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Bankruptcy Trustee's Avoidance Rights Are Nearly Limitless

Law360, New York (October 22, 2012, 12:34 PM ET) -- Section 550 of the Bankruptcy Code applies where the trustee, having already avoided a transfer of some property, seeks to recover that property. Under those circumstances, the recovery must be "for the benefit of the estate." This requirement does not apply, however, where the trustee seeks only to avoid an obligation that the debtor incurred, which does not require any recovery to the estate. Additionally, Section 550 does not limit the amount of avoidance to a creditor's claim permitting recovery of a transfer or negation of an obligation in its entirety.

As discussed below, these considerations provide a trustee with extraordinary flexibility and range when pursuing claims under sections 544 and 548 of the Code.

Section 550 Does Not Apply to the Avoidance of Obligations

Sections 544 and 548 permit the avoidance of a debtor's obligations under state and federal law, respectively. Section 544(b) permits an estate to avoid obligations that are voidable under applicable state law, often a codification of the Uniform Fraudulent Transfer Act: a "trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim." 11 U.S.C § 544(b).

Similarly, Section 548(a)(1) provides a federal avoidance right and permits an estate to avoid obligations incurred two years prior to the petition date: a "trustee 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" if certain other elements are satisfied.[1] 11 U.S.C. § 548(a)(1).

By contrast, section 550 states that "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." 11 U.S.C. § 550.

In many circumstances where a debtor seeks to avoid liens and obligations pursuant to sections 544 and 548, rather than to recover property or money, the debtor can obtain full relief without invoking the recovery provision of section 550. See In re Coleman, 426 F.3d at 726 (requirements of "the recovery statute ha[ve] no application" where debtor avoided deeds of trust, because "avoidance itself was the meaningful event" and "no recovery was necessary"); see also Glanz v. RJF Int'l Corp. (In re Glanz), 205 B.R. 750, 757-58 (Bankr. D. Md. 1997) (rejecting claim that transfer could not be avoided for lack of benefit to estate where defendant's "argument fail[ed] … to take into account the critical distinction between the avoidance of a transfer and the recovery of a transfer.").

As the court held in Coleman, "[i]n the absence of equivalent language in § 544, the presence of the phrase 'for the benefit of the estate' in § 550 merely highlights the fact that Congress knew how to include such a limitation when it wanted to," and that Congress chose not to impose "such a limitation" on obligation avoidances under sections 544 and 548. In re Coleman, 426 F.3d at 725 (citing Keene Corp. v. United States, 508 U.S. 200, 208 (1993) ("Where Congress includes particular language in one section of a statute but omits it in another, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (internal quotation marks & alterations omitted))." See also In re McFeeley, 362 B.R. 121, 125 (Bankr. D. Vt. 2007) (where "Congress used different phrases ('the debtor,' 'the property of the debtor,' and 'the property of the estate') to make different parts of the statute apply to different entities," such distinctions are presumptively deliberate and should be given effect) (citing In re Coleman, 426 F.3d at 725).

Section 550 Does Not Limit the Amount of the Avoidance

Additionally, Coleman did not limit the recovery to the amount of the creditors' claims. Indeed, that limitation was expressly rejected by the court. In re Coleman, 426 F.3d at 725 ("The Bank contends that … transfer avoidance could be limited to the extent necessary to benefit the creditors and pay the administrative expenses of the estate. We do not accept this assertion.").

Other courts agree. See also In re Acequia Inc., 34 F.3d at 810 ("[A] transaction that is voidable by a single, actual unsecured creditor may be avoided in its entirety, regardless of the size of the creditor's claim.") (quoting Harris v. Huff (In re Huff), 160 B.R. 256, 261 (Bankr. M.D. Ga. 1993)); Abramson v. Boedeker, 379 F.2d 741, 748 n.16 (5th Cir. 1967) ("If the transfer is avoidable at all by any creditor, it is avoidable in full for all creditors regardless of the dollar amount of the prevailing claim."), cert. denied, 389 U.S. 1006 (1967); Bergquist v. Theisen (In re Theisen), 45 B.R. 122, 126 (Bankr. D. Minn. 1984) ("Once avoidability is determined under state law, the transfer is entirely avoidable by a trustee in bankruptcy regardless of the amount of the creditor's claim relied on by the trustee.").

Nor do the provisions of state law limit a trustee's ability to avoid obligations in their entirety, without more. In invoking section 544(b), a trustee seeks to avoid fraudulent conveyances and obligations "under applicable law" — usually a codification of the Uniform Fraudulent Transfer Act (UFTA). The UFTA provides that a creditor may avoid a transfer or obligation only to the extent of that creditor's injury. But that limitation has no bearing in a bankruptcy context because section 544(b) says that the trustee "may avoid any transfer … that is avoidable under [state] law."

This language does not impose the state law remedy limitations on the bankruptcy court. Rather, under the federal law, "[t]he statutory remedy is avoidance of the entire obligation upon a finding of fraudulent conveyance" under state law. NextWave Pers. Commc'ns Inc. v. FCC (In re NextWave Pers. Commc'ns Inc.), 235 B.R. 305, 310 (Bankr. S.D.N.Y. 1999).

The question under section 544(b), therefore, is whether the obligation is avoidable at all under the applicable state law. Once that determination is made, then the court returns to the provisions of section 544(b), which allow the trustee to avoid such an obligation in its entirety. This distinction between federal and state law — what one court called the "federal law gloss on … avoidability in the context of a bankruptcy" — derives from the text of section 544(b) itself. In re Theisen, 45 B.R. at 126. The statute "is clear on its face and under the case law." Nextwave, 235 B.R. at 310.

The United States Supreme Court has made this result abundantly clear. As it held in Moore v. Bay, 284 U.S. 4 (1931), a case decided under the predecessor of section 544(b), "once avoidability is determined under state law, the transfer is entirely avoided by a trustee in bankruptcy regardless of the amount of the creditor's claim relied upon by the trustee."[2] In re Theisen, 45 B.R. at 126-27; see also Pajaro Dunes Rental Agency Inc. v. Spitters, 174 B.R. 557, 595-96 (Bankr. N.D. Cal. 1994) (Moore held that "improper transfers may be avoided in their entirety, regardless of the relationship between the size of the transfer and the amount of the unsecured claims.") (citing Vadnais Lumber Supply Inc. v. Byrne, 100 B.R. 127, 134 (Bankr. D. Mass. 1989)).

In other words, "while the transfer or obligation must be voidable as against a creditor holding an allowable claim, the measure and distribution of recovery is not limited by the creditor's right." In re Acequia Inc., 34 F.3d at 809 (internal quotations and citations omitted) (emphasis in original) ("existence of a 'triggering creditor' under section 544(b) gives the trustee an unlimited right to invoke state-law avoidance powers").

Thus, even where state law — like the UFTA — "limits a creditor's recovery in a fraudulent transfer action to the amount necessary to satisfy the creditor's claim, this is not controlling in bankruptcy." Stainaker v. DLC Ltd (In re DLC, Ltd.), 295 B.R. 593, 606 (Bankr. App. Panel, 8th Cir. 2003) (citing Decker v. Voisenat (In re Serrato), 214 B.R. 219, 231 (Bankr. N.D. Cal. 1997)); see also MC Asset Recovery LLC v. The Southern Co. (N.D. Ga. Dec. 11, 2006) (section 544(b) "does not … limit the amount of [the avoided] transfer to the extent necessary to satisfy the creditor's claim") (internal quotations and citation omitted).

The rule of Moore v. Bay, "which may be taken as a permanent feature of our bankruptcy law," In re Theisen, 45 B.R. at 127 n.5, has been recognized and effectuated in numerous cases applying "applicable [state] law" under section 544(b).[3]

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[1] The statute was amended in 2005 to provide a two-year look-back period with respect to cases filed one year after the amendment's enactment. Bankruptcy Abuse Prevention And Consumer Protection Act of 2005, Pub. L. No. 108-9, Section 1406(b)(2), 119 Stat. 23, 215-16 (2005).

[2] "Section 544(b) of the Code is," in fact, "a codification of … Moore v. Bay, … and in section 544(b) Congress expressly rejected limiting the estate's recovery to the amounts of particular creditors' claims." Comm. of Unsecured Creditors of Interstate Cigar Co. v. Interstate Distribution, Inc., 278 B.R. 8, 18 (E.D.N.Y. 2002) (plaintiff is "entitled to obtain the avoidance of the entire transfer under applicable state law for the benefit of the estate"). Such codification was Congress's explicit purpose. See S. Rep. No. 95-989, at 85 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5871 (section 544 of the Code "follows Moore v. Bay"); see also Liebersohn v. IRS (In re C.F. Foods, L.P.) 265 B.R. 71, 86 (Bankr. E.D. Pa. 2001) (citing Congressional Committee Report for section 544(b)); In re DLC, Ltd., 295 B.R. 593, 606 (Bankr. App. Panel, 8th Cir. 2003, aff'd, 376 F.3d 819 (8th Cir. 2004) (identifying section 544(b) as a "codification[] of the Supreme Court's decision in Moore v. Bay" and noting that "Congress expressly rejected limiting the estate's recovery to the amount of a particular creditor's claims").

[3] See Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.), 226 F.3d 237, 243 (3d Cir. 2000) (once a transfer is avoidable pursuant to section 544(b), "the transfer is avoided in its entirety for the benefit of all creditors, not just to the extent necessary to satisfy the individual creditor actually holding the avoidance claim") (citing Moore); In re Leonard, 125 F.3d 543, 544-45 (7th Cir. 1997 (trustee could avoid a real estate transaction entirely "even if he cannot point to creditors whose claims total more than the value of the" fraudulent transfer) (citing Moore); Baldi v. Samuel Son & Co. (In re McCook Metals, L.L.C.), No. 05-C-2990, 2007 U.S. Dist. LEXIS 89412, *10 (N.D. Ill. Dec. 4, 2007) ("under section 544 … the Trustee, if he can establish that a transfer is voidable, is entitled to recover the value of the property transferred"); Brown v. Phillips (In re Phillips), 379 B.R. 765, 776 (N.D. Ill. 2007) (transaction attacked under section 544(b) "can be avoided completely even if the trustee cannot produce creditors whose liens total more than the value of the property"); Liebersohn v. IRS (In re C.F. Foods, L.P.), 265 B.R. 71, 86 (Bankr. E.D. Pa. 2001) ("an entire transfer can be set aside even though the creditor's claim is nominal"); Harris v. Huff (In re Huff), 160 Bankr. 256, 261 (Bankr. M.D. Ga. 1993) ("A transaction that is voidable by a single, actual unsecured creditor may be avoided in its entirety, regardless of the size of the creditor's claim.") (citing Moore); Gennet v. Silver (In re Harry Kaiser Assocs., Inc.), 14 Bankr. 107, 109 (Bankr. S.D. Fla. 1981) (amount recovered by trustee suing under section 544(b) is "not limit[ed by] the trustee's cause of action") (citation omitted); Abramson, 379 F.2d at 749 n. 16 ("if the transfer is avoidable at all by any creditor, it is avoidable in full … regardless of the dollar amount of the prevailing claim"), cert. denied, 389 U.S. 1006 (1967).