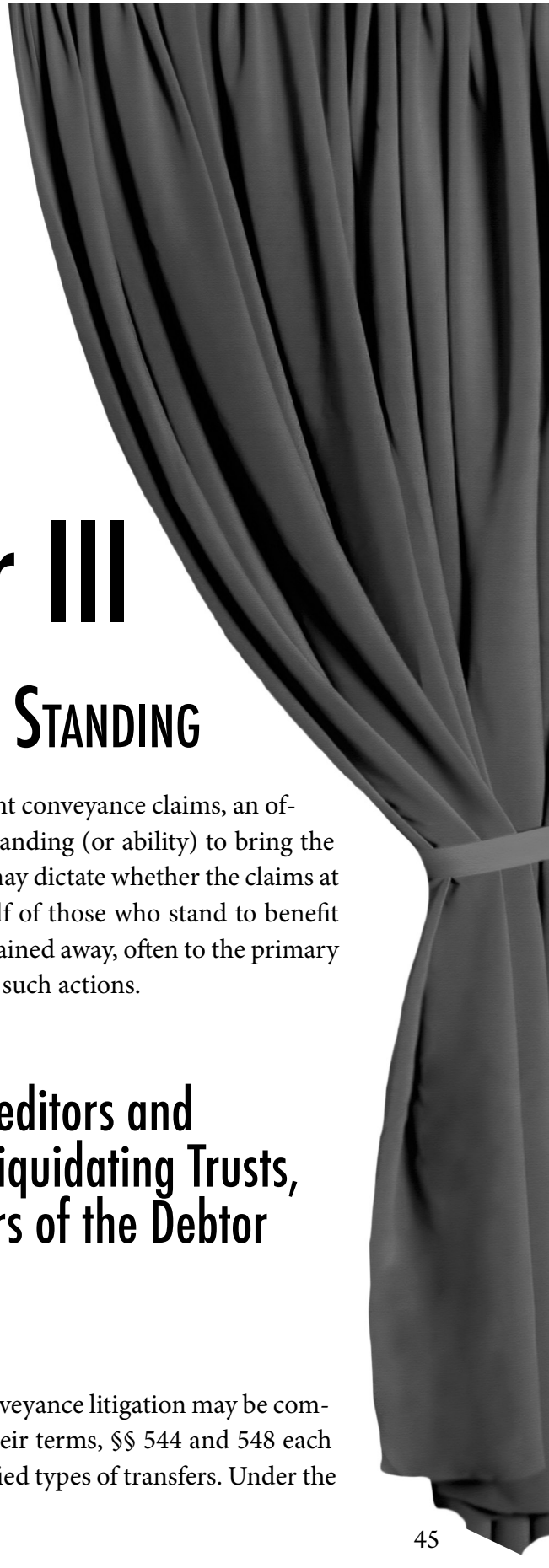

Chapter III

Standing

Given the potential value of fraudulent conveyance claims, an often-litigated issue is who has the standing (or ability) to bring the litigation. Resolution of that issue may dictate whether the claims at issue are pursued vigorously by or on behalf of those who stand to benefit the most from their prosecution, or are bargained away, often to the primary benefit of those who would be the targets of such actions.

A. Trustees and Debtors, Creditors and Creditors' Committees, Liquidating Trusts, Officers and Shareholders of the Debtor

1. Trustees and Debtors

Under the Bankruptcy Code, fraudulent conveyance litigation may be commenced under either § 544(b) or 548. By their terms, §§ 544 and 548 each provide that "[t]he trustee may avoid" specified types of transfers. Under the

Bankruptcy Code, the term "trustee" is used in multiple contexts under the Bankruptcy Code, and so requires some unpacking for purposes of understanding who has standing to bring an action under § 544 and/or § 548. The answer will depend on the chapter under which the main case is pending and the circumstances at the time standing is sought.

First, in a chapter 7 case, a trustee may be appointed[247] or elected by creditors.[248] Once appointed or elected, the chapter 7 trustee will have primary responsibility for the liquidation (including pursuit of estate claims) and distribution of the estate for the benefit of stakeholders. The person or entity so appointed or elected qualifies as the "trustee" for purposes of § 544 or 548, and would have standing to bring a fraudulent conveyance claim thereunder.

In a chapter 9 case, §§ 544 and 548 are made applicable to the proceeding under § 901(a). Further, § 902(5) provides that the term "trustee," when used in a section made applicable to the chapter 9 case, means the "debtor, except as provided in [§ 926]." As such, the chapter 9 debtor initially bears the mantle of the "trustee" for purposes of §§ 544 and 548 and so has standing, in the first instance, to bring fraudulent conveyance claims. But § 926(a) (entitled "Avoiding Powers") provides that "[i]f the debtor refuses to pursue a cause of action under Section 544, 545, 547, 548, 549(a) or 550 of [the Bankruptcy Code], then, on request of a creditor, the court may appoint a trustee to pursue such cause of action."[249] Thereafter, the trustee so appointed would be vested with standing to pursue fraudulent conveyance claims. It is unclear whether the appointment of a § 926(a) trustee divests the debtor of standing to pursue the applicable claims. However, absent such appointment (which is discretionary), only the chapter 9 debtor would have standing.

In cases under chapters 11 and 12, a debtor in possession is empowered, initially, to "stand in the shoes" of the trustee, including as to the exercise of the trustee's avoiding powers.[250] So long as the chapter 11 or 12 debtor remains in possession, it has the standing of a trustee for purposes of §§ 544 and 548, and may pursue fraudulent conveyance actions. But whether the debtor in possession remains in control is a rebuttable presumption. That presumption may be overcome, and a trustee installed in place of the debtor in possession, with evidence of fraud, dishonesty,

247 *See* 11 U.S.C. § 701.
248 *See* 11 U.S.C. § 702.
249 *See* 11 U.S.C. § 926(a).
250 *See* 11 U.S.C. §§ 1107 and 1203.

incompetence or gross mismanagement of the affairs of the debtor (occurring either before or after commencement of the case)[251] or, in a chapter 11 case, whether the appointment of a trustee is in the interests of creditors, equity security-holders and other interests of the estate.[252] Upon appointment, the trustee obtains standing to pursue fraudulent conveyance claims, and the debtor in possession is thereafter without standing (unless, in the context of a chapter 12 case, the debtor in possession is reinstated).[253]

Unlike chapter 7, where the term "trustee" has an obvious meaning, or chapters 9, 11 or 12, where there are statutory provisions addressing when debtors have the ability to stand in the shoes of, or be displaced by, a trustee, chapter 13 does not generally bestow the debtor with standing to pursue avoidance actions.[254] The exception to that general statement is found in § 522(h), which allows a "debtor" to employ §§ 544, 545, 547, 548, 549 or 724(a) to avoid a transfer or recover a setoff to the extent the debtor could have exempted the property at issue under § 522(g).[255] Even this limited right to pursue a fraudulent conveyance claim is circumscribed in that the debtor is granted standing only to the extent that the chapter 13 trustee does not attempt to avoid the same transfer.[256]

Outside the context of § 522(h), the question of a chapter 13 debtor's standing to bring fraudulent conveyance claims is much less clear. Currently, there is a circuit split on this issue. Appellate courts in the Third, Fifth, Eighth and Tenth Circuits have held that, given Congress's failure to specifically provide for a chapter 13 debtor to pursue avoidance actions (outside the context of § 522(h)), as Congress showed it knew how to do in other chapters, a chapter 13 debtor generally does not have standing to bring fraudulent conveyance actions.[257] Other courts, including the Ninth Circuit, have adopted a "holistic" construction of the Bankruptcy Code, with a tip of the hat to practicality, in allowing chapter 13 debtors standing

251 *See* 11 U.S.C. §§ 1104(a)(1) and 1204(a).
252 *See* 11 U.S.C. § 1104(a)(2).
253 *See* 11 U.S.C. §§ 1204(b).
254 Section 1303 does provide the debtor with the rights and powers of the trustee under §§ 363(b), 363(d), 363(e), 363(f) and 363(l) of the Bankruptcy Code. But otherwise, chapter 13 contemplates the active participation in, and management of, the case by the trustee (as defined in § 1302).
255 *See* 11 U.S.C. § 522(h)(1).
256 *See* 11 U.S.C. § 522(h)(2).
257 *See Knapper v. Bankers Trust Co.* (*In re Knapper*), 407 F.3d 573, 583 (3d Cir. 2005); *Hansen v. Green Tree Servicing LLC* (*In re Hansen*), 332 B.R. 8, 16 (B.A.P. 10th Cir. 2005); *Realty Portfolio Inc. v. Hamilton* (*In re Hamilton*), 125 F.3d 292, 298 (5th Cir. 1997); *La Barge v. Benda* (*In re Merrifield*), 214 B.R. 362, (B.A.P. 8th Cir. 1997).

to pursue avoidance actions, noting that the trustee otherwise has little incentive to pursue these potentially valuable claims.[258]

Under chapter 15, § 1521(a)(7) specifically omits from relief that can be granted upon recognition of a foreign main or non-main proceeding the ability of the foreign representative to pursue claims under §§ 544 and 548.[259] Instead, to take advantage of the Bankruptcy Code's avoidance powers, the foreign representative is typically required to commence a plenary case under chapter 7 or 11. But a foreign representative may be able bring an avoidance action based on foreign law, rather than on §§ 544 or 548.[260]

2. Creditors and Creditors' Committees

As they are often the ultimate beneficiaries (or representatives thereof) of successful fraudulent conveyance actions, creditors and creditors' committees have a significant interest in ensuring that such claims are pursued vigorously. Concern may arise that the debtor (to the extent not displaced by a trustee) either lacks sufficient will (perhaps out of loyalty to the target) or resources to pursue avoidance litigation, or has waived the right to bring such claims under the terms of post-petition financing arrangments. In such cases, individual creditors or creditors' committees, although not specifically authorized under either § 544 or 548, may desire to control the litigation themselves.

In most jurisdictions, this practice is allowed — albeit in the nature of a derivative action.[261] Some courts have gone so far as to state that §§ 1103(c)(5) and 1109 "imply a qualified right for creditors' committees to initiate suit with the prior approval

258 *See Houston v. Eiler* (*In re Cohen*), 305 B.R. 886, 899 (B.A.P. 9th Cir. 2004) ("Our conclusion that a holistic construction of the Bankruptcy Code supports the standing of chapter 13 debtors to exercise trustee avoiding powers without first obtaining special permission from the court draws support from the approach that various courts of appeals have taken with respect to analogous aspects of chapter 13.").

259 *See* 11 U.S.C. § 1521(a)(7).

260 *See Tacon v. Petroquest Res. Inc.* (*In re Condor Ins. Ltd.*), 601 F.3d 319, 327 (5th Cir. 2010).

261 *See, e.g.*, *Hyundai Translead Inc. v. Jackson Truck & Trailer Repaid Inc*. (*In re Trailer Source Inc.*), 555 F.3d 231, 240 (6th Cir. 2009) ("[T]he Bankruptcy Code, as well as pre-Code practice, clearly contemplate the equitable power of bankruptcy courts to authorize creditors, in appropriate instances, to bring claims on behalf of the bankruptcy estate."); *Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 580 (3d Cir. 2003) (*en banc*) ("We believe that the ability to confer derivative standing upon creditors' committees is a straightforward application of the bankruptcy courts' equitable powers."); *Commodore Int'l Ltd. v. Gould* (*In re Commodore Int'l Ltd.*), 262 F.3d 96, 99-100 (2d Cir. 2001); *Fogel v. Zell*, 221 F.3d 955, 965-66 (7th Cir. 2000); *Louisiana World Expo. v. Fed. Ins. Co*., 858 F.2d 233, 247 (5th Cir. 1988) (holding that to grant derivative standing, courts generally require "that the claim be colorable, that the debtor-in-possession have refused unjustifiably to pursue the claim, and that the committee first receive leave to sue from the bankruptcy court").

of the bankruptcy court when the trustee or debtor in possession has unjustifiably failed to bring suit or abused its discretion in not [pursuing an avoidance action]."[262] The touchstone should be whether pursuit of the action will benefit the reorganization estate.[263] Allowing derivative standing, in addition to being a longstanding practice both before and after passage of the Bankruptcy Code, is also consistent with *dicta* in the Supreme Court's ruling in *Hartford Underwriters Insurance Co. v. Union Planters Bank N.A.,* in which the Court acknowledged the possibility of derivative standing in place of a "trustee."[264]

Generally, the test for whether derivative standing should be granted is that the claim at issue is colorable, that the debtor has unreasonably refused or failed to pursue it, and that the creditor or committee first seek derivative standing.[265] In addition to committees, individual creditors may be granted derivative standing in appropriate circumstances.[266] Indeed, the Bankruptcy Code specifically contemplates such creditors receiving reimbursement of their actual and necessary expenses from the estate.[267]

As noted above, under § 544(b), the "trustee" is initially granted standing to pursue state law fraudulent transfer actions that would, absent the bankruptcy, be capable of assertion by the holder of an unsecured claim against the debtor. Under § 546(a) of the Bankruptcy Code, the trustee (or other appropriate party, as discussed herein) may commence such an action until the later of: a) two years after entry of the order for relief; or b) one year after appointment or election of a trustee under

262 *In re STN Enterprises*, 770 F.2d 901, 904 (2d Cir. 1985). *But see Official Comm. of Unsecured Creditors of Grand Eagle Cos. v. Asea Brown Boveri Inc.* (*In re Grand Eagle Cos. Inc.*), 310 B.R. 79 (Bankr. N.D. Ohio) (allowing grant of derivative standing *nunc pro tunc* to date commenced by committee without prior approval).

263 *Id.* at 905.

264 *See* 530 U.S. 1, 13 n.5 (2000).

265 *See Commodore Int'l Ltd. v. Gould* (*In re Commodore Int'l Ltd.*), 262 F.3d 96, 99-100 (2d Cir. 2001); *Louisiana World Expo. v. Fed. Ins. Co.*, 858 F.2d 233, 247 (5th Cir. 1988) (holding that to grant derivative standing, courts generally require "that the claim be colorable, that the debtor-in-possession have refused unjustifiably to pursue the claim, and that the committee first receive leave to sue from the bankruptcy court").

266 *See In re Moore*, 608 F.3d 253, 261 n.13, 262 (5th Cir. 2010) (authorizing sale of § 544(b) avoidance actions, but reserving on § 548 claims); *PW Enters. Inc. v. N.D. Racing Comm'n* (*In re Racing Servs. Inc.*), 540 F.3d 892, 898 (8th Cir. 2008) (holding that "derivative standing is available to a creditor to pursue avoidance actions when it shows that a Chapter 7 trustee (or debtor-in-possession in the case of Chapter 11) is 'unable or unwilling' to do so"); *Glinka v. Murad* (*In re Housecraft Indus. USA Inc.*), 310 F.3d 64, 70-2 (2d Cir. 2002) (debtor's primary secured creditor granted standing to bring a fraudulent transfer action where the chapter 7 trustee had consented and where all of the other elements of the test set forth in *Commodore* were satisfied); *Contractors, Laborers, Teamsters & Eng'rs Health & Welfare Plan v. M & S Grading Inc.* (*In re M & S Grading Inc.*), 541 F.3d 859 (8th Cir. 2008); *Smart World Techs. L.L.C. v. Juno Online Servs.* (*In re. Smart World Techs. LLC*), 423 F.3d 166 (2d Cir. 2005); *Canadian Pac. Forest Prods. Ltd. v. J.D. Irving Ltd.* (*In re Gibson Grp. Inc.*), 66 F.3d 1436 (6th Cir. 1995).

267 *See* 11 U.S.C. § 503(b)(3)(B) (addressing actual, necessary expenses of "a creditor that recovers, after the court's approval, for the benefit of the estate any property transferred or concealed by the debtor").

§ 702, 1104, 1163, 1202 or 1203 if such appointment or election occurs before expiration of the two years following entry of the order for relief.[268] An interesting question is whether § 544(b)'s grant of exclusive standing to the trustee is permanent or transitory for the period until the § 546(a) limitations period expires. This becomes relevant when the state law statute of limitations expires after the § 546(a) limitations period.

In *In re Tribune Co.*, the debtor failed to bring potentially valuable state law fraudulent conveyance claims during the two years following entry of the order for relief (and no trustee was appointed during that period to otherwise extend the limitations). At the request of unsecured creditors who would have had standing to bring the claims, absent the bankruptcy filing, the *Tribune* court held that the fraudulent transfer claims reverted to the unsecured creditors from the trustee and that the automatic stay was lifted to allow filing of the complaint (although further litigation of the claims was to be stayed pending further order of the court).[269]

3. Liquidating Trusts

A common feature of modern chapter 11 cases is the creation, through a confirmed plan, of a liquidating trust charged with liquidating assets, resolving claims and making distributions to creditors in specified priority. Among the assets often vested in such trusts are estate claims and causes of action, including avoidance actions. In this regard, § 1123(b)(3)(B) of the Code allows a plan to "provide for ... the retention and enforcement by the debtor, by the trustee, *or by a representative of the estate appointed for such purpose*, of any such claim or interest..." (emphasis added).

Generally, to ensure that the liquidating trust has standing to pursue the claims at issue, the plan and related materials should make clear that (1) the trust has been appointed to pursue the litigation and (2) the trust is the representative of the estate.[270] The retained fraudulent conveyance claim "should be pursued in a manner that will satisfy the basic bankruptcy purpose of treating all similarly situated creditors alike; one or more similarly situated creditors should not be able to pursue

268 *See* 11 U.S.C. § 546(a).
269 *See In re Tribune Co.*, Case No. 08-13141 (Bankr. D. Del.), Docket No. 8740, Order, dated April 25, 2011.
270 *See Fleet Nat'l Bank v. Gray* (*In re Bankvest Capital Corp.*), 375 F.3d 51, 59 (1st Cir. Mass. 2004); *I. Appel Corp. v. Val Mode Lingerie Inc.*, 2000 U.S. Dist. LEXIS 2084 (S.D.N.Y. Feb. 28, 2000); *Pardo v. Pacificare of Tex. Inc*. (*In re APF Co*.), 264 B.R. 344, 353 (Bankr. D. Del. 2001); *Guttman v. Martin* (*In re Railworks Corp.*), 325 B.R. 709, 715 (Bankr. D. Md. 2005); *Torch Liquidating Trust v. Stockstill*, 561 F.3d 377, 387 (5th Cir. La. 2009); *Kipperman v. Onex Corp.*, 2006 U.S. Dist. LEXIS 96944 (N.D. Ga. Sept. 15, 2006).

an avoidance action for their exclusive benefit."[271] Moreover, even once unsecured creditors have been paid in full, the assignee of the fraudulent conveyance claim may still have standing to pursue the litigation if it will benefit the "estate" that encompasses the interests of administrative claimants and even residual equity-holders.[272]

B. Comparison of Who May Avoid a Transfer: Creditors at the Time of the Transfer Versus Current Creditors

As discussed *supra* in Chapter I.A.2, fraudulent conveyance claims arise under a number of different regimes outside of the bankruptcy context, including under the UFTA,[273] its predecessor, the UFCA,[274] and the Statute of Elizabeth.[275] These regimes are also relevant in the bankruptcy context in that § 544(b) provides that "the trustee may avoid any transfer of an interest 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 [the Bankruptcy Code]..." (emphasis added).

271 *See Citicorp Acceptance Co. v. Robinson* (*In re Sweetwater*), 884 F.2d 1323, 1328 (10th Cir. 1989), *but see Official Comm. of Unsecured Creditors of Maxwell Newspapers Inc. v. MacMillan Inc.* (*In re Maxwell Newspapers Inc.*), 189 B.R. 282, 287 (Bankr. S.D.N.Y. 1995) ("This is not to say that unsecured creditors must benefit from a favorable result in the avoidance action; the benefit may come from the transfer of the claim itself through, for example, settlement yielding a benefit to the unsecured creditors.").

272 *See MC Asset Recovery LLC v. Commerzbank A.G.* (*In re Mirant*), 675 F.3d 530, 534 (5th Cir. 2012) ("[T]o the extent [the plaintiff's] successful avoidance of fraudulent transfers will benefit the bankruptcy estate, [the plaintiff] has Article III standing to avoid transfers that injured the estate."); *Stalnaker v. DLC Ltd.*, 376 F.3d 819, 824 (8th Cir. 2004); *but see Adelphia Recovery Trust v. Bank of America N.A.*, 390 B.R. 80, 91-97 (Bankr. S.D.N.Y. 2008) (finding that since the relevant creditors had already been paid in full and would receive no benefit from avoiding the transfer, the plaintiff did not have standing under § 544(b) to assert the claim). *See also Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, 464 B.R. 606 (Bankr. S.D.N.Y. 2012), discussed at Section C of this chapter, *infra*.

273 The UFTA has been adopted in the following states: Alabama, Arizona, Arkansas, California, Colorado, Delaware, District of Columbia, Florida, Hawaii, *Ida*ho, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Texas, Utah, Vermont, Washington, West Virginia and Wisconsin.

274 Replaced in most jurisdictions by the UFTA, the UFCA remains in effect in Maryland, New York, Tennessee, Virgin Islands and Wyoming.

275 The Statute of Elizabeth derives from the Fraudulent Conveyances Act of 1571 (13 Eliz. 1, c. 5), and remains part of U.S. common law in most jurisdictions.

Under the different regimes, claims to avoid fraudulent transfers may be available to parties who were creditors at the time of the transfer and/or to future creditors, depending on the circumstances of the transaction. For example, § 4 of the UFTA, which deals with "transfers fraudulent as to *present* and *future* creditors," provides:

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> (1) with actual intent to hinder, delay, or defraud any creditor of the debtor;[276] or
>
> (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:[277]
>
> (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
>
> (ii) intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due.

Section 5 of the UFTA, dealing with "transfers fraudulent as to *present* creditors" provides:

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.[278]
>
> (b) A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insid-

276 Section 4(a)(1) is derived from § 7 of the UFCA.
277 Section 4(a)(2) is derived from §§ 5 and 6 of the UFCA.
278 Section 5(a) is derived from § 4 of the UFCA.

er for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.