THE CASE FOR DERIVATIVE STANDING IN CHAPTER 11: "IT'S THE PLAIN MEANING, STUPID"

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INTRODUCTION

In a series of opinions beginning with its decision in *United States v. Ron Pair Enterprises*, *Inc.*[1] the United States Supreme Court has applied what has come to be known as the "plain meaning" analysis in its interpretation of Bankruptcy Code provisions.[2] The basic principle from which the plain meaning analysis is derived is the very reasonable proposition that in enacting a statute, Congress says what it means and means what it says.[3] Under the plain meaning doctrine, an unambiguous statute's express language serves as a both the beginning and end of a court's inquiry into its construction.[4] Where a Bankruptcy Code provision is plain, therefore, plain meaning analysis dictates that "the sole function of the courts is to enforce it

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[1] 489 U.S. 235, 245–46 (1989) (stating when statutory language is clear and no conflict with state or federal interests exists, no reason to believe Congress did not intend application of clear language of statute).

[2] The Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101–1330 (2002) (as amended, the Bankruptcy Code). *See generally* Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 (2000) (applying plain meaning interpretation to section 506(c), the Court limited recovery to trustees because they are only party named in statute); Rake v. Wade, 508 U.S. 464, 471 (1993) (stating clear statutory language must be enforced on its terms); Patterson v. Shumate, 504 U.S. 753, 759 (1992) (applying plain meaning interpretation to section 541(c)(2), the Court concluded statute encompasses any relevant non-bankruptcy law).

[3] *See, e.g.*, Conn. Nat. Bank v. Germain, 503 U.S. 249, 253–54 (1992) ("We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there."); Crooks v. Harrelson, 282 U.S. 55, 59–60 (1930) (holding plain meaning interpretation should be abandoned only when it would lead to absurd results and defining "absurd" as shocking to general common or moral sense); U.S. v. Goldenberg, 168 U.S. 95, 102–03 (1897) ("The primary and general rule of statutory construction is that the intent of the lawmaker is to be found in the language that he has used.").

[4] *See Ron Pair Enters*., 489 U.S. at 241 (holding proper interpretation of section 506(b) solely dependent upon plain meaning reading of section 506(b)). The Court went on to state that "[t]he language before us expresses Congress' intent - that post-petition interest be available - with sufficient precision so that reference to legislative history and to pre-Code practice is hardly necessary." *Id*.; *see also* Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 960–61 (1997) (applying plain meaning approach to interpretation of section 506(a) secured claims). *See generally* Walter A. Effross, *Grammarians At The Gate: The Rehnquist Court's Evolving "Plain Meaning" Approach To Bankruptcy Jurisprudence*, 23 SETON HALL L. REV. 1636 (1993) (chronicling Rehnquist Court's approach to bankruptcy cases and plain meaning doctrine).

according to its terms," without reference to legislative history or pre-Code practice.[5]

One of the Supreme Court's more recent applications of plain meaning analysis to the Bankruptcy Code is *Hartford Underwriters Ins. Co. v. Union Planters Bank N.A.*.[6] There, the Court unanimously held that the plain meaning of the statute dictates that *only* a bankruptcy trustee has the independent right to surcharge a secured creditor's collateral under section 506(c) of the Bankruptcy Code.[7] The Court based its decision on the language of section 506(c) – "the trustee may recover" – as evincing clear Congressional intent that authority to surcharge a

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[5] *Ron Pair Enters*., 489 U.S. at 241 (quoting Caminetti v. United States, 242 U.S. 470, 485 (1917)). Although this article analyzes the recent debate surrounding the plain meaning construction of the Bankruptcy Code, plain meaning analysis is not new to the Supreme Court's jurisprudence. Nearly 180 years ago, in *Green v. Biddle*, the Supreme Court held that:

> [W]here the words of a law . . . have a plain and obvious meaning, all construction, in hostility with such meaning, is excluded. This is a maxim of law, and a dictate of common sense; for were a different rule to be admitted, no man, however cautious and intelligent, could safely estimate the extent of his engagements, or rest upon his own understanding of a law, until a judicial construction of those instruments had been obtained.

21 U.S. 1, 118 (1823). Although the plain meaning approach is an accepted maxim of statutory interpretation, the method of carrying out such an analysis is not static. *Compare* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring) ("The starting point in every case involving construction of a statute is the language itself."), *with* Brown v. Duchesne, 60 U.S. 183, 194 (1856):

> [I]n interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute (or statutes on the same subject) and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry into execution the will of the Legislature, as thus ascertained, according to its true intent and meaning.

Id.

[6] 530 U.S. 1, 5–6 (2000) (applying plain meaning approach to interpretation when addressing whether administrative claimant could recover under section 506(c)). Lower courts have also continued to apply a plain meaning analysis to issues arising under Bankruptcy Code provisions. *See, e.g., In re* Adler Coleman Clearing Corp., 263 B.R. 406, 474 (S.D.N.Y. 2001) ("[J]udicial inquiry begins with the text of the statute. The court must first examine whether the plain language is unambiguous, and there end the search if on its face the wording is clear enough to leave no room for doubt or further interpretation."). *But see* David Gray Carlson, *Surcharge and Standing: Bankruptcy Code Section 506(c) After Hartford Underwriters*, 76 AM. BANKR. L.J. 43, 79 (2002) (discussing drawbacks of plain meaning interpretation). Carlson further theorizes that "[t]he true villain . . . is 'plain meaning.' By reading § 506(c) 'plainly,' the Supreme Court unleashed the usual horde of logical goblins and gremlins that can be contained only through an interpretation sensitive to bankruptcy dynamics." *Id*.

[7] *Hartford Underwriters*, 530 U.S. at 6.

> Here, the statute appears quite plain in specifying who may use § 506(c) – 'the trustee.' It is true, however . . . that all this actually 'says' is that the trustee may seek recovery under the section, not that others may not. The question thus becomes whether it is a proper inference that the trustee is the only party empowered to invoke the provision. We have little difficulty answering yes.

Id.; *see* 11 U.S.C. § 506(c) (2002) (providing in pertinent part: *"[t]he trustee may* recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.") (emphasis added).

secured creditor's collateral is limited to the trustee.[8] Consequently, section 506(c) does not provide an administrative claimant an independent right to use the section to seek payment of its claim for reimbursement of expenses incurred in preserving or disposing of a secured creditor's collateral.[9]

Because the words "the trustee may" also appear in various avoidance provisions of the Bankruptcy Code,[10] there is current controversy as to whether the conclusion reached by the Supreme Court through its plain meaning analysis in *Hartford Underwriters* similarly applies to a creditor or creditors' committee seeking to prosecute avoidance actions in a chapter 11 reorganization. For over a century, creditors and creditors' committees have, with court approval, routinely commenced avoidance actions for the benefit of a bankruptcy estate where a trustee or debtor-in-possession ("DIP") unjustifiably fails to do so.[11] Today, this practice is known as the grant of "derivative standing," whereby a creditor or a creditors' committee is designated by the bankruptcy court to take action in the trustee's stead.[12]

Trapped by what appears at first glance to be rigid statutory construction, in late 2002 a panel of the Third Circuit in *Official Committee of Unsecured Creditors v. Chinery (In re Cybergenics Corp.)* ("*Cybergenics I*")[13] extended *Hartford Underwriters'* plain meaning construction to the Bankruptcy Code's avoidance

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[8] *Hartford Underwriters*, 530 U.S. at 14; *see also In re* Caldwell, 147 B.R. 119, 121 (M.D.N.C. 1992) ("Section 506(c) and its legislative history are clear, plain and unambiguous. Both refer only to a trustee as having standing. Neither the statute nor the legislative history refers to another entity."); *In re* Interstate Motor Freight Sys., IMFS, Inc., 86 B.R. 500, 502–03 (Bankr. W.D. Mich. 1988) (stating because language of section 506(c) only mentions trustees, court cannot alter Congressional intent by adding additional terms).

[9] *See Hartford Underwriters*, 530 U.S. at 14 (concluding section 506(c) does not provide administrative claimant independent right to use section to seek payment of claim). Prior to *Hartford Underwriters*, there was a split of authority regarding an administrative claimant's right to surcharge a secured creditor's collateral. *See In re* Great N. Forest Prods., Inc. 135 B.R. 46, 65 (Bankr. W.D. Mich. 1991) (providing only trustee or debtor-in-possession may seek recovery from secured creditors collateral); *In re* Ramaker, 117 B.R. 959, 966 (Bankr. N.D. Iowa 1990) (holding ability to recover from secured party's collateral for expenses incurred is limited to trustee or debtor-in-possession). *But see* McKeesport Steel Castings Co. v. Equibank N.A. (*In re* McKeesport Steel Casting Co.), 799 F.2d 91, 94 (3d Cir. 1986) (supporting contention that in addition to trustee, administrative claimant may seek recovery from secured creditor's collateral under section 506(c)).

[10] *See* 11 U.S.C. §§ 544-45, 547-50 (2002) (providing similar language under chapter 5 of the Code).

[11] *In re* Maxim Computers, Inc., 278 B.R. 189, 197 (B.A.P. 9th Cir. 2002); *see also* Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 568 (3d Cir. 2003) (*Cybergenics II*) (stating natural reading of Code indicates clear Congressional intent to permit adaptable role for committees representing bankruptcy estate); La. World Exposition v. Fed. Ins. Co., 858 F.2d 233, 247 (5th Cir. 1988) (discussing requirements bankruptcy courts have imposed on creditor committees in order to have standing in case of chapter 11 reorganization).

[12] *See Hartford Underwriters*, 530 U.S. at 13 n.5 (acknowledging without endorsing "derivative standing," although Code only names trustee); *see also In re* iPCS, Inc., 297 B.R. 283, 288 (Bankr. N.D. Ga. 2003) (citing *Cybergenics II* as principal case establishing derivative standing). *See generally* Edward D. Jellen, Lawrence Goldberg, & Margaret Sheneman, *Recent Developments in Business Bankruptcy - 2002*, 26 CAL. BANKR. J. 341, 348 (2003) (describing "derivative standing doctrine").

[13] 304 F.3d 316 (3d Cir. 2002) (*Cybergenics I*), *vacated*, *reh'g granted*, 310 F.3d 785 (3d Cir. 2002) (previously published, but subsequently withdrawn from bound reporter by court order vacating opinion).

provisions. Feeling constrained by the Supreme Court's reasoning in *Hartford Underwriters*, the Court held that a creditor or creditors' committee may not bring such avoidance actions derivatively in a chapter 11 case.[14] Shortly thereafter, *Cybergenics I* was vacated *en banc* for rehearing and was ultimately reversed in a 7-4 decision.[15]

Notwithstanding its approval of derivative standing in bankruptcy avoidance actions, the recent *en banc Cybergenics II* opinion contains the same analytical flaw as other post-*Hartford Underwriters* cases that have upheld the practice.[16] In affirming this doctrine, both *Cybergenics II* and other post-*Hartford Underwriters* decisions reach the right result but fail to give credence to the Supreme Court's plain meaning construction of the Bankruptcy Code, as expressed in *Hartford Underwriters*. Although most of these opinions pay lip service to Justice Scalia's plain meaning analysis, they miss the mark because they do not specifically recognize that the plain meaning of applicable Bankruptcy Code provisions *authorize* and *empower* the bankruptcy court to confer derivative standing upon a creditor or creditors' committee. This article will demonstrate that by properly following *Hartford Underwriters*' road map to plain meaning construction of the Bankruptcy Code, the case for derivative standing in the context of chapter 11 cases is both compelling and clear.

I. DERIVATIVE STANDING IN THE CHAPTER 11 CONTEXT

The reorganization provisions of chapter 11 of the Bankruptcy Code serve to balance the competing economic interests of those who extend credit and seek to preserve their collateral with the social benefits of providing financially distressed

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[14] *Id*.; *see also* Jefferson County Bd. of Comm'rs v. Voinovich (*In re* V Cos.), 292 B.R. 290, 298 (6th Cir. B.A.P. 2003) (citing *Cybergenics I* as case agreeing with *Hartford Underwriters* approach). *See generally* Robert M. Quinn, *Not So Fast, Mr. Liquidating Trustee! May Anyone Other Than Bankruptcy Trustee Exercise Avoidance Powers After Confirmation?* AM. BANKR. INST. J., Sept. 2003 at 28, 35 (analyzing *Cybergenics I* holding).

[15] *Cybergenics II*, 330 F.3d at 555; *see also* Official Comm. of Unsecured Creditors v. Cablevision Sys. Corp. (*In re* Valley Media, Inc.), 2003 WL 21956410, at *2 (Bankr. D. Del. 2003) ("*Cybergenics II* holds that under appropriate circumstances a bankruptcy court can authorize creditors committees to sue derivatively to avoid fraudulent transfers for the benefit of the estate.").

[16] Other recent post-*Hartford Underwriters* cases upholding the practice of derivative standing include: *In re V Cos.*, 292 B.R. at 297 (granting derivative standing to creditor); Commodore Int'l Ltd. v. Gould (*In re* Commodore Int'l Ltd.), 262 F.3d 96, 100 (2d Cir. 2001) (holding creditors committee can obtain standing and sue on behalf of debtor); *In re* Exide Techs., Inc., 299 B.R. 732, 739 (Bankr. D. Del. 2003) (stating clear rule that bankruptcy court may grant creditors committee derivative standing); *In re* Stanwich Fin. Servs. Corp., 288 B.R. 24, 27 (Bankr. D. Conn. 2002) (granting unsecured creditors committee derivative standing to commence strong-arm avoidance proceeding on behalf of estate); *In re* Newcorn Enters. Ltd., 287 B.R. 744, 750 (Bankr. E.D. Mo. 2002) (giving creditors committee ability to file adversary complaint to marshal assets of estate via derivative standing); *In re* Dur Jac Ltd., 254 B.R. 279, 286 n.7 (Bankr. M.D. Ala. 2000) (permitting single creditor to initiate avoidance proceeding).

debtors rehabilitation and a reasonable opportunity to reorganize.[17] A DIP in a chapter 11 case serves as a fiduciary of its own bankruptcy estate, and is vested with essentially the same fiduciary duties as a bankruptcy trustee.[18] The right of a bankruptcy trustee to commence an avoidance action is extended to a debtor in possession pursuant to 11 U.S.C. § 1107(a), which gives the debtor in possession "all of the rights . . . and powers" of a trustee.[19] However, notwithstanding this fiduciary role, a DIP is often subjected to conflicts of interest. As such, the DIP can be tempted to use its discretion under avoidance provisions to favor certain creditors over others, instead of as a means to further its reorganization for the benefit of all creditors as Congress intended.[20]

Indeed, DIPs frequently face conflicts where the duty to investigate and prosecute avoidance claims may involve family members,[21] major shareholders whose support they may need post-reorganization,[22] or current and past officers,

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[17] *See In re* Jones & Lamson Mach. Co., Inc., 102 B.R. 12, 15 (Bankr. D. Conn. 1989) (stating reorganization provision in Bankruptcy Code serves dual purpose of preserving creditor's collateral and encouraging rehabilitation); *see also* Moody v. Amoco Oil Co., 734 F.2d 1200, 1216 (7th Cir. 1984) ("[T]he purpose behind chapter 11 is 'to permit successful rehabilitation of debtors' and 'to prevent a debtor from going into liquidation.'") (quoting NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527–28 (1984)); *In re* USN Communications, Inc., 280 B.R. 573, 598 (Bankr. D. Del. 2002) (stating Bankruptcy Code is forum to facilitate rehabilitation and ensure distribution to creditors).

[18] *See* Hollywell Corp. v. Smith, 503 U.S. 47, 54 (1992) (agreeing DIP is fiduciary); *see also* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) (stating debtor-in-possession bears basically same fiduciary obligation as trustee); *see also* Wolf v. Weinstein, 372 U.S. 633, 649–50 (1963) (discussing fiduciary duties and responsibilities of debtor-in-possession).

[19] 11 U.S.C. § 1107(a) (2002); *see also* Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 n.3 (2000) ("Debtors in possession . . . are expressly given the rights and powers of a trustee . . . ."); ReGen Capital III, Inc. v. Official Comm. of Unsecured Creditors (*In re* Trism, Inc.), 282 B.R. 662, 669 (2002) (B.A.P. 8th Cir. 2002) (concluding debtor-in-possession may prosecute avoidance actions); *In re V Cos*., 292 B.R. at 296 (stating debtor-in-possession has all powers of trustee); 5 COLLIER ON BANKRUPTCY ¶ 544.02 at 544-4 n.1, ¶ 548.01[1] at 548–67 (15th ed. rev. 2002) ("A chapter 11 debtor in possession may exercise the avoiding powers of a trustee . . . The bankruptcy trustee is expressly authorized to commence an avoidance action, but this right is also extended to the debtor in possession . . . .").

[20] *See, e.g.*, Canadian Pac. Forest Prods. Ltd. v. J.D. Irving, Ltd. (*In re* The Gibson Group, Inc.), 66 F.3d 1436, 1441 (6th Cir. 1995) (stating debtor-in-possession may act under influence of conflicts of interest); *In re* C & R Beer & Soda, Inc., 186 B.R. 173, 178 (Bankr. E.D.N.Y. 1995) ("[D]ebtor in possession is neither independent nor disinterested . . . [D]ebtor in possession has peculiar features and interests that sometimes conflict with, and are often inconsistent with, the vigorous exercise of avoidance powers."); *In re* Lauria Steel and Trading Corp., 168 B.R. 913, 917 (Bankr. N.D. Ill. 1994) (discussing differing interests of trustees and debtors-in-possession).

[21] *See, e.g., In re* Elec. Materials Co., 160 B.R. 1018, 1023 (Bankr. W.D. Mo. 1993) (explaining debtor-in-possession is often unwilling to file avoidance actions against relatives); *In re* Shelby Motel Group, Inc., 123 B.R. 98, 103 (Bankr. N.D. Ala. 1990) ("The debtor-in-possession has proven that it will never bring adversary proceedings against its own family members and their existing or non-existent business enterprises."); *In re* V. Savino Oil & Heating Co., Inc., 91 B.R. 655, 657 (Bankr. E.D.N.Y. 1988) (acknowledging DIP would not institute lawsuit against companies owned or controlled by relatives of debtor's sole shareholder and principal officer, but noting creditors committee would).

[22] *See, e.g., In re* E. Elec. Sales Co., Inc., 66 B.R. 545, 546 (Bankr. E.D. Pa. 1986) (sustaining objection against debtor-in-possession's proposed compensation to its major shareholder); *In re* Calvary Temple Evangelistic Ass'n, 47 B.R. 520, 523 (Bankr. D. Minn. 1984) ("[D]ebtor in possession may be reluctant to proceed with adversary proceedings against certain defendants who may be major shareholders of the debtor

directors, or other corporate insiders.[23] Unfortunately, the dual objectives of chapter 11 cannot be achieved if such transferees who would otherwise be named as defendants in avoidance actions are insulated by a DIP's reluctance or inability to prosecute such actions.[24] To remedy any possible deficiency, the derivative standing doctrine helps achieve a delicate balance by enabling a DIP to continue with the rehabilitation of its business, notwithstanding any conflicts of interest it may have due to pre-petition transfers made to insiders or other favored creditors.[25]

II. THE HISTORY AND DEVELOPMENT OF THE DERIVATIVE STANDING DOCTRINE

The practice of granting derivative standing to a creditor to commence an avoidance action is rooted in equity, and not any specific statutory provision.[26] In 1878, the Supreme Court held in *Glenny v. Langdon*[27] that "[a]uthority for a creditor to bring suit to recover the property or rights of property of the bankrupt, under any circumstances, is certainly not given in the Bankruptcy Act [of 1878] . . . ; but the argument is that it is founded upon the enlarged principles of equity . . . ."[28]

Following passage of the Bankruptcy Act of 1898, federal courts again recognized that a trustee's failure to properly administer a debtor's estate could lead to the grant of derivative standing upon a creditor to act in the trustee's name consistent with equitable principles. In *Chatfield v. O'Dwyer*,[29] the Eighth Circuit recognized "the right of a creditor to apply to the bankrupt[cy] court for an order

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or major creditors with whom the debtor is attempting to negotiate terms for."); *In re* Joyanna Holitogs, Inc., 21 B.R. 323, 326 (Bankr. S.D.N.Y. 1982) (finding debtor-in-possession entered into possibly avoidable transactions with company whose officer and director was shareholder of debtor corporation).

[23] *See* Commodore Int'l Ltd. v. Gould, (*In re* Commodore Int'l Ltd.), 262 F.3d 96, 100 (2d Cir. 2001) ("A debtor-in-possession often acts under the influence of conflicts of interest . . . .") (quoting *In re Gibson Group*, 66 F.3d at 1441)); *In re* Catwil Corp., 175 B.R. 362, 365 (Bankr. E.D. Cal. 1994) ("The inherent conflict of interest between Catwil [debtor-in-possession] and the insider-defendants made it unlikely that Catwil would initiate an avoidance action against the defendants.").

[24] *See In re* Together Dev. Corp., 262 B.R. 586, 592 (Bankr. D. Mass. 2001) (noting derivative standing "provide[s] the practical solution of permissive delegation in order to avoid an insider's circumvention of either the letter or spirit of the Bankruptcy Code."); *see also* Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 568 (3d Cir. 2003) (*Cybergenics II*) (stating bankruptcy courts able to confer derivative standing in order to serve equities).

[25] *See* Liberty Mut. Ins. Co. v. Official Unsecured Creditor's Comm. of Spaulding Composites Co. (*In re* Spaulding Composites Co.), 207 B.R. 899, 903–04 (B.A.P. 9th Cir. 1997) (noting when committee is granted derivative standing, DIP manages estate while committee pursues estate's litigation); Official Comm. of Unsecured Creditors v. Pardee (*In re* Stanwich Fin. Servs. Corp.), 288 B.R. 24, 26–27 (Bankr. D. Conn. 2002) (affirming grant of derivative standing to creditors' committee to commence and prosecute avoidance proceeding on behalf of chapter 11 estate); 5 COLLIER ON BANKRUPTCY, ¶ 7-1103 (15th ed. rev. 1999) (discussing reasoning behind allowing creditors' committee to commence avoidance action and noting committee pursues litigation while DIP concentrates on business).

[26] *See Cybergenics II*, 330 F.3d at 568 (stating although no statutory authorization existed for derivative standing, courts of equity allowed derivative standing); *In re* SRJ Enter., Inc., 151 B.R. 189, 194 (Bankr. N.D. Ill. 1993) ("It is equity, not the code, that is the basis for allowing derivative standing to pursue the trustee's power.").

[27] 98 U.S. 20 (1878).

[28] *Id*. at 26.

[29] 101 F. 797 (8th Cir. 1900).

permitting him to prosecute an appeal in the name of the trustee, when he has called upon the trustee to take an appeal . . . and the latter has declined to appeal."[30] The Eighth Circuit did not pinpoint any provision contained in the Bankruptcy Act of 1898 giving rise to this right, but rather referred to the bankruptcy court's "undoubted power" which flowed from the trustee's status as an officer of the bankruptcy court.[31] Thus, even after the Bankruptcy Act of 1898's passage, equity still remained as the primary source of support for derivative standing.

Following the Eighth Circuit's decision in *Chatfield*, section 64 of the Bankruptcy Act of 1898 was amended in 1903 to allow creditors who recovered property of the bankrupt for the benefit of the estate to seek reimbursement of their costs and expenses as administrative expenses.[32] The ostensible purpose of the amendment was presumably to make explicit what had already been determined to be implicit: that creditors acting for the benefit of the estate were allowed to sue derivatively.[33]

With the passage of time, and the enactment of the Bankruptcy Code in 1978, various theories developed establishing different grounds of authority upon which bankruptcy courts have relied in granting derivative standing to a creditor or committee to pursue avoidance actions. Historically, courts routinely approved the derivative standing doctrine in chapter 11 cases, relying not only on equitable principles but also upon implied, qualified rights contained in various sections of the Bankruptcy Code, including sections 1103(c)(5) and 1109(b),[34] and an express, qualified right found in section 503(b)(3)(B).[35]

In the chapter 11 context, most courts that have considered the propriety of derivative standing have found an implied, but qualified right for a creditors' committee to initiate adversary proceedings in the name of the DIP under 11 U.S.C. §§ 1103(c)(5) and 1109(b).[36] Applicable only to creditors' committees appointed by

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[30] *Id*. at 800; *see also Cybergenics II*, 330 F.3d at 563 ("Derivative standing was recognized judicially as early as 1900.").

[31] *See Chatfield*, 101 F. at 800 (stating bankruptcy court's power to recognize right of creditor to apply to bankruptcy court for order to allow prosecution of appeal in name of trustee, when trustee has declined to appeal).

[32] *See, e.g., In re* Maximus Computers, Inc., 278 B.R. 189, 197 (B.A.P. 9th Cir. 2002) (explaining section 503(b)(3)(B) codifies long-settled authority of creditors to sue in name of trustee to recover property for benefit of estate and to be compensated with payment of administrative expenses).

[33] *See In re* Godon, Inc., 275 B.R. 555, 561 (Bankr. E.D. Ca. 2002) (stating section 64 of Bankruptcy Act was amended in 1903 in order to explicitly permit creditors acting for benefit of estate to sue derivatively); *see also id*. at 562 ("Gamble & Co. [creditors] were the prosecutors of the suit; *the trustee's name being used simply as a legal necessity*.") (citing *In re Kenny*, 269 F. 54, 57 (W.D. Pa. 1920)) (emphasis added); Patterson-MacDonald Shipbldg. Co. v. MacDonald (*In re* Patterson-MacDonald Shipbldg. Co.), 288 F. 546, 548 (9th Cir. 1923) (explaining bankruptcy court may *sua sponte* allow party to appeal in name of trustee); Ohio Valley Bank v. Mack, 163 F. 155, 156 (6th Cir. 1906) (noting practicality of allowing dissatisfied creditor to appeal in name of trustee).

[34] *See infra* notes 37–51 and accompanying text (discussing sections 1103(c)(5) and 1109(b)).

[35] *See infra* notes 52–70 and accompanying text (discussing section 503(b)(3)(B)).

[36] *See* Unsecured Creditor's Comm. of STN Enters., Inc. v. Noyes (*In re* STN Enters., Inc.), 779 F.2d 901 (2d Cir. 1985) (stating most bankruptcy courts "have found implied, but qualified, right for creditors'

the United States Trustee in chapter 11 cases, section 1103(c)(5) provides: "(c) A committee appointed under section 1102 of this title may . . . (5) perform such other services as are in the interest of those represented."[37] Section 1109(b), on the other hand, provides a broad right to "raise and be heard on any issue" in a chapter 11 case, and is applicable to all parties in interest, including creditors' committees, equity security holders' committees, indenture trustees, equity security holders, and creditors.[38] The Second Circuit in *In re STN* noted that traditionally the grant of derivative standing based on implied statutory rights occurs where a DIP unjustifiably fails to bring suit or abuses its discretion in not suing to avoid a preferential or fraudulent transfer.[39] Under *In re STN*'s implied rights theory, in determining whether to allow a creditors' committee to commence an avoidance action, a court must consider: (1) whether the creditors' committee has presented a colorable claim; and (2) whether the action is likely to benefit the reorganization estate.[40] Relying on § 1109(b), other courts subsequently recognized that the derivative standing rule was applicable not only to creditors' committees but to individual creditors as well, permitting them to sue individually on behalf of the DIP or the trustee.[41]

The setting for derivative standing typically involves a DIP who is hostile to the proposed litigation. However, in *In re Spaulding Composites Co., Inc.*,[42] the Bankruptcy Appellate Panel of the Ninth Circuit further expanded the practice in the context of a consensual arrangement between a DIP and a creditors' committee, allowing the creditors' committee to prosecute on behalf of the estate with the DIP's permission.[43] As the *Spaulding* court noted, permitting a DIP to coordinate litigation

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committees to initiate adversary proceedings in name of debtor in possession under 11 U.S.C. §§ 1103(c)(5) and 1109(b)."); *In re* Joyanna Holitogs, Inc., 21 B.R. 323, 325–26 (Bankr. S.D.N.Y. 1983) (noting implied right under sections 1103(c)(5) and 1109(b)); *In re* Monsour Med. Ctr., 5 B.R. 715, 717–18 (Bankr. W.D. Pa. 1980) (implying continuation of committee powers under pre-1978 Bankruptcy Act).

[37] 11 U.S.C. § 1103(c)(5) (2002).

[38] 11 U.S.C. § 1109(b) (2002).

[39] *In re STN Enters*., 779 F.2d at 904; *see also In re* Toledo Equip. Co., Inc., 35 B.R. 315, 319 (Bankr. N.D. Ohio 1983) (emphasizing committee's standing becomes warranted only when DIP's "inactivity becomes unjustified or abusive of its discretion"); *In re Monsour Med. Ctr.*, 5 B.R. at 718 (discussing same).

[40] *In re STN Enters*., 779 F.2d at 905; *see also In re* Valley Park, Inc., 217 B.R. 864, 866 (Bankr. D. Mont. 1998) (discussing same); *In re Toledo Equip*., 35 B.R. at 320 (illustrating necessary conditions for committees to initiate avoidance actions, including "a *prima facia* demonstration that a colorable claim exists which, if successful, would benefit the state . . . .").

[41] *See In re* Shelby Motel Group, 123 B.R. 98, 102 (Bankr. N.D. Ala. 1990) (reversing bankruptcy court denial of individual creditor's standing to sue on behalf of debtor); *In re* McConnell, 122 B.R. 41, 44 (Bankr. S.D. Tex. 1989) (finding no "extraordinary circumstances" to permit creditor to initiate action on behalf of debtor); *In re* V. Savino Oil & Heating Co., Inc., 91 B.R. 655, 657 (Bankr. E.D.N.Y. 1988) (refusing to grant relief in absence of extraordinary circumstances).

[42] 207 B.R. 899 (B.A.P. 9th Cir. 1997).

[43] *See id*. at 904 (using "impartial judicial balancing," court held DIP "may stipulate to representation by an unsecured creditors' committee"). Several years after *In re STN*, the Second Circuit adopted *In re Spaulding Composites*' approach to consensual agreements to prosecute, and ruled that a creditors' committee may acquire consensual standing to pursue a DIP's claims if (1) the committee has consent of the DIP or trustee, and (2) the court finds that suit by the committee is in the best interests of the bankruptcy estate, and is "necessary and beneficial" to the fair and efficient resolution of the bankruptcy proceedings.

responsibilities with an unsecured creditors' committee can be an effective method for the DIP to manage its bankruptcy estate and fulfill its duties.[44]

Reverting back to equitable principles, the Sixth Circuit held in *Canadian Pacific Forest Product, Ltd. v. J.D. Irving, Ltd. (In re Gibson Group, Inc.)*[45] that while section 1109(b) might provide an implied statutory basis for a creditor to bring an avoidance action, "judicially-created derivative creditor standing" was the basis upon which the practice should be affirmed as valid in a chapter 11 case.[46] Relying on the Second Circuit's decision in *In re STN*, as well as prior Third, Fifth, Sixth and Seventh Circuit precedents,[47] the Sixth Circuit reaffirmed the practice and articulated a four prong test for derivative standing, under which a creditor or creditors' committee could act derivatively with court approval only if: (1) a demand has been made upon the statutorily authorized party to take action; (2) the demand is declined; (3) a colorable claim exists; and (4) the inaction is an abuse of discretion in light of the DIP's duties in a chapter 11 case.[48] Under *In re Gibson Group*, a creditor meets its burden to show that it should be granted standing to file an avoidance action if it has fulfilled the first three requirements and the DIP declined to take action without stating a reason.[49] The burden then shifts to the DIP

See also Commodore Int'l Ltd. v. Irving Gould (*In re* Commodore Int'l Ltd.), 262 F.3d 96, 99–100 (2d Cir. 2001) ("[T]he court in *Spaulding Composites* held that a debtor in possession may stipulate to representation by an unsecured creditors' committee '[s]o long as the bankruptcy court exercises its judicial oversight and verifies that the litigation is indeed necessary and beneficial.'") (citing *In re Spaulding*, 207 B.R. at 904); Coral Petroleum, Inc. v. Banque Paribas-London (*In re* Coral Petroleum, Inc.) 797 F.2d 1351, 1362–63 (5th Cir. 1986) (holding DIP's stipulation effective to confer standing on creditors' committee).

[44] *In re Spaulding*, 207 B.R. at 904; *see also* La. World Exposition v. Federal Ins. Co. (*In re* La. World Exposition), 858 F.2d 233 (5th Cir. 1988) (stating where DIP possesses cause of action favorable to estate, but DIP is unable to assert cause of action due to conflict of interest, allowing creditors' committee to pursue action on DIP's behalf is often beneficial to estate). *See generally In re* E. Paul Kovacs & Co., Inc., 16 B.R. 203, 205 (Bankr. Conn. 1981) (detailing duties of DIP).

[45] 66 F.3d 1436 (6th Cir. 1995).

[46] *Id*. at 1446 n.1 (pointing out section 1109(b) does not foreclose possibility of judicially-created derivative creditor standing); *see also* Unsecured Creditors Comm. of Debtor STN Enters., Inc. v. Noyes (*In re* STN Enters.) 779 F.2d 901, 904 (2d Cir. 1985) (recognizing implied qualified right of creditors' committees to initiate proceedings); *In re* Joyanna Holitogs, Inc., 21 B.R. 323, 326 (Bankr. S.D.N.Y. 1982) (explaining section 1109(b) is pointless if those who have general right to be heard cannot act where those who should act will not).

[47] *See In re La. World Exposition*, 858 F.2d at 253 (determining committee may maintain cause of action in lieu of trustee or debtor-in-possession); *see also In re* Xonics Photochemical, Inc., 841 F.2d 198, 203 (7th Cir. 1988) ("An alternative route possibly open to Mitsui was to ask the bankruptcy court to allow it to bring a form of derivative suit in the name of the debtor."); Equitable Gas Co. v. Equibank N.A. (*In re* McKeesport Steel Castings Co.), 799 F.2d 91, 94 (3d Cir. 1986) ("The rule that individual creditors cannot act in lieu of the trustees is often breached when sufficient reason exists to permit the breach."); William B. Tanner Co. v. United States (*In re* Automated Bus. Sys. Inc.), 642 F.2d 200, 201 (6th Cir. 1981) (holding where trustee is unable to pursue suggested suit creditor has right to proceed on behalf of estate).

[48] *In re Gibson Group*, 66 F.3d at 1446; *see also In re McKeesport*, 799 F.2d at 94 (demonstrating how standing existed where individual creditor had colorable claim and was only creditor who would zealously pursue claim); *In re* Toledo Equip. Co., 35 B.R. 315, 320 (Bankr. N.D. Ohio 1983) (holding four criteria must be satisfied in order to achieve standing).

[49] *In re Gibson Group*, 66 F.3d at 1446; *see also In re La. World Exposition* 858 F.2d at 252 (explaining when debtor-in-possession is unable or unwilling to fulfill obligation committee may assert cause of action).

to establish by a preponderance of the evidence that its reason for not acting is justified.[50]

More recently, some courts have looked to section 503(b)(3)(B) as a basis for derivative standing, concluding that the provision provides express authority for a court to grant a creditor derivative standing to pursue an avoidance action in the name of a debtor or trustee.[51] Section 503(b)(3)(B) provides for reimbursement of the actual and 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."[52] The provision is derived from sections 64(a)(1) and (3)[53] of the Bankruptcy Act of 1898, which allowed payment of the costs and expenses of a creditor who recovered property of the bankrupt for the benefit of the estate.[54]

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[50] *In re Gibson Group*, 66 F.3d at 1446; *see also In re La. World Exposition*, 858 F.2d at 253 n.20 (noting courts must look to whether interests of creditors are left unprotected as result of DIP's refusal to act in determining whether such refusal was justified); *In re STN Enters*., 779 F.2d at 905 (stating courts must also examine whether taking action is likely to benefit reorganization estate in order to decide if DIP unjustifiably failed to bring suit).

[51] *In re* Blount, 276 B.R. 753, 761 (Bankr. M.D. La. 2002).

> Section 503(b)(3)(B) . . . must be interpreted to provide statutory authority for a court to approve a creditor to act instead of a trustee, and thus, provides an express statutory grant of the authority of the court to confer derivative standing upon creditors to pursue actions that will lead to the recovery of property transferred or concealed by the debtor, for the benefit of the estate.

Id.; *see also In re* Godon, Inc, 275 B.R. 555, 561 (Bankr. E.D. Cal. 2002) (holding Bankruptcy Code section 503(b)(3)(B) and (4) carries forward from former Bankruptcy Act authority for creditors to sue in name of estate without requiring their counsel be employed by trustee). *But see* Surf N Sun Apts., Inc. v. Dempsey, 253 B.R. 490, 492 (Bankr. M.D. Fla. 1999) ("Federal courts have consistently held that § 503(b)(3)(B) does not confer standing to creditors to sue on behalf of the bankruptcy estate.") (citing *In re* Vogel Van & Storage, Inc., 210 B.R. 27, 32, n.4 (N.D.N.Y. 1997)); *In re* SRJ Enters., Inc, 151 B.R. 189, 193 n.1 (Bankr. N.D. Ill. 1993) ("[S]ection 503(b)(3)(B) does not confer standing; it only authorizes recovery of expenses to a creditor who successfully recovered property, which is to say, a creditor who had standing in the first place.").

[52] 11 U.S.C. § 503(b)(3)(B) (2002).

[53] Section 64(a) of the Bankruptcy Act of 1898, stated, in pertinent part:

> The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) . . . where *property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery* . . . (3) where the confirmation of an arrangement . . . has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of title 18 of the United States Code, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside. . . [.] (emphasis added).

Bankruptcy Act § 64(a), 11 U.S.C. § 104(a) (1976) (redesignated from section 64(b) in 1938) (repealed 1978).

[54] *See In re* Casale, 27 B.R. 69, 70 (Bankr. E.D.N.Y. 1983) (stating creditor's expenses were recoverable under section 64(a) of Bankruptcy Act of 1898). *See generally* Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 563 (3d Cir. 2003) (*Cybergenics II*) (quoting section 64(a)(1)

When this section was recodified within the provisions of 503(b)(3)(B) of the Bankruptcy Code, Congress specifically limited such an allowance to those situations where the creditor sought and obtained prior court approval to recover the debtor's property on behalf of the estate.[55]

III. THE IMPACT OF *HARTFORD UNDERWRITERS* ON THE DERIVATIVE STANDING DOCTRINE

In *Hartford Underwriters*, the Supreme Court addressed the issue of whether 11 U.S.C. § 506(c) allows an administrative claimant of a bankruptcy estate to seek payment of its claim independently from property encumbered by a secured creditor's lien in a chapter 7 case.[56] Section 506(c) provides that:

> *The trustee may* recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.[57]

In a unanimous opinion delivered by Justice Scalia, the Supreme Court ruled that by using the phrase "the trustee may" in this section, Congress granted the trustee exclusive authority to bring an action under the statute.[58] As such, the workers' compensation insurer in *Hartford Underwriters*, as a creditor in the case, lacked standing and was prohibited from seeking to surcharge a secured creditor's collateral for unpaid post-petition insurance premiums owed by the debtor following conversion of the debtor's case from chapter 11 to chapter 7.[59]

Significantly, in a critical footnote, the *Hartford Underwriters* Court explicitly refused to rule on the propriety of derivative standing, as that precise issue was not before it:

> We do not address whether a bankruptcy court can allow other interested parties to act in the trustee's stead in pursuing recovery under § 506(c). *Amici* American Insurance Association and

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of Bankruptcy Act of 1898 and explaining how courts have interpreted it); *In re* Ira Marcus, 1987 Bankr. LEXIS 2424, at *2–3 (Bankr. S.D.N.Y. 1987) (noting section 64(a)(3) of former Bankruptcy Act undoubtedly permitted reimbursement of creditor's expenses).

[55] *See In re Casale*, 27 B.R. at 70 (describing how Bankruptcy Reform Act of 1978 altered section 64(a) of Bankruptcy Act of 1898); *see also In re Blount*, 276 B.R. at 758 (agreeing section 503(b)(3)(B) required prior court approval); *In re* Romano, 52 B.R. 590, 593 (Bankr. M.D. Fla. 1985) (concluding prior court approval is required for creditor to collect her reasonable fees and expenses under section 503(b)(3)(B)).

[56] *See* Hartford Underwriters Ins. Co. v. Union Planters Bank, 530 U.S. 1, 3 (2000); *see also Cybergenics II*, 330 F.3d at 552–53 (distinguishing issue presented from *Hartford Underwriters*); *In re* McLeroy, 250 B.R. 872, 880–81 (Bankr. N.D. Tex. 2000) (comparing issue before court with *Hartford Underwriters*).

[57] 11 U.S.C. § 506(c) (2002) (emphasis added).

[58] *Hartford Underwriters*, 530 U.S. at 6.

[59] *See id*. at 8 (holding creditor lacked standing to recover under section 506(c) of the Code).

> National Union Fire Insurance Co. draw our attention to the practice of some courts of allowing creditors or creditors' committees a derivative right to bring avoidance actions when the trustee refuses to do so, even though the applicable Code provisions mention only the trustee. Whatever the validity of that practice, it has no analogous application here, since petitioner did not ask the trustee to pursue payment under § 506(c) and did not seek permission from the Bankruptcy Court to take such action in the trustee's stead. Petitioner asserted an independent right to use § 506(c), which is what we reject today.[60]

Given the Supreme Court's express reluctance to pass on the viability of derivative standing in footnote 5, it is not surprising that in the aftermath of *Hartford Underwriters*, bankruptcy courts continue to authorize creditors and creditors' committees to pursue avoidance claims.[61] In the post-*Hartford Underwriters* decision of *Together Development Corp. v. Pappas* (*In re Together Development Corp.*)[62] for example, the debtor filed a voluntary chapter 11 petition, and a problem arose when allegations surfaced concerning possible fraudulent transfers by the debtor's principals. The statute of limitations for avoidance actions was fast approaching, and in order to protect the estate's claims, the debtor and the creditors' committee entered into a stipulation to effectuate permission for the committee to initiate all causes of action on behalf of the debtor prior to the expiration of the statute of limitations.[63] The committee in *In re Together* sought recovery on behalf of the debtor and for the benefit of the debtor's estate.[64]

The defendants in *In re Together* cited *Hartford Underwriters* and argued that the committee lacked standing to bring the avoidance claims because of section 547's plain meaning and the Supreme Court's prior construction of the words "the trustee may."[65] Rejecting this assertion and concluding that "the specter of [*Hartford*] . . . is no more than a red herring[,]" the bankruptcy court in *In re Together* held that long-standing Code practice and the Code itself required that the

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[60] *Id*. at 13 (internal citations omitted). *See generally In re* Concord Mktg., 268 B.R. 415, 428–29 (Bankr. D. N.J. 2001) (describing limited holding of *Hartford Underwriters*).

[61] *See, e.g.*, Glinka v. Murad (*In re* Housecraft Indus. USA, Inc.), 310 F.3d 64, 70 (2d Cir. 2002) (stating creditors' committee may bring avoidance claims so long as certain criterion are met) (citing Commodore Int'l Ltd. v. Gould (*In re* Commodore Int'l Ltd.)), 262 F.3d 96 (2d Cir. 2001)); Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 345 (3d Cir. 2001) (noting Bankruptcy Court approved stipulation authorizing creditors' committee "to commence and prosecute . . . [l]itigation on behalf of the Debtors' estates"); Buncher Co. v. Official Comm. of Unsecured Creditors of GenFarm Ltd. P'ship IV, 229 F.3d 245, 250 (3d Cir. 2000) (explaining when recovery is sought under section 544(b) of Bankruptcy Code, "any recovery is for the benefit of all unsecured creditors, including those who individually had no right to avoid the transfer").

[62] 262 B.R. 586 (Bankr. D. Mass. 2001).

[63] *Id*. at 587

[64] *Id*.

[65] *Id*. at 589.

action continue.[66] The *In re Together* court also noted that the Supreme Court's decision was easily distinguishable, given the fact that the committee sought recovery for all creditors and on behalf of the bankruptcy estate, and not for its sole benefit.[67] Similarly, other post-*Hartford Underwriters* cases such as *In re Stanwich Financial Services*[68] and *In re Dur Jac Ltd.*[69] rely almost entirely on footnote 5 and distinguish *Hartford Underwriters* as inapplicable to the continuing validity of derivative standing.[70]

IV. THE GIVE AND TAKE OF DERIVATIVE STANDING IN THE THIRD CIRCUIT: *CYBERGENICS*

A. Cybergenics I

Not all post-*Hartford Underwriters* decisions however have been so quick to distinguish the Supreme Court's decision and support derivative standing. In September of 2002 a Third Circuit panel announced *Cybergenics I* which, on the heels of *Hartford Underwriters*, attempted to put a quick end to the practice.[71] In typical fashion, a creditors' committee in *Cybergenics I* had successfully secured bankruptcy court authorization to bring fraudulent transfer claims derivatively on behalf of the DIP, after the DIP refused to do so.[72] The defendant transferees moved to dismiss, arguing that the Supreme Court's interpretation of section 506(c) in *Hartford Underwriters* applied with equal force to section 544(b), and therefore only a trustee or DIP could bring such claims against them.[73] The district court granted defendants' motion to dismiss, and the ruling was subsequently affirmed by the Third Circuit on appeal.[74]

Cybergenics I limited the power to commence avoidance actions to a trustee or DIP, holding that in light of the Supreme Court's construction of "the trustee may"

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[66] *See id.* at 592 (holding both long standing bankruptcy practice and Bankruptcy Code dictate practice must be continued).

[67] *In re Together*, 262 B.R. at 591 (distinguishing circumstances in present case from *Hartford Underwriters* because "[p]laintiff herein is the [d]ebtor seeking recovery for all the creditors of the bankruptcy estate, not a lone creditor seeking recovery for its sole benefit.").

[68] 288 B.R. 24, 26–27 (Bankr. D. Conn. 2002).

[69] 254 B.R. 279, 286 n.7 (Bankr. M.D. Ala. 2000).

[70] *See In re Stanwich Fin. Servs.*, 288 B.R. at 26–27 ("[R]espondents' insistence that *Hartford Underwriters* is controlling is troublesome . . . as that decision involved the interpretation of 506(c) . . . ."); *In re Dur Lac, Ltd.*, 254 B.R. at 286 n.7 (holding court may permit creditor to act in lieu of chapter 11 debtor-in-possession in order to initiate avoidance proceeding).

[71] *See* Official Comm. of Unsecured Creditors v. Chinery (*In re* Cybergenics Corp.) (*Cybergenics I*), 304 F.3d 316 (3d Cir. 2002), *vacated, reh'g granted*, 310 F.3d 785 (3d Cir. 2002) (previously published, but subsequently withdrawn from bound reporter by court order vacating opinion) (rejecting historical basis for derivative standing by holding power to commence avoidance action is limited to trustee or debtor-in-possession).

[72] *Id.* at 319.

[73] *Id.* at 321.

[74] *Id.* at 335 (affirming judgment to dismiss complaint for lack of standing).

language in section 506(c), and in the absence of clear statutory authority to the contrary, it could not interpret the same phrase in section 544 any other way.[75] In reaching this conclusion, the *Cybergenics I* panel began its analysis with the plain meaning mantra articulated in *Hartford Underwriters*, that Congress, "says in a statute what it means and means what it says there."[76] The panel also pointed to *Hartford Underwriters'* observation that statutes such as section 544(b) which name a particular party as having the right to invoke its provision are "the least appropriate in which to presume nonexclusivity."[77]

The panel then went on to systematically reject all of the historical bases for derivative standing.[78] Regarding implied rights under sections 1109(b) and 1103(c), the panel noted that these provisions only provide a general right to be heard and list specific committee powers, none of which specifically include the right to commence avoidance actions on behalf of a DIP or trustee.[79] Although the panel cited one court's reliance on section 503(b)(3)(B) as a statutory basis for derivative standing, it offered no analysis as to the applicability of the provision to the doctrine.[80] Finally, with respect to equitable considerations, pre-chapter practice, and the *In re Gibson Group* court's "judicially-created" derivative standing doctrine, the panel considered *Hartford Underwriters'* reluctance to give weight to such factors in the face of the statute's clear language, and concluded that section 544(b)'s plain meaning can only be altered by Congress, not the courts.[81]

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[75] *Id*. at 319.

[76] *Cybergenics I*, 304 F.3d at 324 ("The Court noted that if Congress intended 'the trustee may' to mean 'the trustee and other parties in interest may,' 'it could simply have said so, as it did in describing the parties who could act under other section of the Code.'") (quoting Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 7 (2000))).

[77] *See Cyberbenics I*, 304 F.3d at 324 (quoting *Hartford Underwriters*, 530 U.S. at 6–7); *see also* Official Unsecured Creditors Comm. v. United States Nat'l Bank (*In re* Suffola, Inc.), 2 F.3d 977, 980 (9th Cir. 1993) (stating bankrupcty judges lack discretion to ignore plain meaning of statute).

[78] *Cybergenics I*, 304 F.3d at 324–33.

[79] *See id*. at 325–27 (maintaining where Congress prescribed set of limited, discrete rights in which committee can participate, section 1103(c)(5) cannot be read to grant broader, implied powers); Schwartz v. Romnes, 495 F.2d 844, 849 (2d Cir. 1974) ("It is a familiar canon of statutory construction that such (catchall terminating) clauses are to be read as bringing within the statute categories similar in type to those specifically enumerated.") (citing FMC v. Seatrain Lines, Inc., 411 U.S. 726, 734 (1973))).

[80] *See Cybergenics I*, 304 F.3d at 328 (citing *In re* Blount, 276 B.R. 753, 761–62 (Bankr. M.D. La. 2002) which maintained that section 503(b)(3)(B) provides express grant of statutory authority for creditor to act in lieu of trustee); *contra* Surf N Sun Apts., Inc. v. Dempsey, 253 B.R. 490, 492 (M.D. Fla. 1999) (emphasizing Federal courts consistently hold section 503(b)(3)(B) does not grant creditors standing to sue on behalf of estate). *But see* 5 COLLIER ON BANKRUPTCY ¶ 503.10[3] at 61 (15th ed. rev. 2002) (noting court approval or standing can be given pursuant to § 503(b)(3) when suing on behalf of estate).

[81] *See Cybergenics I*, 304 F.3d at 331–32; *see also* Lake County v. Rollins, 130 U.S. 662, 670–71 (1889) (asserting where statute, on its face, is plain and unambiguous, no room for judicial construction).

B. Cybergenics II

Despite its strict adherence to the plain meaning doctrine, the uncertainty and controversy surrounding the panel's decision in *Cybergenics I* was short-lived. The decision was promptly vacated for *en banc* rehearing, its published opinion was ordered to be removed from the reporter, and the ruling was ultimately reversed.[82] After carefully navigating its way through sections 1109(b), 1103(c), and 503(b)(3)(B) of the Bankruptcy Code, and examining pre-Code practice in depth, the Third Circuit concluded in a 7-4 decision that derivative standing still lives notwithstanding *Hartford Underwriters*, based primarily on a bankruptcy court's equitable powers.[83]

The *en banc* majority succinctly re-defined the issue before it as concerning "a bankruptcy court's equitable power to craft a remedy when the Code's envisioned scheme breaks down."[84] Like other courts before it that have applied *Hartford Underwriters* to the derivative standing doctrine, the *en banc* panel was quick to rely on footnote 5. The court noted that the situation in *Hartford Underwriters* involving a lone creditor who sought to surcharge collateral for its own benefit was "markedly different" and "materially unlike" the facts before it involving a committee which sought to prosecute an avoidance action in the debtor's name and on the debtor's behalf.[85]

Keeping this factual distinction in mind, the majority next recognized the need to interpret chapter 11 as a whole when determining whether "the trustee may" truly means "**only** the trustee may" under section 544(b).[86] The majority noted that while the *Hartford Underwriters* Court indeed construed section 506(c) in isolation, it did so only after it looked at the remaining provisions of the Bankruptcy Code and reached the conclusion that resort to the other Code sections was improper due to the trustee's unique role in chapter 7.[87] The court observed that the same cannot be said of the trustee's role under section 544(b) in the chapter 11 context, given that a trustee is appointed in a chapter 11 case only on rare occasions and that it is most often a DIP who avails itself of the statute.[88] According to the panel, reading section 544(b) in a vacuum "would lead to the fatuous conclusion that Congress vested its cause of action exclusively in a party that usually does not exist."[89] Considering these distinctions, and the fact that the Supreme Court in *Hartford* interpreted the Code holistically when it construed section 506(c), the majority concluded that

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[82] *Cybergenics I*, 304 F.3d 316, *vacated, reh'g granted*, 310 F.3d 785, *rev'd* 330 F.3d 548 (3d Cir. 2003).
[83] Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 568 (3d Cir. 2003) (*Cybergenics II*).
[84] *Id*. at 559.
[85] *Id*. at 558.
[86] *Id*. at 559–60 (emphasis added).
[87] *Id*.
[88] *Cybergenics* II, 330 F.3d at 560.
[89] *Id*.

section 544(b) "must be viewed as merely a part, albeit an important part, of the chapter 11 framework that is designed to help debtors reorganize while continuing as viable concerns."[90]

After opening the door to consideration of other Code provisions, the *Cybergenics II* majority ultimately concluded that the "natural reading" of Bankruptcy Code sections 1109(b) and 1103(c)(5), when paired with 503(b)(3)(B), clearly demonstrates that Congress approved of derivative standing.[91] The majority did not, however, explicitly hold that the plain meaning of these provisions either authorize or empower a bankruptcy court to confer a DIP's avoidance rights derivatively upon a creditor or committee in order to satisfy *Hartford Underwriters'* requirements. With respect to a creditor or committee's right to "raise and . . . appear and be heard on any issue in a [chapter 11] case" under section 1109(b), the majority held that this language "addresses only a committee's direct rights – it says nothing whatever about a *court's power* to allow derivative standing to remedy a violation of those rights."[92] Regarding section 1103(c)(5)'s broad declaration that a committee "may perform such other services as are in the interest of those represented," the majority agreed with the defendants' position that the provision does not confer the requisite authority for a committee independently to initiate an avoidance action.[93] According to the majority, these two Code sections, at best provide "indirect evidence" that Congress granted bankruptcy courts the power to confer derivative standing.[94]

With regard to section 503(b)(3)(B) and its express allowance of payment of a creditor's expenses who recovers for the benefit of the estate after obtaining court approval, the majority found that while this provision came very close to authorizing a bankruptcy court to confer derivative standing, it did not come close enough to provide a statutory basis for the exercise of such power.

> [R]ead fairly . . . [section 503(b)(3)(B)] merely empowers bankruptcy courts to reimburse creditors' committees for the expenses they incur while suing derivatively. It does not authorize derivative actions in the first instance. To be sure, that section would be meaningless unless authority existed, but such reasoning by negative implication is less than satisfying.[95]

After concluding that sections 1109(b), 1103(c)(5), and 503(b)(3)(B) simply contemplate but do not expressly provide for derivative standing, the majority

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[90] *Id*.
[91] *Id*. at 567 ("The Code clearly demonstrates that Congress approved of derivative standing . . . .").
[92] *Id*. at 562 (emphasis added).
[93] *Cybergenics* II, 330 F.3d at 563 ("We agree that § 1103(c)(5) does not confer the sort of blanket authority necessary for the Committee independently to initiate an adversarial proceeding . . . .").
[94] *Id*. at 580.
[95] *Id*. at 567.

nevertheless upheld the practice based on equitable principles. The majority reasoned that a bankruptcy court's historical status as a court of equity enables it to "craft flexible remedies that, while not expressly authorized by the Code, effect the result the Code was designed to obtain."[96] Despite *Hartford Underwriters'* command that policy be dictated by Congress and not the courts,[97] the majority conducted an in-depth examination of pre-Code practice and various policy concerns relevant to derivative standing, carefully weighing their salutary effects and their drawbacks.[98]

The majority further considered the propriety of various alternatives to the practice, including appointment of a bankruptcy trustee under section 1104(a), appointment of an examiner with authority to sue under section 1104(c), moving the bankruptcy court to order the DIP to sue, conversion to a chapter 7 liquidation, and moving the bankruptcy court to authorize a committee to bring a post-confirmation avoidance action pursuant to a plan of reorganization.[99] None of these alternatives, according to the majority, could serve as a realistic substitute for the grant of derivative standing, which furthers Congressional purpose by ensuring that creditors' claims are not thwarted by fraudulent transfers.[100]

C. The Cybergenics II Dissent

Four of the eleven judges comprising the *Cybergenics II en banc* panel joined in a dissenting opinion, which argued that the majority's ruling was inconsistent with *Hartford Underwriters'* plain meaning analysis.[101] The dissent rejected the majority's conclusion that sections 1109(b) and 1103(c)(5), when paired with

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[96] *Id*. at 567–68; *see also* Young v. United States, 535 U.S. 43, 50 (2002) (noting bankruptcy courts adhere to rules of equity); United States v. Energy Res. Co., 495 U.S. 545, 549 (1990) (holding as courts of equity, bankruptcy courts possess power to modify creditor-debtor relationship).

[97] Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 13–14 (2002); *see also* Kawaauhau v. Geiger, 523 U.S. 57, 64 (1998) (deferring policy choices addressing discharge of debt in malpractice suit to Congress); United States v. Noland, 517 U.S. 535, 542 (1996) (stating bankruptcy courts cannot use legislative history to expand rules, but rather need to uphold substantive Congressional judgments).

[98] *Cybergenics II*, 330 F.3d at 572–76 (weighing advantages of derivative suits and their ability to deter managerial overreaching against potential problems, such as dissipation of estate value, consumption of judicial resources, and lack of competency of bankruptcy court to decide when it is appropriate to confer derivative standing).

[99] *Id*. at 576–79.

[100] *Id*. at 580.

[101] *Id*. at 580 (Fuentes, J., dissenting) (stating section 544(b)(1) was textually unambiguous and "majority view was inconsistent with [both] the plain and natural reading of § 544 [as well as] . . . the Supreme Court's plain meaning analysis of the identical phrase in *Hartford Underwriters*."); *see also Hartford Underwriters*, 530 U.S. at 5 (emphasizing notion statute means what it says) (citing Conn. Nat. Bank v. Germain, 503 U.S. 249, 254 (1992)); Bates v. United States, 522 U.S. 23, 29–30 (1997) (reaffirming as fundamental "[w]here Congress includes particular language in one section of a statute but omits it in another section of the same act, it is generally presumed that Congress acted intentionally and purposely in the disparate inclusion or exclusion.") (internal citations and quotations omitted).

section 503(b)(3)(B), make it clear that Congress approved of derivative standing,[102] and further observed that equity was an improper basis upon which to circumvent the express provisions of the Bankruptcy Code.[103] The dissent reasoned that reliance on equity as a means to overcome the limiting language, "the trustee may," in section 544(b) does not comport with the Supreme Court's plain meaning analysis:

> What happens if we adopt the principle inherent in the majority's reasoning, that a court may use its equitable power to confer standing to a party that is explicitly omitted from a statute? The Code contains nearly 40 provisions that authorize only the trustee to act. Could a bankruptcy court broaden standing to act under one provision or narrow standing under a different provision depending on its view of the equities involved? I would say not. If it were otherwise, the Supreme Court might very well have thought it "equitable" to broaden the phrase "the trustee may" in section 506(c) and allow the administrative claimant to recover in Hartford Underwriters. It did not. If the language of the Code is not ambiguous, it seems to me simply wrong to use equity to confer

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[102] *See Cybergenics II*, 330 F.3d at 582–83 (Fuentes, J., dissenting). According to the dissent, section 1109(b) only establishes a committee's right to be heard, "including among other powers, an unconditional right to intervene in a chapter 11 adversary proceeding" initiated by a trustee. *Id*. at 582 (citing Phar-Mor, Inc. v. Coopers & Lybrand, 22 F.3d 1228, 1232 (3d Cir. 1994), and *In re* Marin Motor Oil, Inc., 689 F.2d 445, 446 (3d Cir. 1982), *cert. denied*, 459 U.S. 1206 (1983)). Similarly, the dissent held that 1103(c)(5) cannot confer express authority upon a committee to file a lawsuit, as the powers granted to a committee under that provision are specific and enumerated, but do not reference the ability of a committee to commence such an action. *Id*. at 583. Responding to the majority's holding that section 503(b)(3)(B) contemplates derivative standing because it empowers a committee to recover its reasonable expenses incurred in recovering estate property, the dissent, at 583–84, cited a line of federal cases holding that this provision, standing alone, does not itself confer standing, and further observed that such reasonable expenses are typically recovered by committee counsel pursuant to the professional compensation provisions contained in section 330 of the Bankruptcy Code, and not 503(b)(3)(B). *Id*. at 582–83.

[103] *Cybergenics II*, 330 F.3d at 584–86 (Fuentes, J., dissenting) ("[B]ankruptcy courts are equitable tribunals that apply equitable principles. But courts of equity must still follow the law."). Continuing, the dissent concluded "[t]he Code is the law here and equity cannot be used to change the clear and plain language of a Code provision" and therefore in conformance with *Hartford Underwriters*, the dissent believed it "wrong to use equity to confer derivative standing where the statute specifically names the parties who may act." *Id*.; *see also* Yates Dev., Inc. v. Old Kings Interchange, Inc. (*In re* Yates Dev., Inc.), 256 F.3d 1285, 1288–89 (11th Cir. 2001) (finding application of plain meaning statutory interpretation "applies with equal force when interpreting the Bankruptcy Code"), *reh'g denied*, 275 F.3d 50 (11th Cir. 2001); *In re* ATD Corp., 278 B.R. 758, 760 (Bankr. N.D. Ohio 2002) (observing equity only empowers bankruptcy courts to enter orders consistent with Bankruptcy Code, and prohibits courts from disregarding unambiguous statutory language); *In re* Sims, 278 B.R. 457, 478 (Bankr. E.D. Tenn. 2002) (observing bankruptcy courts cannot use section 105 to add remedies otherwise expressly provided for by Bankruptcy Code).

> derivative standing where the statute specifically names the parties who may act.[104]

Finally, the *Cybergenics II* dissent dismissed the notion that the words "the trustee may" become ambiguous in the chapter 11 context, and argued that because the language in the statute was not ambiguous, the majority's review of pre-chapter practice and detailed analysis of the public policy implications of derivative standing was unnecessary.[105]

V. *IN RE V COMPANIES*: PLAIN MEANING OR EQUITY?

A few weeks prior to the Third Circuit's reaffirmation of derivative standing based on equitable principles in *Cybergenics II*, the Bankruptcy Appellate Panel ("BAP") of the Sixth Circuit, in *Jefferson County Board of Commissioners v. Voinovich* (*In re* V Companies),[106] rendered a decision similarly upholding the practice. There, the BAP affirmed the lower bankruptcy court's reliance on *In re Gibson Group* as proper authority for the grant of derivative standing upon a sole creditor in a chapter 11 case to commence avoidance litigation against some of the debtor's insiders following the debtor's refusal to prosecute.[107]

The Sixth Circuit BAP had the opportunity to revisit the holding in *In re Gibson Group* in light of *Hartford Underwriters'* plain meaning directives, and, as in *Cybergenics II*, considered the import of various present and past bankruptcy statutes, including current Bankruptcy Code sections 1107(a)[108] and 1109(b).[109]

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[104] *Cybergenics II*, 330 F.3d at 585 (Fuentes, J., dissenting) (internal citations omitted); *see also* Jamo v. Katahdin Fed. Credit Union (*In re* Jamo), 283 F.3d 392, 403 (1st Cir. 2002) (observing equity "does not provide bankruptcy courts with a roving writ, much less a free hand" and 11 U.S.C. § 105 authority "may be invoked only if the equitable remedy dispensed by the court" is necessary to preserve an identifiable right conferred elsewhere in the Bankruptcy Code."); United States v. Pepperman, 976 F.2d 123, 131 (3d Cir. 1992) (finding equitable powers inherent in general provision of 11 U.S.C. § 105, do not "give the court the power to create substantive rights that would otherwise be unavailable under the Code.") (quoting *In re Morristown & Erie R.R. Co.*, 885 F.2d 98, 100 (3d Cir. 1989)). *But see In re* iPCS, Inc., 297 B.R. 283, 289 (Bankr. N.D. Ga. 2003) (embracing and applying majority rationale from *In re Cybergenics II*, which granted unsecured creditors' committee derivative standing).

[105] *Cybergenics II*, 330 F.3d at 587 (Fuentes, J., dissenting); *cf.*, BFP v. Resolution Trust Co., 511 U.S. 531, 546 (1994) (stating "where the meaning of the Bankruptcy Code's text is itself clear . . . its operation is unimpeded by contrary state law prior practice.") (internal citations omitted). *But see Hartford Underwriters*, 530 U.S. at 6 (noting statute's clarity, yet proceeding to analyze contextual, as well as other relevant factors in determining Congressional intent).

[106] 292 B.R. 290 (B.A.P. 6th Cir. 2003).

[107] *Id*. at 298.

[108] 11 U.S.C. § 1107(a) (2002). As discussed in further detail in Section VII below, section 1107(a) gives a bankruptcy court discretion to place limits and conditions on the rights, duties, and power of a debtor-in-possession acting in the place of a trustee. *Id*. Section 1107(a) provides:

> [s]ubject to any limitations on a trustee serving in a case under this chapter . . . and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation . . . and the powers, and shall perform all the functions and duties, except those specified . . . .

The *In re V Companies* court began its analysis by referencing footnote 5 of *Hartford Underwriters*, observing that the Supreme Court unequivocally declined to extend its ruling regarding trustee standing under section 506 to the practice of derivative standing.[110] Extending the Supreme Court's construction of "the trustee may" in 506(c) to the same phrase in 544(b), according to the court, was inappropriate because a DIP does not necessarily share the same perspective and interest in a bankruptcy estate as a trustee, and, as such, the question of who may bring an avoidance action must be analyzed in its proper context.[111]

The BAP reasoned that because *Hartford Underwriters* did not specifically reject the requirement that statutory language contained in the avoidance provisions be considered in the proper chapter 11 context, and because bankruptcy courts have historically possessed the power to grant derivative standing, reaffirmation of the rule set forth in *In re Gibson Group* was appropriate.[112] In its review of pre-Code practice, the court specifically referred to the statutory language contained in former section 64(a)(1) of the Bankruptcy Act of 1903, noting that while it may not "specifically empower a creditor to recover property of the estate, it obviously contemplates such action and provides that the costs of it may be reimbursed."[113]

Finally, *In re V Companies* held that the concerns in *Hartford Underwriters* giving rise to the Supreme Court's refusal to consider pre-Code practice when it construed section 506(c) are not present when dealing with the avoidance provisions. The court pointed out that pre-Code statutes and case law established a "sufficiently widespread and well-recognized" bankruptcy practice so as to evidence a bankruptcy court's power to confer derivative standing.[114]

Although the *In re V Companies* decision specifically refers to key elements of *Hartford Underwriters'* plain meaning analysis often overlooked by reviewing

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Id.

[109] 11 U.S.C. § 1109(b) (2002) (stating parties in interest may raise, appear and be heard on any issue in case under chapter 11).

[110] *In re V Cos.*, 292 B.R. at 295; *see Hartford Underwriters*, 530 U.S. at 13 n.5 (explaining court's refusal to examine issue of "whether a bankruptcy court can allow other interested parties to act in the trustee's stead in pursuing recovery under § 506(c)."). *But see In re* Xonics Photochemical, Inc., 841 F.2d 198, 202–03 (7th Cir. 1988) (providing possibility of creditor bringing derivative suit despite inability to bring independent avoidance action).

[111] *See In re V Cos.*, 292 B.R. at 296 (questioning application of section 506(c) construction to section 544(b) because of different contextual circumstances and lack of analogous situations). *See generally* 7 COLLIER ON BANKRUPTCY ¶ 1109.05, ¶ 1109.05[1] (15th ed. 2003) (discussing certain situations or circumstances under which courts intervene to authorize individual other than trustee to carry out necessary litigation).

[112] *In re V Cos.*, 292 B.R. at 296; *see* Canadian Pac. Forest Prods. Ltd., v. J.D. Irving, Ltd. (*In re* Gibson Group, Inc.), 66 F.3d 1436, 1440–1441 (1995); *see also In re* Godon, Inc., 275 B.R. 555, 560 (Bankr. E.D. Cal. 2002) (asserting bankruptcy courts have authority to weigh factors and grant standing to parties other than trustee).

[113] *In re V Cos.*, 292 B.R. at 297; *In re Godon*, 275 B.R. at 561 (stating creditors may proceed for benefit of estate and have attorney's fees reimbursed).

[114] *In re V Cos.*, 292 B.R. at 297; *see also In re Gibson Group*, 66 F.3d at 1443 (agreeing with principle that bankruptcy courts may grant standing to creditor to proceed on behalf of estate); *In re Godon*, 275 B.R. at 565 (noting in certain situations bankruptcy court has power to authorize standing).

courts (i.e., consideration of contextual features and the relevancy of pre-Code practice), the decision is somewhat vague as to which specific provisions of the Bankruptcy Code empower a bankruptcy court to grant derivative standing. The court in *In re V Companies* casually references sections 1107(a) and 1109(b) as relevant to the issue, but does not conduct detailed inquiry into whether these sections actually contain a Congressional grant of authority upon which bankruptcy courts may confer standing. Moreover, the express ruling in *In re V Companies* that "*Gibson* is not inconsistent with *Hartford Underwriters*" implies that judicially created derivative standing, as set forth in *In re Gibson Group*, is alive and well in the Sixth Circuit notwithstanding *Hartford Underwriters'* mandate that "[w]here a statute . . . names the parties granted [the] right to invoke its provisions, . . . such parties only may act."[115]

VI. THE PLAIN MEANING ROAD MAP TO DERIVATIVE STANDING

The post-*Hartford Underwriters* decisions passing upon the viability of derivative standing in chapter 11 rely on *Hartford Underwriters'* footnote 5 with little or no analysis, or, as in the case of *Cybergenics II*, misapply *Hartford Underwriters'* reasoning. Instead of embracing *Hartford Underwriters'* analysis, these cases side-step key elements of Justice Scalia's directives pertaining to statutory construction. Post-*Hartford Underwriters* cases give insufficient weight to the Supreme Court's command that a reviewing court consider the "contextual features" and "natural reading" of applicable sections of the Bankruptcy Code, and the circumstances pursuant to which it is proper to consider pre-Code practice.[116] Examination of the avoidance provisions in their proper context, i.e., in the context of a chapter 11 case, compels the conclusion that a bankruptcy court possesses the requisite authority under the Bankruptcy Code to grant standing to a creditor or creditors committee to prosecute avoidance actions on behalf of a DIP and for the benefit of the bankruptcy estate. As such, the Third Circuit's reliance on equity as a basis for such authority makes little sense, as a bankruptcy court need not resort to equitable principles to craft a remedy for which express provision is made in the Bankruptcy Code.

Justice Scalia begins his analysis of section 506(c) in *Hartford Underwriters* by noting that "a situation in which a statute authorizes specific action and designates a particular party empowered to take it is surely among the least appropriate in which to presume non-exclusivity."[117] He then states that "because the trustee has a unique role in bankruptcy proceedings, it is entirely plausible that Congress would provide

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[115] *See Hartford Underwriters*, 530 U.S. at 6–7; *In re Gibson Group*, 66 F.3d at 1443 (acknowledging authority of bankruptcy court to grant standing to creditors); *see also In re Godon*, 275 B.R. at 566 (stating court may grant permission in certain situations to party other than trustee to sue for benefit of estate).

[116] *See Hartford Underwriters*, 530 U.S. at 6.

[117] *Id*. at 6.

a power to him and not to others."[118] At first glance, these observations would seemingly apply to the avoidance provisions as well, since the trustee is also the sole party named. However, as alluded to in both *Cybergenics II* and *In re V Companies*, the presumption of exclusivity as applied to the avoidance provisions is easily overcome in a chapter 11 case because of the inherent distinctions between the functions of a chapter 7 trustee and a chapter 11 DIP.[119]

The unique role of a chapter 7 trustee is of no consequence in the context of a chapter 11 reorganization, as a DIP typically acts as trustee and fiduciary of its own bankruptcy estate.[120] Indeed, the DIP in a chapter 11 case is not specifically named in the avoidance provisions, but may nevertheless commence such actions pursuant to the grant of authority contained in 11 U.S.C. §1107(a).[121] A DIP, unlike a trustee, however, may be subject to conflicts of interest which could affect its decision to initiate avoidance actions.[122] Under these circumstances, and in light of the well-established pre-Code practice recognizing the doctrine of derivative standing, it is entirely *implausible* that Congress intended to provide the power to commence avoidance actions solely to a DIP in a chapter 11 case and not to others in appropriate circumstances.

The logical starting point for analyzing the "contextual features" of the Bankruptcy Code in chapter 11 to determine whether a bankruptcy court has the power to confer standing upon a creditor or committee to commence avoidance actions thus lies in section 1107(a), which provides, in pertinent part:

> Subject to any limitations on a trustee serving in a case under this chapter, *and to such limitations and conditions as the court prescribes*, a debtor-in-possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter.[123]

Although the Sixth Circuit BAP in *In re V Companies* casually refers to section 1107(a), the Third Circuit in *Cybergenics II* as well as the other post-*Hartford Underwriters* decisions addressing the continuing validity of derivative standing fail to consider the bankruptcy court's express authority to "condition" and "limit" a DIPs rights and powers. Clearly, based upon the plain meaning of the statute, a

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[118] *Id*. at 7.

[119] *See* Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 560 (3d Cir. 2003) (*Cybergenics II*) (discussing distinctions between trustees in chapter 7 proceedings and debtors-in-possession in chapter 11 proceedings); *In re V Cos.*, 292 B.R. at 296 (stating in avoidance actions debtors-in-possession have similar powers as trustees but different interests in bankruptcy estate); *see also In re* McLeroy, 250 B.R. 872, 881 (N.D. Tex. 2000) (holding bankruptcy trustees have unique role in bankruptcy proceedings).

[120] *Cybergencis II*, 330 F.3d at 560.

[121] 11 U.S.C. § 1107(a) (2002).

[122] *See supra* notes 21–26 (explaining possible conflicts facing DIP).

[123] 11 U.S.C. § 1107(a) (2002) (emphasis added).

bankruptcy court may limit a DIP's ability to prosecute avoidance actions if it so chooses under section 1107(a). A "natural reading" of 1107(a) inevitably leads to the conclusion that among the "limitations" the court may impose upon a DIP is the withdrawal of the right to pursue avoidance actions.

Section 1109(b), on the other hand, gives interested creditors or committees the right to appear and "raise . . . any issue" in a chapter 11 case.[124] Read together, sections 1107(a) and 1109(b) allow a bankruptcy court to withdraw from the DIP the right to pursue avoidance actions and confer upon a creditor or other party in interest the ability to raise and assert such claims so as to protect the interests of creditors and the estate.[125] *Hartford Underwriters'* holding that section 1109(b)'s general provision of a right to be heard should not be "read . . . as broadly allowing a creditor to pursue substantive remedies that other Code provisions make available only to specific parties,"[126] does not stand in the way of this conclusion. As footnote 5 of the decision makes clear, when the Supreme Court limited 1109(b)'s reach, it was referring to the right of a creditor to take action *independently* under that section in a chapter 7 case, and not addressing the *power of the bankruptcy court* to confer standing upon a creditor to commence avoidance actions for the benefit of the estate in a chapter 11 proceeding.[127] The major flaw of *Cybergenics II* is its failure to recognize the express authority conferred upon the bankruptcy court under section 1107(a), and the interplay of this provision with section 1109(b).

Section 503(b)(3)(B) additionally bolsters the argument that the contextual features of the Bankruptcy Code, section 1107(a) and 1109(b) permit a bankruptcy court to confer standing upon a creditor to act in the DIP's stead. Again, section 503(b)(3)(B) provides for reimbursement of the actual and 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."[128] *Hartford Underwriters* directs

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[124] 11 U.S.C. § 1109(b) (2002) (permitting parties in interest to appear and raise any issue arising under chapter 11).

[125] *See In re* Jermoo's, Inc., 38 B.R. 197, 199 (Bankr. W.D. Wis. 1984) ("Unless 'raise' excludes the usual means of bringing an issue to the attention of the court by motion or complaint, the plain language of the statute grants 'standing' . . . to bring [an avoidance] action."); *cf. In re* Caldor Corp., 303 F.3d 161, 163 (2d Cir. 2002) (holding plain text of section 1109(b) indicates Congress' intent to grant unconditional statutory right for parties in interest to intervene in chapter 11 adversary proceedings). *But see In re* Calvary Temple Evangelistic Assoc., 47 B.R. 520, 523, 525 (Bankr. D. Minn. 1984) (indicating power of creditors' committee to act in place of debtor under section 1109(b) does not extend to authority to sell property free and clear of liens).

[126] Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 8 (2000).

[127] *See Hartford Underwriters*, 530 U.S. at 8 ("[Section 1109(b)]…is by its terms inapplicable here, since petitioner's attempt to use § 506(c) came after the bankruptcy proceeding was converted from chapter 11 to chapter 7."); *see also id.* at 13, n.5 (rejecting petitioner's claim of independent right to use section 506(c) without addressing whether bankruptcy courts can allow interested parties to act in place of trustees in pursuing recovery under section 506(c)); *cf. In re* Xonics Photochemical, Inc., 841 F.2d 198, 202–03 (7th Cir. 1988) (stating creditor had no right to bring avoidance action independently but may have been able to bring derivative suit).

[128] 11 U.S.C. § 503(b)(3)(B) (2002) (emphasis added).

that the "natural reading" of a provision controls its interpretation.[129] Although the Third Circuit in *Cybergenics II* correctly observed that 503(b)(3)(B) does not contain any language expressly granting the bankruptcy court the authority to confer derivative standing,[130] the section explicitly refers to the court's ability to approve a creditor's right to recover for the benefit of a bankruptcy estate.[131] Construed together with sections 1107(a) and 1109(b), the natural reading of 503(b)(3)(B) plainly indicates that Congress did not intend to confer exclusive authority upon a trustee or DIP to commence avoidance actions.

Considering the objectives of chapter 11,[132] the general reluctance of DIPs to commence litigation against their own insiders,[133] and the contextual features of sections 1107(a), 1109(b), and 503(b)(3)(B), it should be clear that the avoidance provisions of the Bankruptcy Code, unlike section 506(c) in a chapter 7 case, can be "sensibly read" to extend to creditors and committees in a chapter 11 case.[134] At the very least, sections 1107(a), 1109(b), and 503(b)(3)(B) are subject to interpretation, which under *Hartford Underwriters'* plain meaning construction opens the door to consideration of and clarification by pre-chapter practice.[135] In construing section 506(c), Justice Scalia states that where a bankruptcy practice is "sufficiently widespread and well recognized," the conclusion of implicit adoption into the

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[129] *See Hartford Underwriters*, 530 U.S. at 9 ("Because we believe that by far the most natural reading of § 506(c) is that it extends only to the trustee, petitioner's burden of persuading us that the section must be read to allow its use by other parties is 'exceptionally heavy.'") (citations omitted).

[130] Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 567 (3d Cir. 2003) (*Cybergenics II*). *But see In re* Blount, 276 B.R. 753, 761 (Bankr. M.D. La. 2002) (stating section 503(b)(3)(B) provides "an express statutory grant" of court authority to confer derivative standing upon creditors to pursue actions leading to recovery of property transferred or concealed by debtor).

[131] 11 U.S.C. § 503(b)(3)(B) (2002) (stating creditor may be allowed expenses incurred by creditor who recovers for benefit of estate property transferred or concealed by debtor).

[132] *See* Bonner Mall P'ship v. U.S. Bancorp Mortgage Co. (*In re Bonner P'ship*), 2 F.3d 899, 915 (9th Cir. 1993) (listing successful rehabilitation of debtor and maximization of estate value as key objectives of chapter 11); *In re* Jones & Lamson Mach, 102 B.R. 12, 15 (Bankr. D. Conn. 1989) (seeing Bankruptcy Code as fulcrum between competing economic interests: right of creditor to receive benefit of bargain and rehabilitation of debtor).

[133] *See* Canadian Pac. Forest Prod., Ltd. v. J.D. Irving, Ltd. (*In re* Gibson Group, Inc.), 66 F.3d 1436, 1441 (6th Cir. 1995) (recognizing debtors in possession may act under conflict of interest and use discretion to favor one set of creditors over another); *see also* La. World Exposition v. Fed. Ins. Co., 858 F.2d 233, 252–253 (5th Cir. 1988) (allowing debtor to bring action on behalf of corporation against its officers and directors when debtor-in-possession refused to bring action itself citing conflict of interest); *In re* Ca. Canners and Growers, 172 B.R. 941, 944 (Bankr. N.D. Cal. 1994) ("Since debtors in possession are often comprised of the same persons who are insiders of the debtor, there is a stronger possibility of fraudulent conveyances where the insiders can defeat avoidance actions."); *supra* notes 20–23 and accompanying text (discussing DIP's potential conflicts of interest).

[134] *See Hartford Underwriters*, 530 U.S. at 8 (stating provisions of Bankruptcy Code not containing an exclusion clause, "cannot sensibly be read to extend to all parties in interest.").

[135] *See id*. at 10–11 (finding section 506(c) leaves "no room for clarification," and, therefore, pre-Code practice may not be considered in interpreting its meaning); *In re* Arzt, 252 B.R. 138, 141 (8th Cir. B.A.P. 2000) (precluding consideration of pre-Code practice where the plain meaning of section 551 was "clear and unambiguous.").

Bankruptcy Code may be justified.[136] While *Hartford Underwriters* holds that the sparse precedents permitting administrative claimants to surcharge collateral under section 506(c) in a chapter 7 case do not establish widespread recognition of that practice, the same cannot fairly be said for the doctrine of derivative standing.[137] As it has been well-settled and accepted by bankruptcy courts for over a century that creditors may, under appropriate circumstances, recover for the benefit of a bankruptcy estate,[138] pre-Code practice of derivative standing can and should be considered in interpreting these particular Code sections.

CONCLUSION

By resorting to equitable principles in *Cybergenics II* as a basis for derivative standing, the Third Circuit fails to adequately consider the "contextual features" and "natural reading" of sections 1107(a), 1109(b), and 503(b)(3)(B), and how the widespread recognition of this pre-Code practice relates to the plain meaning of these provisions. Although the Sixth Circuit BAP's decision in *In re V Companies* implies that the Bankruptcy Code provides the requisite authority for a bankruptcy court to confer derivative standing, it is somewhat imprecise with regard to which specific provisions grant such authority. Reviewing courts should, in no uncertain terms, say what has not yet been said: the authority for derivative standing lies in the plain meaning of the Bankruptcy Code.

The derivative standing doctrine has served and continues to serve as a means by which a DIP can continue the rehabilitation of its business notwithstanding any conflicts of interest it may have due to pre-petition transfers to insiders or other favored creditors. The doctrine is therefore consistent with and furthers the purposes of chapter 11. Despite the fact that the words "the trustee may" are contained in both section 506(c) and the avoidance provisions, the precise textual interpretation of these sections cannot and should not be "blindly applied to

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[136] *Hartford Underwriters*, 530 U.S. at 10; *see also* United States v. Ron Pair Enters., Inc., 489 U.S. 235, 246 (1989) (relying on "clearly established" pre-Code practice); Kelly v. Robinson, 479 U.S. 36, 46 (1986) (giving weight to pre-Code practice "widely accepted" and "established").

[137] *See generally* Jefferson County Bd. of Comm'rs v. Voinovich (*In re* V Cos.), 292 B.R. 290, 297 (B.A.P. 6th Cir. 2003) (discussing body of case law related to derivative standing doctrine); *In re* Xonics Photochemical, Inc., 841 F.2d 198, 203 (1988) (noting creditor may have been able to seek to bring derivative suit).

[138] *See In re* Godon, 275 B.R. 555, 561 (Bankr. E.D. Cal. 2002) (highlighting potential ability of creditors to recover property for benefit of estate is well-established principle of bankruptcy law); *In re Kenny*, 269 F. 54, 57 (W.D. Pa. 1920) (allowing creditors acting for benefit of estate to use name of bankruptcy trustee). Although the panel in *Cybergenics II* overlooked *Hartford Underwriters'* specific holding with respect to the applicability of pre-Code practice, the panel surveyed the significant body of pre-Code case law on the subject and recognized that, "[The derivative standing doctrine] has been adopted in varying forms by several of our sister circuits, and we recognized this practice in our prior opinion." *See Cybergenics II*, 330 F.3d at 571–72 (citing Official Comm. of Unsecured Creditors v. Chinery (*In re* Cybergenics Corp.) (*Cyberbergenics I*), 226 F.3d 237, 240 (3d Cir. 2000)).

another."[139] Proper analysis of Justice Scalia's reasoning and plain meaning construction in *Hartford Underwriters* as applied to sections 1107(a), 1109(b), and 503(b)(3)(B), compels the conclusion that this practice should continue. Bankruptcy courts indeed possess the requisite statutory authority to confer standing upon a creditor or committee in a chapter 11 case to commence avoidance actions on behalf of a DIP when the DIP unjustifiably refuses to act.

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[139] *See In re* Stanwich Fin. Servs. Corp., 288 B.R. 24, 25 (Bankr. D. Conn. 2002) (explaining "precise textual interpretation of one section cannot and should not be blindly applied to another"); *see also* United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 217 (2001) (explaining statutory construction is a "holistic endeavor" and meaning of provision is clarified by remainder of statutory scheme when only one of permissible meanings produces substantive effect compatible with rest of law) (quoting United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., 484 U.S. 363, 371 (1988))).