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Chasing the Money: Unpacking Subsequent-Transfer Claims Under § 550(a)(2)

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Chasing the Money: Unpacking Subsequent Transfer Claims Under § 550(a)(2)

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OVERVIEW OF 11 U.S.C. § 550(a)(2)

I. Overview of 11 U.S.C. § 550(a)(2)

A. The concepts of avoidance and recovery are separate and distinct under the Bankruptcy Code.

B. Section 550(a)(2) provides:

> "[e]xcept as otherwise provided in [§ 550], to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from-- any immediate or mediate good faith transferee of such transferee."

C. Section 550(a) is a remedies section, and its purpose is to restore the estate to the financial condition it would have enjoyed if the transfer had not occurred. *See In re JTS Corp.*, 617 F.3d 1102, 1111–12 (9th Cir. 2010).

OVERVIEW OF 11 U.S.C. § 550(a)(2)

II. Pleading a Subsequent Transfer Claim

A. To state a claim under § 550(a)(2), the trustee must plead that (i) the initial transfer is avoidable under one of the enumerated sections of the Bankruptcy Code; (ii) the property or funds at issue originated with the debtor; and (iii) the defendant is a subsequent transferee of that initial transferee. *Rajala v. Spencer Fane (Generation Res. Holding Co.)*, LLC, 964 F.3d 958, 966 (10th Cir. 2020).

B. The subsequent transfer claim is governed by the pleading standards of Fed. R. Civ. P. 8(a). The trustee must allege the necessary vital statistics—the who, when, and how much–of the purported transfers to establish an entity as a subsequent transferee of the funds. *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 641 B.R. 78, 90 (Bankr. S.D.N.Y. 2022).

C. The trustee must also plead the avoidability of the initial transfer. Those allegations will be governed by the pleading requirements of either Fed. R. Civ. P. 8(a) or Fed. R. Civ. P. 9(b), depending on whether the initial transfer will be avoided under a theory of constructive fraud or intentional fraud. *See Wahoski v. Classic Packaging Co. (In re Pillowtex Corp.)*, 427 B.R. 301, 310 (Bankr. D. Del. 2010).

1. The particularity requirement of Fed. R. Civ. P. 9(b) is relaxed when a trustee is asserting the fraud claims. *In re Fedders N. Am., Inc.*, 405 B.R. 527, 544 (Bankr. D. Del. 2009).

WHO QUALIFIES AS A "SUBSEQUENT TRANSFEREE"?

I. Who Qualifies as a "Subsequent Transferee"?

A. Defining "mediate" vs. "immediate" transferees

1. Section 550(a)(1) of the Code provides "to the extent that a transfer is avoided …, the trustee may recover, for the benefit of the estate, the property transferred ... from the initial transferee of such transfer...." The Code does not define initial transferee. Likewise, the Code does not define immediate or mediate transferees.

    1. Most courts apply some version of a "dominion and control" test to determine whether a party is an initial transferee. The dominion prong focuses on whether the recipient had dominion over the money or other asset transferred. The control prong focuses on an examination of the entire circumstances of the transaction, including whether the recipient acted in good faith, to determine whether the recipient actually controlled the transferred funds.

    2. Section 550 distinguishes between initial transferees and immediate and mediate transferees of the initial transferee. Both immediate and mediate transferees are subsequent transferees of the initial transferee. Notably, the 550(b) protections are only potentially available to subsequent transferees, not initial transferees.

WHO QUALIFIES AS A "SUBSEQUENT TRANSFEREE"?

I. Who Qualifies as a "Subsequent Transferee"? (continued)

2. The mere conduit defense can apply to parties that receive funds but are not an initial transferee. If they don't meet the dominion and control test such that they can't put the funds to their own use, they may be a mere conduit and not liable. This can occur in situations where the recipients of avoidable transfers are agents or fiduciaries of the debtor-transferor, such as banks or insurance brokers, who are duty bound to take only limited actions with respect to the funds received … Where a fiduciary, agent, or other entity with legal obligations to the debtor transferor is the recipient of an avoidable transfer, the control test turns on the recipient's legal rights and obligations toward the transferred assets, not simply their legal relationship with the debtor-transferor or the ultimate use of the assets.

B. The Tenth Circuit has held that a party must receive a transfer of the fraudulently transferred property (as opposed to proceeds from the property) in order to be considered a subsequent transferee. *Rajala v. Spencer Fane (Generation Res. Holding Co.), LLC*, 964 F.3d 958 (10th Cir. 2020).

IS AVOIDANCE OF THE INITIAL TRANSFER A PREREQUISITE?

The overwhelming majority of courts to consider the issue of whether the trustee must first avoid a transfer against an initial transferee prior to recovering that transfer from subsequent transferees have held that the avoidance of the initial transfer is not a prerequisite to the commencement of a recovery suit against subsequent transferees.

I. Dispute over "to the extent that a transfer is avoided" language in § 550(a)

A. "Recovery 'to the extent that' a transfer is avoided has sometimes been interpreted to require a successful avoidance action against the initial transferee before recovery may be had from a subsequent transferee. The better view, adopted by the majority of courts, is that a transfer may be found avoidable and a recovery may be had from a subsequent transferee without suing the initial transferee." *See* 5 Collier on Bankruptcy ¶550.02 (16th Ed. 2024).

B. Most court find that § 550 must be construed flexibly to avoid harsh and inequitable results.

1. "The strict interpretation of § 550(a) produces a harsh and inflexible result that runs counterintuitive to the nature of avoidance actions. If the initial transaction must be avoided in the first instance, then any streetwise transferee would simply re-transfer the money or asset in order to escape liability. The chain of transfers would be endless." *In re Int'l Admin. Servs., Inc.*, 408 F.3d 689, 704 (11th Cir. 2005).

IS AVOIDANCE OF THE INITIAL TRANSFER A PREREQUISITE?

C. The legislative history reveals that the qualifying language "to the extent that a transfer is avoided" was designed to incorporate the protection of transferees found in § 548(c). Congress contemplated the qualifying language to mean that "liability is not imposed on a transferee to the extent that a transferee is protected under a provision ... which grants a good faith transferee for value of a transfer that is avoided only as a fraudulent transfer, a lien on the property transferred to the extent of value given." *See* 124 Cong. Rec. H32400 (Sept. 28, 1978), S34000 (Oct. 5, 1978).

II. Conflict with the statute of limitations for recovery found in § 550(f)?

A. Section 550(f) provides that "[a]n action or proceeding under [§ 550] may not be commenced after the earlier of—(1) one year after the avoidance of the transfer ... or (2) the time the case is closed or dismissed."

B. Some courts have expressed a concern that if the trustee did not have to avoid the initial transfer before pursuing a subsequent transferee, § 550(f)(1) would become meaningless. The majority have rejected this concern, explaining that "if the trustee seeks to avoid a transfer and recover the property or its value in the same adversary proceeding, assuming the avoidance is timely and established, then the recovery action will necessarily be within the one year pursuant to § 550(f)." *In re AVI, Inc.*, 389 B.R. 721, 734 (B.A.P. 9th Cir. 2008).

III. Practical Considerations

A. There may be strategic reasons for a trustee to seek avoidance and recovery in the same adversary proceeding as opposed to separate adversary proceedings.

THE § 550(b) DEFENSE

I. Overview of § 550(b)(1)

A. Section 550(b)(1) provides a key limitation on the trustee's power to recover property in bankruptcy: it ensures that innocent parties who receive property through subsequent transactions are not unfairly penalized for the initial fraudulent transfer.

B. Subsequent transferees are shielded under section 550(b)(1) from liability if they received the property: in good faith, for value, and without knowledge of the voidability of the transfer avoided.

C. Section 550(b)(1) provides subsequent transferees with a complete defense to recovery of the property transferred.

D. Initial transferees can find similar recourse under section 548(c), which provides that an initial transferee who receives property in good faith and for value will be given a lien to the extent that value was given in good faith. Unlike 550(b)(1), 548(c) does not provide a complete defense to recovery.

THE § 550(b) DEFENSE

II. Who has the burden of proof?

A. All circuit courts to address the issue have held that § 550(b)(1) is an affirmative defense for which the subsequent transferee bears the burden of proof. *See In re Bernard L. Madoff Inv. Sec. LLC*, 12 F.4th 171, 198 (2d Cir. 2021) (collecting cases).

1. But *see Wasserman v. Bressman (In re Bressman)*, 327 F.3d 229 (3d Cir. 2003). In a footnote, the Third Circuit explained that it had "never addressed this burden of persuasion issue, and we find it to be a difficult one." *Id.*, at 236 n.2. Moreover, the court agreed with the *Nordic Village* dissent that the Bankruptcy Code "treats initial transferees in a different manner than subsequent transferees and that a substantial argument can be made in favor of placing the burden of proof on the trustee with respect to subsequent transferees." *Id.*

B. The argument that the trustee should bear the burden of proof relies, in part, on the difference in language between § 548(c) and § 550(b) and the fact that subsequent transferees are much more likely to be innocent third parties.

C. The majority of courts interpret the legislative history as proof that Congress did not intend to create a different pleading burden with respect to subsequent transferees compared to initial transferees.

1. Reports express that Congress designed § 550(b) to ensure that a subsequent transferee with affirmative knowledge of a voidable transfer does not then quickly convey that property to an innocent third party to "wash" the transaction. *See In re Smith*, 811 F.3d 228, 246 (7th Cir. 2016); *see also* S. Rep. No. 95-989, at 90 (1978); H.R. Rep. No. 95-595, 376 (1978).

THE § 550(b) DEFENSE

III. Subsequent Transferee must take "for value"

A. Section 550(b)(1) does not require that a subsequent transferee give value to the debtor in order to successfully defend against a trustee's claims. Rather, the "value" element under § 550(b)(1) looks to what the transferee gave up rather than what the transferor received. *See Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 2024 WL 780589, at *7 (Bankr. S.D.N.Y. Feb. 26, 2024); *see also In re Stevinson*, 194 B.R. 509, 513 (D. Colo. 1996).

B. The "value" element under § 550(b)(1) differs from the "value" element under § 548(c). The affirmative defense under § 548(c) focuses on value given to the debtor and gives the initial recipient of a fraudulent conveyance a lien against any assets it hands back, to the extent that such transferee gave value to the debtor in exchange for such transfer.

THE § 550(b) DEFENSE

III. Subsequent Transferee must take "for value" (continued)

As the Seventh Circuit explained in *Bonded Financial*:

> The statute does not say "value to the debtor"; it says "value". A natural reading looks to what the transferee gave up rather than what the debtor received. Other portions of the Code require value to the debtor. Section 548(c), for example, gives the initial recipient of a fraudulent conveyance a lien against any assets it hands back, 'to the extent that such transferee ... gave value to the debtor in exchange for such transfer'. The difference between 'value' in § 550(b)(1) and 'value to the debtor' in § 548(c) makes sense. Section 550(b)(1) implements a system well known in commercial law, in which a transferee of commercial paper or chattels acquires an interest to the extent he purchased the items without knowledge of a defect in the chain. These recipients receive protection because monitoring of earlier stages is impractical, and exposing them to risk on account of earlier delicts would make commerce harder to conduct. Benefits to the commercial economy, and not to the initial transferors (who may be victims of fraud), justify this approach.
>
> Transferees and other purchasers generally deal only with the previous person in line; they give value, if at all, to their transferors (or the transferors' designees). The statute emulates the pattern of other rules protecting good faith purchasers. All of the courts that have considered this question have held or implied that value to the transferor is sufficient. We agree with these cases.

See Bonded Fin. Servs., Inc. v. Eur. Am. Bank, 838 F.2d 890, 897 (7th Cir. 1988) (internal citations omitted).

THE § 550(b) DEFENSE

IV. Taking in "good faith" and "without knowledge of voidability"

A. Courts generally find that there is little difference between "good faith" and "without knowledge of the voidability of the transfer," as they both require an examination of transferee's knowledge about the transfer.

B. "Good faith" is not defined in the Bankruptcy Code, so courts often apply a fact-intensive determination. Good faith encompasses an inquiry notice standard. In determining good faith for the purposes of a § 550(b)(1) defense, a transferee is not acting in good faith when he has sufficient actual knowledge to place him on inquiry notice of the debtor's possible insolvency.

C. Still, different circuits have different approaches. The Second Circuit has held that inquiry notice, rather than willful blindness, is the correct standard to determine good faith. *Picard v. Citibank N. Am., Inc. (In re Bernard L. Madoff Invs. Sec. LLC)*, 12 F.4th 171 (2d Cir. 2021). The Fourth Circuit considers whether the subsequent transferee was aware or should have been aware of the fraud. *Gold v. First Tenn. Bank Nat'l Ass'n (In re Taneja)*, 743 F.3d 423 (4th Cir. 2014). The Sixth Circuit held that the court must apply a holistic review of the facts to determine whether a reasonable person would have been alerted to a transfer's voidability. *Meoli v. Huntington Nat'l Bank*, 848 F.3d 716 (6th Cir. 2017).

THE § 550(b) DEFENSE

IV. Taking in "good faith" and "without knowledge of voidability" (continued)

A. "Without knowledge of voidability" means that a subsequent transferee cannot shield itself from liability if it "knew facts that would lead a reasonable person to believe that the property transferred was recoverable." 16 Collier on Bankruptcy, ¶ 550.03 (16th Ed. 2025).

B. Courts have considered the sophistication of the transferee, knowledge of the debtor's financial condition, and the general circumstances of the transaction. *See In re Key Developers Group, LLC*, 449 B.R. 148 (Bankr. M.D. Fla. 2011).

V. Practical Considerations

A. How does a trustee establish that a subsequent transferee was on inquiry notice?

B. Expert witness testimony on red flags

1. If the circumstances would place a reasonable prudent person on inquiry of a debtor's fraudulent purpose and a diligent inquiry would have discovered the fraudulent purpose, then the good faith defense is not available to an intentional fraudulent transfer. Likewise, whether a reasonable prudent person would have made inquiries of the subject transfers, and after a diligent investigation, would have learned of the issues, could also destroy a good faith defense. A circumstance sufficient to put the transferee on inquiry notice is referred to as a "red flag" (unusual items that should have prompted due diligence investigations). *See In re Brooke Corp. (Redmond v. NCMIC)*, 568 B.R. 378 (Bankr. D. Kan. 2017).

2. Red flags can include disclosure of financial difficulties in public filings, contents of loan files, disclosure of risks factors in business model, adherence to internal loan, credit or other policies.

OTHER ISSUES

I. Extraterritoriality Issues

A. The reach of § 550(a)(2) is not limited by either the presumption against extraterritoriality or principles of international comity. Thus, a trustee may use § 550(a)(2) to recover property from a foreign subsequent transferee that received the property from a foreign initial transferee. *See In re Picard, Tr. for Liquidation of Bernard L. Madoff Inv. Sec. LLC*, No. 17-2992 (L), 2019 WL 903978 (2d Cir. Feb. 25, 2019).

II. Single Satisfaction Rule under § 550(d)

A. The "single satisfaction rule" seeks to limit the trustee to a single recovery for his or her fraudulent transfer claim to ensure the bankruptcy estate is put back in its pre-transfer position but receives no windfall through the avoidance provisions.

1. The rule is typically used to prevent a trustee from collecting from multiple parties for the same transfer, *i.e.*, an initial transferee and a subsequent transferee. *In re Prudential of Fla. Leasing, Inc.*, 478 F.3d 1291, 1297 (11th Cir. 2007).

2. In some cases, courts have had to value non-cash property received by trustee in settlement to determine trustee's maximum possible recovery against subsequent transferee. *See*, *e.g.*, *In re Provident Royalties, LLC*, 581 B.R. 185 (Bankr. N.D. Tex. 2017).

Faculty

Camille C. Bent is a partner in BakerHostetler's Bankruptcy and Restructuring practice group in New York, where she focuses her practice in the areas of business bankruptcy and restructuring. She advises debtors, creditors and other interested parties in transactions and in litigation arising out of corporate insolvencies. Ms. Bent counsels clients on a broad range of insolvency-related matters, including cases under chapters 11, 15 and 7. She has significant experience in intercreditor disputes, international insolvencies and defending parties in fraudulent transfer and preference litigation. Ms. Bent is a frequent author and speaker for ABI, the National Conference of Bankruptcy Judges and the New York City Bar Association (NYCBA), for which she serves on its Bankruptcy & Corporate Reorganization Committee and has led its Voidable Transactions Subcommittee. She previously served at the local and international levels of the International Women's Insolvency & Restructuring Confederation. In addition, she co-chairs the firm's Inclusion and Diversity Committee, leading programming and other initiatives that support the New York office's diversity, inclusion and equity goals. Ms. Bent received *Law360*'s "Rising Star award in 2021 and was honored as one of ABI's "40 Under 40" in 2019. She received her B.A. from Johns Hopkins University and her J.D. and M.B.A. from Emory University, after which she clerked for Hon. Pamela Pepper in the Eastern District of Wisconsin.

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Hon. Michael B. Slade is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago. Prior to his appointment, he practiced at Kirkland & Ellis LLP in Chicago for 24 years, 19 of them as a partner. While at Kirkland, Judge Slade had a broad commercial and appellate practice, focusing on products liability, employment and restructuring-related matters across the country. He also taught seminars as a Lecturer in Law at the University of Chicago Law School and had an active *pro bono* practice in which he, among other things, accepted appointments representing individual criminal defendants in their criminal cases. Following law school, Judge Slade clerked for Hon. Emilio M. Garza of the U.S. Court of Appeals for the Fifth Circuit in San Antonio. In 2000, he served on the board of directors for CARPLS (the Coordinated Advice and Referral Program for Legal Services), Cook County's largest legal aid provider, for 10 years, including two as president. He currently serves on the boards of directors of the Chicago Bar Foundation and Thrive Scholars. Judge Slade received his B.A. in political science with high honors from Emory University, where he was a member of the Barkley Forum and was admitted to Phi Beta Kappa, and his J.D. with honors in 1999 from Harvard Law School.