrase as setting the "amount protected" was "vanishingly improbable."[494] The Tenth Circuit noted that the only other court to interpret this aspect of section 548(a)(2) of the Bankruptcy Code—the United States Bankruptcy Court for the Middle District of Louisiana—likewise found that transfers above the 15% GAI limitation were wholly subject to avoidance.[495] Citing to and agreeing with that court's decision, the Tenth Circuit in *McGough* identified alternative "rewrites" of

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[490]McGough, 737 F.3d at 1272.

[491]McGough, 737 F.3d at 1274.

[492]McGough, 737 F.3d at 1274.

[493]McGough, 737 F.3d at 1274.

[494]McGough, 737 F.3d at 1274. The Tenth Circuit provided a number of examples of statutes where it would be nonsensical to substitute "to the extent" for "in any case in which" or to otherwise read the phrase as "amount-indicating." McGough, 737 F.3d at 1274 (citing 47 U.S.C. § 252(e)(6) ("*In any case in which* a State commission makes a determination under this section, any party aggrieved by such determination may bring an action in an appropriate Federal district court . . .") (emphasis in original); 28 U.S.C. § 455(a) ("Any justice or judge of the United States shall disqualify himself *in any case in which* he has a substantial interest.") (emphasis in original); 28 U.S.C. § 1605(a) ("A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States *in any case* . . . *in which* the foreign state has waived its immunity either explicitly or by implication.") (emphasis in original)).

[495]McGough, 737 F.3d at 1274 (citing *In re Zohdi*, 234 B.R. 371, 34 Bankr. Ct. Dec. (CRR) 609, 42 Collier Bankr. Cas. 2d (MB) 453 (Bankr. M.D. La. 1999)).

section 548(a)(2) which Congress could have adopted, but did not, to achieve the result argued for by the Center.[496]

Furthermore, the Tenth Circuit emphasized that the Center's interpretation of section 548(a)(2) effectively removed key language from the statute.[497] While the statute's text reads "the *contribution* shall not be avoidable if the amount *of* that contribution does not exceed 15% of [the debtor's GAI]," the Center's interpretation would render the word "of" superfluous.[498] The Tenth Circuit remarked that "of" is critical to understanding the phrase "the amount of that contribution."[499] In giving effect to every word of the statute, the Tenth Circuit found that the 15% limit only establishes when a transfer is subject to avoidance, and not the amount of the transfer protected if that limit is exceeded.[500]

The Center also argued that adoption of the statute's plain meaning would reach an absurd result because it protects donations up to 15% of GAI, but permits avoidance of donations that exceed by even one cent 15% of GAI.[501] The Center argued that such a result would place an "undue burden" on churches and charitable organizations which would have to investigate a generous debtor's financial background in order to use funds within two years of receipt (or fear their clawback in a subsequent bankruptcy by the donor).[502] According to the Center, such a result would be entirely against Congress's purpose in enacting the Charitable Donation Act, which was designed to protect religious and charitable organizations from disgorging donations they receive from individuals who subsequently file for bankruptcy.[503]

The Center failed to persuade the Tenth Circuit.[504] In holding against the Center, the Tenth Circuit explained that under the "absurdity doctrine"—an exception to the rule that the plain language of the statute controls—it is insufficient to show that some outcome is contrary to what Congress desired or what

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[496]McGough, 737 F.3d at 1274–75 (citing Zohdi, 234 B.R. at 371).

[497]McGough, 737 F.3d at 1275.

[498]McGough, 737 F.3d at 1275 (emphasis in original) (quoting 11 U.S.C. § 548(a)(2)(A)).

[499]McGough, 737 F.3d at 1275.

[500]McGough, 737 F.3d at 1275.

[501]McGough, 737 F.3d at 1275.

[502]McGough, 737 F.3d at 1275–76.

[503]McGough, 737 F.3d at 1276.

[504]McGough, 737 F.3d at 1277.

Congress may have anticipated in a given case.[505] The Tenth Circuit observed that the "absurdity rule is 'a tool to be used to carry out Congress' intent—not to override it.' "[506] The doctrine is only applied "when it would have been unthinkable for Congress to have intended the result commanded by the words of the statute—that is, when the result would be so bizarre that Congress could not have intended it."[507] Courts are bound by the language of the statute in "all but the most compelling of cases" and that, subject to constitutional restrictions, Congress is "free to enact any number of foolish statutes."[508] In light of that standard, the Tenth Circuit found no absurdity in the Center's case.[509] The statute establishes a "bright-line rule—donations not exceeding 15% of GAI are protected; donations exceeding 15% are not."[510] The burden on churches and charitable organizations propounded by the Center exists even in cases where 15% of the transfer was safe harbored—in fact the burden might be more onerous because organizations would have to precisely calculate in each case that portion above 15% that might be exposed to avoidance liability.[511] In addition, the Tenth Circuit observed that if the Center was unhappy with the results in this case, it can seek to have Congress amend the statute.[512] Finally, the Tenth Circuit highlighted that the Center had ignored other protections built into the Charitable Donation Act, such as section 548(a)(2)(B) which protects transfers above 15% of GAI so long as such transfers are within the ordinary tithing practices of the debtor.[513] Accordingly, the Tenth Circuit reversed and remanded.[514]

The Tenth Circuit's decision avoiding the entirety of the debtors' transfers to the Center because they exceeded 15% GAI based

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[505]McGough, 737 F.3d at 1277.

[506]McGough, 737 F.3d at 1276 (citing *Resolution Trust Corp. v. Westgate Partners, Ltd.*, 937 F.2d 526, 529 (10th Cir. 1991)).

[507]McGough, 737 F.3d at 1276.

[508]McGough, 737 F.3d at 1276.

[509]McGough, 737 F.3d at 1277.

[510]McGough, 737 F.3d at 1277.

[511]McGough, 737 F.3d at 1277.

[512]McGough, 737 F.3d at 1276.

[513]McGough, 737 F.3d at 1277.

[514]McGough, 737 F.3d at 1277. On remand, the bankruptcy court entered a judgment of $4,758.00 in favor of the trustee, reflecting the avoidance of the 2008 and 2009 transfers in their entirety. *See* Judgment for Trustee Against Defendant at 1, In re McGough, No. 09-37932 (SBB), Adv. No. 10-01910 (SBB) (Bankr. D. Colo. Mar. 18, 2014), ECF No. 46.

upon its "plain language" interpretation of section 548(a)(2)(A) is somewhat noteworthy under the circumstances of the *McGough* case. Because the Center did not appeal the issue of aggregation of the debtors' annual transfers made to the Center in order to determine whether they exceeded 15% of GAI for the years in question, one can only speculate that the outcome of the case might have been different if the Center had appealed that issue. The "plain language" of section 548(a)(2) provides that the section addresses a single transfer (i.e., not aggregate annual transfers to a charity),[515] although the legislative history for the section indicates that transfers should be considered in the aggregate.[516] Had the Center appealed the aggregation issue and the "plain language" doctrine been applied, it is possible that the issue decided in *McGough*—whether the entirety of the donations are avoided if it exceeds 15% of GAI—would not have been reached because the transfers to the Center would have been sheltered by section 548(a)(2), as each of the debtors' individual transfers was less than 15% of the debtors' GAI, even though such a result would have been contrary to the legislative history for section 548(a)(2) of the Bankruptcy Code.

IV. SUMMARY

The cases discussed above demonstrate the ever-changing landscape of fraudulent transfer law, especially in in the aftermath of *Stern v. Marshall*, which has put into question the authority of bankruptcy courts to hear and determine fraudulent transfer actions, particularly those against defendants who have not filed proofs of claims against the debtor. The Court of Appeals for the Seventh Circuit in its *Sentinel* decision arguably lightened the burden for proving actual intent to defraud, hinder or delay creditors in actions seeking to avoid transfers as actually fraudulent because it did not require evidence of badges of fraud or the existence of a Ponzi scheme when it determined that Sentinel's transfers of its FCM customers' assets without their knowledge

[515]The Tenth Circuit in dicta noted that Second Circuit Court of Appeals in the case of *Universal Church v. Geltzer*, 463 F.3d 218, 223–224, Bankr. L. Rep. (CCH) P 80725, 36 A.L.R. Fed. 2d 649 (2d Cir. 2006), had examined this aspect of section 548(a)(2), found the language to be ambiguous, and turned to the legislative history to determine that Congress intended that a debtors' contributions should be considered in the aggregate, and not individually. McGough, 737 F.3d at 1275 n.6.

[516]*See* H. R. Rep. No. 556, 105th Cong., 2d Sess. 8 (1998) ("[The 15% limit] is intended to apply to transfers that a debtor makes on an aggregate basis during the one-year reachback period preceding the filing of the debtor's bankruptcy case.").

to secure Sentinel's overnight loan with BONY satisfied the actual fraudulent intent requirement of section 548(a)(1)(A) because Sentinel should have been aware of the consequences of its actions when it pledged its FCM customers' assets as collateral for Sentinel's overnight loan. The Bankruptcy Court for the Southern District of New York collapsed a series of related transactions in order to determine that an action was not time-barred, and endorsed the approach taken by the Seventh Circuit in *Sentinel* in holding that the series of transfers that left Tronox's Chemical Business saddled with all of Tronox's legacy environmental and tort liabilities were actually fraudulent transfers. The bankruptcy court also indicated that claims asserted under section 502(h) of the Bankruptcy Code by recipients of fraudulent transfers may include amounts that comprise more than the consideration given in exchange for the avoided transfers. The Court of Appeals for the Ninth Circuit in its *Fitness Holdings* decision created a majority of circuits when it held that a bankruptcy court has authority to recharacterize debt transactions as equity. It also held that the question of whether a transaction qualifies as debt or equity is determined as a matter of state law, unless Congress provides otherwise. Finally, in *McGough*, the Court of Appeals for the Tenth Circuit, in a decision of concern to charities throughout the nation, adopted a "plain language" approach in deciding that when a debtor's annual donations to a charity exceed 15% of the debtor's GAI, the entire amount of those donations may be avoided pursuant to section 548(a)(2) of the Bankruptcy Code. A careful practitioner will take note of these developing areas of law and continue to follow them with interest.