# Commercial Fraud/Unsecured Trade Creditors

## Advanced Defenses to Avoidance Actions: Understanding Them Can Make All the Difference

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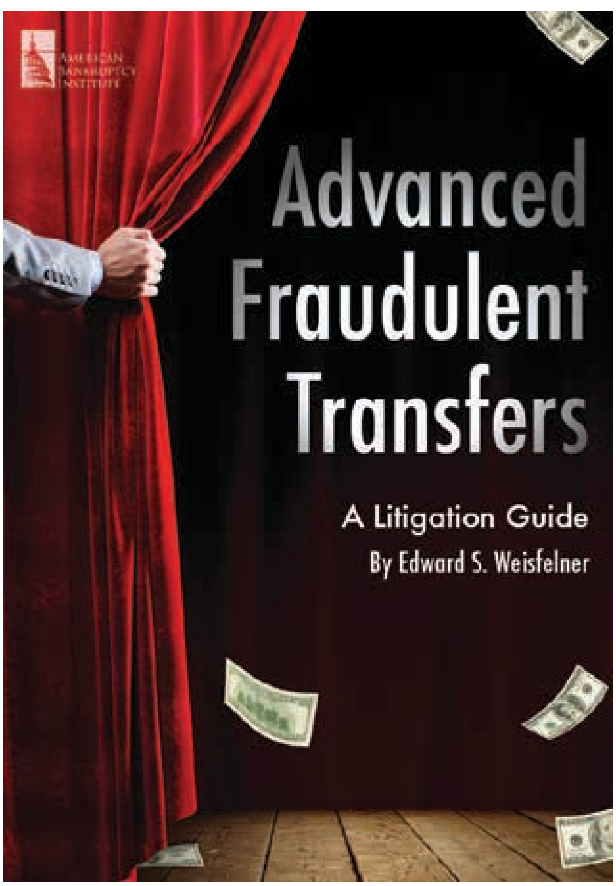


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# B. The § 546(e) Safe Harbor

Section 546(e) of the Bankruptcy Code limits the powers granted to the trustee under several of the Code's avoidance provisions by restricting the trustee's ability to avoid under those provisions a broadly defined range of securities transactions:

> Notwithstanding sections 544, 545, 547, 548 (a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment ... or settlement payment ... made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract ... commodity contract ... or forward contract, that is made before the commencement of the case, except under section 548 (a)(1)(A) of this title.

11 U.S.C. § 546(e). The limitation is broadly stated but partial; most significantly, the § 546(e) safe harbor does not apply to claims for intentional fraudulent conveyance under § 548(a)(1)(A) of the Code.[880]

The coverage of the safe harbor has changed over time as a result of both legislative enactments and court decisions, giving the provision a broad plain-language construction. A brief overview informs both current construction issues and questions about the section's preemptive effect and related questions of standing, discussed in Section B.4 of this chapter, *infra*.

## 1. Original Enactment and Broader Constructions

Congress enacted the original precursor to § 546(e) in response to litigation in which a bankruptcy trustee for a commodities broker, acting pursuant to the federal avoidance powers, sought to recover a margin payment made to a commodities exchange.[881] In light of the disruption that could result from the unwinding of such

880 *See* 11 U.S.C. § 546(e); *see also Whyte v. Barclays,* 494 B.R. 196 (S.D.N.Y. 2013).
881 *See* S. Rep. 95-989, at *104 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5892 (citing *Seligson v. New York Produce Exch.*, 394 F. Supp. 125 (S.D.N.Y. 1975)).

transactions, a safe harbor was enacted to protect margin payments made to commodities clearing organizations.[882]

In 1982, Congress extended the scope of the safe harbor to include, more broadly, the securities markets. As the House Report accompanying the amendment explains, concerns about a ripple effect through the markets as a result of unwinding of settled securities transactions are intended to be addressed in the amendments by expanding the limitation on the trustee's avoidance powers so that it includes such securities transactions.[883]

Although originally enacted to address a rather specific danger — that of a ripple effect through clearinghouses and brokerages that rely on interlocking guarantees and netting arrangements — the applicability of § 546(e) does not require a demonstration that such danger is presented. This is in large part because courts have increasingly resolved issues regarding the construction of § 546(e) based on "plain language" statutory construction principles, even if that results in coverage of a significantly wider scope of transactions than those originally targeted by Congress.[884] Thus, while some courts have cited the legislative history as a basis for

882 As the House Report explains:

> Subsection (c) insulates variation margin payments and other deposits from the avoiding powers except to the extent of actual fraud under Section 548(A)(1). This facilitates prepetition transfers and protects the ordinary course of business in the market.

H.R. Rep. 95-595, at *392 (1978), as reprinted in 1978 U.S.C.C.A.N. 5963.

883 The House Report explains:

> The commodities and securities markets operate through a complex system of accounts and guarantees. Because of the structure of the clearing systems in these industries and the sometimes volatile nature [of] the markets, certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possibl[y] threatening the collapse of the affected market.
>
> The thrust of several of the amendments contained in H.R. 4935 is to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market. The amendments will ensure that the avoiding powers of a trustee are not construed to permit margin or settlement payments to be set aside except in cases of fraud and that, except as otherwise provided, the stay provisions of the Code are not construed to prevent brokers from closing out the open accounts of insolvent customers or brokers.

H.R. Rep. 97-420, at *1-2 (1982), as reprinted in 1982 U.SC.C.A.N. 583, 583.

884 *See Lowenschuss v. Resorts Int'l Inc. (In re Resorts Int'l)*, 181 F.3d 505 (3d Cir. 1999) ("When the language is clear, no further inquiry is necessary unless the plain language leads to an absurd result."); *In re Kaiser Steel Corp.*, 952 F.2d 1230, 1237 (10th Cir. 1991) ("[O]ur task is to apply the term 'settlement payment' according to its plain meaning.").

limiting application of the safe harbor,[885] the trend is to the contrary and in favor of broader construction based on the plain-language doctrine.[886]

## 2. Applicability of the Safe Harbor and Current Construction Issues

For the safe harbor to apply, a litigant must show that the transaction being targeted for avoidance is:

(i) a "margin payment" or "settlement payment" made by, to or for the benefit of a "financial institution" (or other enumerated counterparty); or

(ii) a "transfer" made by, to or for the benefit of a "financial institution" (or other enumerated counterparty) "in connection with a securities contract" (or commodity or forward contract).[887]

The coverage of the phrase "settlement payment" and the required degree of "financial intermediary" involvement have engendered significant controversy, although the trend is now in favor of constructions that give the safe harbor the broadest reading.

### a. "Settlement Payment"

A "settlement payment" is defined in § 741(8) of the Code as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade."[888]

While this definition has a circular aspect to it, courts have interpreted the provision to be an "extremely broad"[889] reference to "the transfer of cash or securities made to complete [a] securities transaction."[890] As the Second Circuit has ex-

885 *Wiebolt Stores v. Schottenstein*, 131 B.R. 655, 663-65 (N.D. Ill 1991) (ruling that § 546(e) does not apply to a leveraged buyout).

886 *See* n.884, *supra*; *see also In re Enron Creditors Recovery Corp. v. Alfa*, 651 F.3d 329, 334-38 (2d Cir. 2011) (construing the § 741(8) "settlement payment" definition that is incorporated into § 546(e) to include redemption payments because they "fall within the plain language of § 741(8)").

887 11 U.S.C. § 546(e).

888 11 U.S.C. § 741(8).

889 *In re QSI Holdings Inc.*, 571 F.3d 545, 549 (6th Cir. 2009) (quoting *Contemporary Indus. Corp.*, 564 F.3d at 985).

890 *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 985 (8th Cir. 2009) (quoting *In re Resorts Int'l Inc.*, 181 F.3d at 515).

plained, "[s]everal circuits ... have rejected limitations on the definition that would exclude transactions in privately held securities or transactions that do not involve financial intermediaries that take title to the securities during the course of the transaction."[891]

The increasingly broad construction of the term "settlement payments" can be seen in the development of cases involving leveraged buyouts. Initially, many courts found the safe harbor to apply to leveraged buyouts that involved publicly traded securities,[892] but inapplicable to leveraged buyouts involving privately held securities.[893] However, multiple circuit courts, based in large part on principles of statutory construction, have subsequently held that leveraged buyouts involving private securities may qualify for safe harbor protection.[894] The trend appears to favor viewing the "settlement payment" definition to refer broadly to transfers of cash made to complete a securities transaction.[895]

### b. "Financial Institution"

Aside from the question of the financial intermediary's role in the context of satisfying the "settlement payment" definition of § 741(b), the role of the "financial institution" requirement in the § 546(e) definition itself has generated controversy. The Eleventh Circuit has held that the "financial institution" must acquire a beneficial interest in the transferred funds or securities for § 546(e) to apply.[896] However, other circuits, including the Second, Third, Sixth and Eighth, have held to the

891 *In re Enron Creditors Recovery Corp.*, 651 F.3d at 334 (citing *In re Plassein Int'l Corp.*, 590 F.3d 252, 258-59 (3d Cir. 2009); *In re QSI Holdings Inc.*, 571 F.3d at 549-50; *Contemporary Indus. Corp.*, 564 F.3d at 986).

892 *See Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 847 (10th Cir. 1990) (payments made to securities broker in connection with leveraged buyout of publicly held corporation); *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1239 (10th Cir. 1991) (payments made to holders of publicly traded securities by stockbrokers and clearing agencies in connection with leveraged buyout); *Lowenschuss v. Resorts Int'l Inc. (In re Resorts Int'l Inc.)*, 181 F.3d 505, 516 (3d Cir. 1999) (payments made to shareholders of publicly held corporation by financial institution); *Official Comm. of Unsecured Creditors v. Fleet Retail Fin. Group (In re Hechinger Inv. Co. of Delaware*), 274 B.R. 71, 87 (D. Del. 2002) (payments made to shareholders of publicly held company by financial institution in leveraged buyout).

893 *See, e.g.*, *Official Comm. of Unsecured Creditors v. Lattman (In re Norstan Apparel Shops Inc.)*, 367 B.R. 68, 77 (Bankr. E.D.N.Y. 2007).

894 *Contemporary Industries Corp. v. Frost*, 564 F.3d 981 (8th Cir. 2009); *Brandt v. B.A. Capital Co. (In re Plassein International Corp.)*, 590 F.3d 252 (3d Cir. 2009); *c.f. QSI Holdings Inc. v. Alford (In re QSI Holdings Inc.)*, 571 F.3d 545 (6th Cir. 2009) (addressing legislative history in concluding that the safe harbor applies).

895 *See, e.g.*, *In re Quebecor World (USA) Inc.* (2d Cir. 2013) (citing *In re Enron Creditors Recovery Corp.*, 651 F.3d at 339).

896 *See Munford v. Valuation Research Corp. (In re Munford Inc.)*, 98 F.3d 604, 610 (11th Cir. 1996).

contrary.[897] In the most recent circuit court decision on this matter, the Second Circuit, having relied in part on plain-language construction principles, added that "[a] clear safe harbor for transactions made through these financial intermediaries promotes stability in their respective markets and ensures that otherwise avoidable transfers are made out in the open, reducing the risk that they were made to defraud creditors."[898]

### 3. Prospects for Limitations on the Safe Harbor

Where a transaction appears on its face to satisfy the plain language of § 546(e), the prospects for invoking an exception appear increasingly dim. At times, certain courts, noting the original congressional purpose, have suggested that a transaction that would have minimal impact on the securities markets should not trigger the safe harbor.[899] However, other courts have rejected such approaches,[900] and more broadly, the trend now appears to favor a broad application of § 546(e) based in large part on plain-language construction principles —particularly in the Second, Third and Sixth Circuits.[901] While the Eleventh Circuit has taken a differing approach on the financial intermediary question, and the Supreme Court has not yet ruled on these issues, in light of current trends it appears safest to assume that the sole exception to the safe harbor that will be consistently observed by the courts is that written into it explicitly: the exception for intentional fraudulent transfer claims under § 548(a)(1)(A).[902]

### 4. Section 546(e), Preemption Doctrine and Standing Issues

Beyond the question of § 546(e)'s direct application, one issue that has drawn increasing attention in recent years is whether § 546(e) should be held to preempt certain actions asserted under state law.

897 *See In re Quebecor World (USA) Inc.* (2d Cir. 2013) ("To the extent *Enron* left any ambiguity in this regard, we expressly follow the Third, Sixth, and Eighth Circuits in holding that a transfer may qualify for the section 546(e) safe harbor even if the financial intermediary is merely a conduit."); *In re QSI Holdings Inc.*, 571 F.3d at 551; *Frost*, 564 F.3d at 987; *In re Resorts Int'l Inc.*, 181 F.3d at 516.

898 *In re Quebecor World (USA) Inc.* (2d Cir. 2013).

899 *See In re MacMenamin's Grill Ltd.*, 450 B.R. 414 (Bankr. S.D.N.Y. 2011).

900 *See AP Services LLP v. Silva*, 483 B.R. 63, 70 (S.D.N.Y. 2012) (rejecting argument that safe harbor should not apply here because unwinding transaction would not disrupt financial markets).

901 *But see Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, Adv. Pro. No. 10-04609 (REG), 2014 WL 118036, at *18-19, 22 (Bankr. S.D.N.Y.) (explaining that safe harbor was intended to offer measure of protection for "markets" rather than all "market participants," and expressing skepticism that its purpose is implicated in protecting stockholders "at the very end of the asset transfer chain").

902 *See* 11 U.S.C. § 546(e).

### a. Preemption Doctrine and the Absence of Express Preemption

The Supremacy Clause provides that "the Laws of the United States ... shall be the supreme Law of the Land ... any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."[903] "Despite this sweeping language, courts do not readily assume preemption. To the contrary, in the absence of compelling congressional direction, courts will not infer that Congress has deprived the States of the power to act."[904]

Where Congress has not expressly preempted state law, preemption may occur in two situations: (1) where the scheme of federal regulation is "so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it" (*i.e.*, field preemption), and (2) where "compliance with both federal and state regulations is a physical impossibility" or where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (*i.e.*, conflict preemption).[905]

Although Congress in other Code avoidance power provisions expressly preempted state law,[906] it did not do so in § 546(e). Those arguing that § 546(e) should nevertheless be understood to have a preemptive effect have therefore relied primarily on the argument that allowing the prosecution of state law claims that target the types of securities transactions referenced in § 546(e) would "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" in enacting the safe harbor. This contention and its reception in court decisions are discussed herein.

### b. Background: Creditor State Law Claims and Trustee Standing

As explained in Chapter I, claims for fraudulent transfer existed in the common law long before the introduction of the Bankruptcy Code and its predecessors, and state law fraudulent transfer claims continue to be a significant creditor remedy to this day. Upon the commencement of a bankruptcy action, however, § 544(b) of the Code confers on the bankruptcy trustee (or debtor in possession) standing to

903 U.S. Const. art. VI, cl. 2.
904 *Madeira v. Affordable Hous. Found. Inc.*, 469 F.3d 219, 238 (2d Cir. 2006) (internal quotations omitted).
905 *Gade v. Nat'l Solid Wastes Mgmt. Ass'n*, 505 U.S. 88, 98 (1992) (internal citations omitted).
906 *See* 11 U.S.C. § 544(b)(2) ("Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.").

prosecute creditors' state law claims on behalf of the debtors' estates as part of his or her broad avoidance powers:

> [T]he trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim....[907]

For so long as a trustee retains standing to pursue claims under § 544(b), the trustee's standing is exclusive, and creditors may not prosecute their fraudulent conveyance claims against nondebtors.[908]

A long line of cases, however, establishes that following the end of the estate representative's exclusive bankruptcy standing period, creditors regain the ability to assert any of their state law claims that were not settled or otherwise extinguished by the estate representative.[909] This is so because, as courts have held, the creditors' state law claims are understood to remain the property of the creditors throughout the bankruptcy case, notwithstanding the trustee's temporary exclusive standing to assert them under § 544(b) of the Code.[910] That is, for so long as a trustee retains

907 11 U.S.C. § 544(b).

908 Section 362(a)(1) of the Code provides that actions "against the debtor" or "to recover a claim against the debtor" are subject to the automatic stay. Upon the filing of a petition, the fraudulent transfer claims of creditors are subject to the automatic stay of bankruptcy. Under Second Circuit law, the stay is applicable to state law fraudulent transfer claims because these are properly regarded as a third-party actions "to recover a claim against the debtor" within the meaning of § 362(a)(1). *See In re Colonial Realty Co.*, 980 F.2d at 131 (internal quotation marks omitted); *but see In re MortgageAmerica Corp.*, 714 F.2d 1266, 1275 (5th Cir. 1983) (finding that the automatic stay applied because property that could be recovered pursuant to state law creditor claims was "property of the estate").

909 *See, e.g.*, *Hatchett v. United States*, 330 F.3d 875, 886 (6th Cir. 2003) (the "Code does not extinguish the right of the Government to bring a state law action for fraudulent conveyance after the debtor receives a discharge in bankruptcy"); *Unisys Corp. v. Dataware Prods. Inc.*, 848 F.2d 311, 314 (1st Cir. 1988) (holding that when a trustee abandons his § 544(b) claim, a creditor with the right to sue under state law may pursue the claim); *In re Metro. Elec. Mfg. Co.*, 295 B.R. at 12 (stating that the trustee is the only party who is authorized to bring an action under § 544(b) of the Bankruptcy Code "until he abandons it or otherwise allows the creditors to pursue it independently"); *United States v. Doyle*, 276 F. Supp. 2d 415, 429 (W.D. Pa. 2003) (stating that once bankruptcy proceedings are closed, a creditor may pursue its state law fraudulent transfer claims); *In re Integrated Agri Inc.*, 313 B.R. 419, 428-29 (Bankr. C.D. Ill. 2004) (creditor may bring fraudulent transfer action on its own behalf after trustee's standing expires); *Klingman v. Levinson*, 158 B.R. 109, 113 (N.D. Ill. 1993) ("The trustee's exclusive right to maintain a fraudulent conveyance cause of action expires and creditors may step in (or resume actions) when the trustee no longer has a viable cause of action."); *Casey Nat. Bank v. Roan*, 668 N.E.2d 608, 612-13 (Ill. App. 1996) ("While the trustee has the exclusive right to pursue fraudulently conveyed assets pursuant to the Code once bankruptcy has been initiated[], the trustee loses that right and creditors may step in once the trustee no longer has a viable cause of action (in this case because the statute of limitations for initiating a cause for fraudulent conveyance had expired as to the trustee)."); *In re Pasian*, No. 94-31563 TEC, Adv. No. 09-3182 TC, 2010 WL 935598, at *2 (Bankr. N.D. Cal. Mar. 15, 2010) (bankruptcy discharge of the debtor not a bar to action against pre-petition transfer of fraudulent transfer made by the debtor, even if the debtor's pre-transfer liability to creditor was discharged in bankruptcy); *In re Boynewitz*, No. 02-30250 LMW, 2002 WL 33951315, at *2, n.5 (Bankr. D. Conn. Nov. 27, 2002) (observing that a creditor may proceed with its fraudulent transfer claims against a nondebtor once automatic stay is terminated).

910 The § 544(b) avoidance power has been described as a temporary "legal fiction" that "enables a debtor in possession to bring certain causes of action that actually belong to its creditors." *In re Cybergenics Corp.*, 226 F.3d at 241; *see also Zilkha Energy Co. v. Leighton*, 920 F.2d 1520, 1523 (10th Cir. 1990), *aff'd*, 999

standing under § 544(b), he may, subject to court approval, settle, compromise and/or release certain claims of creditors,[911] but following the end of that exclusivity period, if claims have not been extinguished, the creditors regain their right to pursue them.[912] It is at the intersection of these creditor rights and the limits on federal avoidance powers that the questions of preemption have been litigated.

### c. Identity of the Plaintiff: Estate Representative or Creditor Assignee?

Questions regarding the preemptive effect of § 546(e) first arose in District of Delaware and Eighth Circuit cases out of efforts by bankruptcy trustees and estate fiduciaries to avoid under state law — during their exclusive bankruptcy standing period — the type of transactions that § 546(e) prevented them from avoiding under the Code.[913] In these cases, the court found the estate fiduciary's effort to assert state law claims to be preempted by § 546(e).[914]

The effect of the rulings in *Contemporary Industries* and *Hechinger*, however, was merely to block a bankruptcy estate representative that was concurrently exercising the Code's avoidance powers during bankruptcy from prosecuting claims assertable under those powers without adhering to the limits on those powers set forth in § 546(e).

Whatever force arguments for preemption may have where an estate representative seeks to assert under state law the same claims that he cannot assert under § 544(b), arguments for preemption would appear to lose much or all of that force where claims are asserted by the creditors themselves or their assignee. That is, in

F.2d 548 (10th Cir. 1990) ("Congress has fashioned a legal fiction ... the fiction permits the trustee ... to assume the guise of a creditor with a judgment against the debtor."). That is, "[m]uch like a public official has certain powers upon taking office as a means to carry out the functions bestowed by virtue of the office or public trust, the debtor in possession is similarly endowed to bring certain claims on behalf of, and for the benefit of, all creditors." *In re Cybergenics Corp.*, 226 F.3d at 244; *accord, In re Metro. Elec. Mfg. Co.*, 295 B.R. 7, 12 (Bankr. E.D.N.Y. 2003) (citing "public official" analogy).

911 *In re PWS Holding Corp.*, 303 F.3d at 309 (holding that debtor in possession may choose to extinguish claims he had standing to pursue under § 544(b), even though the claims are not property of the debtor's estate).

912 *See* n.909, *supra*. As discussed *infra*, the decision of the Southern District of New York in *In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. 310 (S.D.N.Y. 2013), raises questions about what is required to bring the exclusivity period to an end under circumstances where a trustee's assignee continues to prosecute claims.

913 *See Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 988 (8th Cir. 2009); *In re Hechinger Investment Co.*, 274 B.R. 71 (D. Del. 2002) ("If the court were to entertain the Committee's unjust enrichment claim, a claim that effectively acts as an avoidance claim against the shareholders in a transaction that the court has already found is an unavoidable settlement payment, and allow the Committee to circumvent section 546(e) by asserting a state law claim for unjust enrichment based on the same facts and seeking essentially the same relief, the purpose of section 546(e) would be frustrated.").

914 *Id.*

light of the well-established line of cases holding that creditors may assert their surviving claims following the end of the trustee's exclusivity period,[915] and the principle that such claims in any event remain property of the creditors throughout the trustee's exclusivity period,[916] it is not clear why § 546(e) — a federal limitation on federal statutory powers — should have any post-bankruptcy impact on state fraudulent transfer claims that pre-date the bankruptcy and have remained the property of the creditors throughout.

Thus, at least two cases have found that § 546(e), on its face, simply has no application to state law claims asserted by creditors or their assignees — and these courts have not even addressed the issue of preemption. As the District of Delaware explained in one such case:

> [T]he Court concludes that if the avoidance action were brought by a trustee or a debtor-in-possession (or the successor to a debtor-in-possession), the avoidance action would be barred by Section 546(e) of the Bankruptcy Code. However, in this case, PHP LLC has not asserted its claims against Movants in the capacity of a trustee or as a successor-in-interest to a trustee or debtor-in-possession. Rather, PHP LLC is bringing the instant claims as a direct assignee of the unsecured creditors. As such, Section 546(e) is not a bar to PHP LLC's claims.[917]

These cases suggest, then, a principle for distinction: Where state law claims are asserted by an estate representative, there is a greater chance that the courts may find the claims preempted,[918] while if claims are asserted by creditors or their assignees, following the end of the trustee's exclusive bankruptcy standing period, courts are less likely to find that § 546(e) preempts the claims or otherwise applies.[919]

915 *See* n.909, *supra*.
916 *See* n.910, *supra*.
917 *See PHP Liquidating v. Robbins*, 291 B.R. 603, 607 (D. Del. 2003), *aff'd by* 128 Fed. App'x. 839 (3d Cir. 2005); *see also Development Specialists Inc. v. Kaplan (In re Irving Tanning Co.)*, Adv. Pro. 12-1024 (Bankr. D. Me. Feb. 11, 2013) ("I believe that the liquidating trustee, as assignee of creditors, may assert these actions and that being so, that 546(e) does not apply.").
918 *See, e.g.*, *AP Services LLP v. Silva*, 483 B.R. 63, 70 (S.D.N.Y. 2012); *U.S. Bank Nat'l Assoc. v. Verizon, Comms. Inc.*, No. 3:10-CV-1842-G, 2012 WL 4050088 (N.D. Tex. Sep. 14, 2012).
919 *See* n.917, *supra*.

### d. *Tribune*, *Lyondell* and *SemGroup*: Preemption, Standing and Future Developments

The distinction between estate representatives and independent creditor assignees played a central role in three preemption decisions issued by lower courts within the Second Circuit, two of which, as of this writing, are on appeal.

In *Whyte v. Barclays Bank PLC (In re SemGroup),*[920] a district court ruled that a bankruptcy estate representative that purportedly was assigned both estate claims and state law creditor claims (although the assignment was in dispute) could not assert state law claims concerning swap transactions on the theory that § 546(g) (a safe harbor that covers swap transactions) preempts the state law claims. The district court reasoned that allowing such claims to proceed would contradict a congressional purpose of preventing the unwinding of settled securities transactions.[921] The district court limited its holding, however, to the situation where creditor claims are assigned "along with Chapter 5 federal avoidance claims" to a litigation trust organized pursuant to a chapter 11 plan.[922]

By contrast, in *In re Tribune Fraudulent Conveyance Litig.*,[923] where the claims are brought not by an estate representative but by sucessor trustees on behalf of individual creditors, the district court ruled that § 546(e) did not preempt state law constructive fraudulent conveyance actions. In rejecting the argument that allowing the claims to proceed would undermine the congressional purpose of protecting the markets, the district court explained that "Congress has repeatedly indicated that it did not enact Section 546(e) to protect market stability to the exclusion of all other policies." [924] The district court further noted that Congress has on multiple occasions amended the safe harbors, but has not chosen to preempt state law creditor actions (even though it has chosen to expressly preempt other actions). Acknowledging that the avoidance power and safe harbor provisions represent a balance between multiple competing objectives, the district court explained that

920 494 B.R. 196, (S.D.N.Y. 2013).
921 *Whyte*, 494 B.R. at 199.
922 *Id.* at 200.
923 499 B.R. 310 (S.D.N.Y. 2013).
924 *See also In re Cybergenics Corp.*, 226 F.3d at 244, n.9 ("[B]olstering creditors' rights is the primary objective of avoidance powers such as section 544(b)."); *In re Greenberg*, 266 B.R. 45, 49 (Bankr. E.D.N.Y. 2001) ("[T]he basic policy implications of the Bankruptcy Code emphasize maximization of recovery of estate assets and fairness to all creditors."); *In re Kingbrook Dev. Corp.*, 261 B.R. 378, 379 (Bankr. W.D.N.Y. 2001) ("Among the goals of the bankruptcy process is maximization of distribution to creditors."); *In re Selinky*, 365 B.R. 260, 267 (Bankr. S.D. Fla. 2007) ("The goal of every bankruptcy case should be a discharge of debts and maximizing value for creditors.").

"[t]he Court is not authorized to upend Congress's balance between the operation of state and federal law." [925]

The district court in *Tribune* expressly distinguished the *SemGroup* decision, noting, *inter alia*, that in *SemGroup* it was the estate representative that was attempting to prosecute the creditor claims, whereas in *Tribune*, plaintiffs were not estate representatives.

Similarly, in *Lyondell*,[926] where the plaintiff creditor trust was not an estate representative, the bankruptcy court found that the state law fraudulent conveyance claims arising out of its failed LBO were not preempted by § 546(e).[927] In *Lyondell*, all rights to prosecute the state law creditor claims had been expressly abandoned and relinquished by the estate in the plan of confirmation and assigned to the plaintiff trust, a non-estate representative that is not invested with the Code's avoidance powers. The bankruptcy court, in a lengthy analysis that relied in part on the decision in *Tribune*, explained that the state law fraudulent transfer remedy pre-dates and has long existed alongside federal law, and that Congress was balancing multiple objectives when it partially limited the federal avoidance powers through the safe harbor. The bankruptcy court further noted that even the "market protection" purpose was more narrowly directed than defendants assert and would not appear to be implicated by receipt of fraudulent transfer proceeds by market participants at "the very end of the asset transfer chain," as they can "give the money back to injured creditors with no damage to anyone but themselves."[928] Finally, the bankruptcy court noted that while there were multiple weaknesses in the *SemGroup* court's analysis, the outcome was in any event distinguishable because the plaintiff there was an estate representative asserting federal avoidance claims, unlike in *Lyondell*.[929]

As of this writing, the decisions in *SemGroup* and *Tribune* are on appeal before the Second Circuit, and its rulings should clarify the operation of preemption doctrine

925 *Cf. Chamber of Commerce of U.S. v. Whiting*, 131 S. Ct. 1968, 1985 (2011) (Roberts, J.) (warning that a "freewheeling judicial inquiry" as part of implied preemption "would undercut the principle that it is Congress rather than the courts that preempts state law"); *Wimbush v. Wyeth*, 619 F.3d 632, 643 (6th Cir. 2010) ("Conflict preemption analysis should be narrow and precise, to prevent the diminution of the role Congress reserved to the States while at the same time preserving the federal role.") (internal citations omitted).

926 *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, Adv. Pro. No. 10-04609 (REG), 2014 WL 118036, at *1 (Bankr. S.D.N.Y.).

927 *Id.* at *7-23.

928 *Id.* at *18.

929 *Id.* at *19-23.

in connection with § 546(e) and state law fraudulent transfer remedies. However, an additional aspect of the decision in *Tribune* raises a further issue with respect to the assertion of state law remedies by a non-estate representative.

The district court in *Tribune*, having found that § 546(e) did not preempt the state law remedies, ruled in a separate portion of its opinion that the plaintiffs lacked "standing" to pursue their claims on the ground that an estate representative was still purusing the same recoveries (albeit on an intentional fraudulent conveyance theory). The district court endeavoured to ground its decision in § 362(a) of the Code, but its expansive and novel reading of that provision appears to have been based on broader policy concerns, in particular the notion that bankruptcy is intended to consolidate creditor recovery in the trustee. As the district court reasoned, "[u]nless and until the Committee actually and completely abandons [the] claims, the Individual Creditors lack standing to bring their own fraudulent conveyance claims targeting the same transactions."

Because the *Tribune* decision breaks new ground in using an expansive notion of § 362 "standing" to bar creditor claims, its longevity and viability remain unclear. The standing aspect of the *Tribune* decision is also on appeal before the Second Circuit. The Second Circuit's rulings in *Tribune* and *SemGroup* thus appear likely to clarify the operation of both preemption doctrine and § 362 "standing" in the context of state law fraudulent transfer claims asserted by non-estate representatives.

# 13-2653-cv

IN THE

## United States Court of Appeals

**FOR THE SECOND CIRCUIT**

BETTINA M. WHYTE, AS TRUSTEE OF THE SEMGROUP LITIGATION TRUST,

*Plaintiff - Appellant*

—against—

BARCLAYS BANK PLC AND BARCLAYS CAPITAL, INC.,

*Defendants - Appellees.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

**BRIEF OF *AMICA CURIAE* SHARON B. CHRISTHILF IN SUPPORT OF DEFENDANTS-APPELLEES**

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## INTEREST OF *AMICA CURIAE*[1]

Ms. Sharon Christhilf submits this brief *amica curiae* in support of Defendants-Appellees and of affirmance of the judgment below. Creditors in the Tribune Company bankruptcy – arguing, as Plaintiff-Appellant argues here, that they may avoid one of the safe harbors contained within 11 U.S.C. § 546 – have sued her for tendering public shares. The final outcome of that action, which could have significant impact on her retirement, may be dictated by this appeal. All parties have consented to Ms. Christhilf's filing.

Ms. Christhilf is 70, and lives in Baltimore, Maryland. In 2007, she owned shares in Tribune Company, inherited from her mother, which played a

[1] No party to this appeal, or counsel to such a party, participated in writing the Brief or contributed any money toward its preparation. Ms. Christhilf joined a group of defendants that engaged Bingham McCutchen LLP to defend their interests in *In re Tribune Company Fraudulent Conveyance Litigation*, Case No.11-MD-2296 (S.D.N.Y.) (Sullivan, J.) ("*Tribune*"). That defendant group, and a group of similarly situated defendants in *Weisfelner v. Fund 1, et al. (In re Lyondell Chemical Co.)*, Adv. Pro. No. 10-04609 (Bankr. S.D.N.Y.) (Gerber, J.) ("*Lyondell*"), shared in the cost of the Brief. Group members include: Pioneer High Yield Fund, Thrivent Financial for Lutherans, Ohio National Fund, Inc., Allstate Insurance Company, Great-West Life & Annuity Insurance Company, Prudential Insurance Company of America, Weiss Multi-Strategy Advisers, LLC, Ms. Susan Bruce and Mr. Steven Bruce, Aetna Life Insurance Company, Alecta Pensionsforsakring Omsesidigt, The Church Pension Fund, Employers Mutual Casualty Company, The Hartford, ING Capital LLC, ING Investment Management, Legg Mason, Inc., Madison Square Investors, City of Los Angeles Employees Retirement System, City of Los Angeles Fire and Police Pension Plan, Nordea Bank AB, Northwestern Mutual Life Insurance Company, Putnam Investments, Redwood Capital Management, LLC, Skandinaviska Enskilda Banken AB, Sterne Agee & Leach, Inc., T. Rowe Price, and Ms. Ruth M. Tankersley.

meaningful role in her retirement plans, and those of her family. She received notice that the company had commenced a tender offer for its shares, at a price consistent with earlier public trading values. According to the notice, the company would be taken private, leaving small investors like Ms. Christhilf with no real alternative but to tender, nor reason to doubt the judgment of the marketplace that the Company's shares were valuable. Ms. Christhilf tendered her shares. Thereafter the company filed a chapter 11 case. Ms. Christhilf had never been involved in the direction, management or operations of the company, but like thousands of other former shareholders, she later received a summons and complaint seeking the full price paid for the shares, and substantial interest.

The *Tribune* complaint rests on an artifice that has swept recent bankruptcy practice and is at issue in this appeal. Barred by safe-harbor provisions in section 546 of the Bankruptcy Code from bringing certain avoidance claims themselves, and egged on by debt traders who accumulate debt claims in bankruptcy, chapter 11 debtors purport to assign or "disclaim" avoidance claims to creditor "trusts," or sometimes to creditors themselves. These trusts or creditors then pursue avoidance claims in a collective proceeding that is indistinguishable, in practical terms, from the barred suit of the trustee herself.

The district court in *Tribune* recently ruled that the plaintiff-creditors were barred from proceeding, *see Memorandum and Order*, *In re Tribune Company Fraudulent Conveyance Litigation*, Case No.11-MD-2296 (RJS) (S.D.N.Y. Sept. 23, 2013) [Doc. No. 2710] (the "*Tribune* Dismissal Order"),[2] but in *dictum* rejected arguments that section 546(e) barred or pre-empted the plaintiffs' claims. *Id.* at 14. The ultimate outcome in *Tribune* for Ms. Christhilf, and thousands like her, may well be set by the Court's resolution of this appeal.[3]

Ms. Christhilf writes separately from other *Tribune amici* to expand upon Issue 2 in the Defendants-Appellees' Statement of the Issues. Under the authority of *Trimble v. Woodhead*, 102 U.S. 647 (1880), which has been misunderstood in the few modern decisions to have analyzed it, the SemGroup bankruptcy estate's fraudulent transfer claims could not revert through SemGroup's creditors to Ms. Whyte. Read together with section 349 of the

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[2] The plaintiff creditors have noticed an appeal. *Joint Notice of Appeal*, *In re Tribune Company Fraudulent Conveyance Litigation*, Case No. 11-MD-02296 (RJS) (S.D.N.Y. Sept. 30,2 013) [Doc. No. 2730].

[3] Ms. Whyte's theory commonly is deployed, as in *Tribune*, to evade the parallel safe harbor for "settlement payments" in subsection 546(e). *See also Weisfelner v. Fund 1, et al. (In re Lyondell Chemical Co.)*, Adv. Pro. No. 10-04609 (Bankr. S.D.N.Y.) (Gerber, J.).

modern Bankruptcy Code, *Trimble* bars the vogue reverter theory advanced below, and in numerous recent bankruptcy cases.[4]

## SUMMARY OF ARGUMENT

Ms. Whyte theorizes that (i) the collective avoidance claim held by SemGroup, L.P., as a debtor-in-possession at the commencement of its chapter 11 case was later unwound to the discrete avoidance claims that each creditor held prior to the chapter 11 case; (ii) those creditor-specific claims reverted from the estate to the individual creditors, and thence, through a plan of reorganization or otherwise, to Ms. Whyte; and (iii) the reverted claims have shed the limitations imposed by section 546(g).

Read together with section 349 of the modern Bankruptcy Code, 11 U.S.C. § 349, *Trimble* bars this theory, and compels affirmance of the judgment below. Once a title 11 case commences, the state-law claims of creditors to avoid and recover for fraudulent transfers are "absorbed", as the Supreme Court put it, in the bankruptcy trustee's "great and comprehensive remedy" to avoid fraudulent transfers made by the debtor. *Glenny v. Langdon*, 98 U.S. 20, 28

4 If this Court were to conclude, notwithstanding *Trimble* and its progeny, that current law does not expressly bar Ms. Whyte's suit, then *amica* agrees with the District Court below, Appellees, and Appellees' other *amici* that Ms. Whyte's claim must be pre-empted, because it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" in enacting section 546(g). *See Arizona v. United States*, 132 S.Ct. 2492, 2505 (2012).

(1878). This comprehensive remedy is a cause of action that is property of the debtor's estate, and limited by the safe harbors in section 546. *Trimble* squarely holds that the comprehensive remedy does not disaggregate into prior creditor claims or revert to creditors, simply because the bankruptcy trustee does not pursue it.

Congress provided means by which causes of action, like any other property of the estate, might leave the estate. But outside of dismissal of the title 11 case, Congress provided no means by which the estate's causes of action for fraudulent transfer could leave the estate shorn of the safe harbor defenses. If fraudulent transfer claims somehow reached Ms. Whyte, they reached her with the same limitations under section 546 that existed within the chapter 11 case.

## ARGUMENT

### A. State-Law Fraudulent Transfer Claims Do Not Revert From A Title 11 Debtor To Creditors Unless The Title 11 Case Is Dismissed.

State statutes afford to creditors a remedy against fraudulent transfers or conveyances made by their obligor. *See, e.g.*, N.Y. Debtor & Creditor Law § 270-81. These statutes provide remedies against the transferee, to the extent of the creditor's debt claim against the obligor. *See, e.g., id*. at § 278. When the obligor commences a case under title 11, as SemGroup did, this creditor-by-



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creditor remedy system changes. Through the Bankruptcy Code and its predecessor statutes, Congress collected the discrete avoidance rights of creditors under state law and brought them within the bankruptcy estate as a comprehensive avoidance power of the estate's representative, who may avoid transfers for the benefit of the estate as a whole. 11 U.S.C. § 544(b). With this comprehensive claim, Congress armed the bankruptcy trustee with a powerful tool. But it tempered that tool in section 546, enacting various "safe harbors," including the one at issue in this appeal, that protect certain classes of transfer from avoidance.[5]

At the commencement of SemGroup's chapter 11 case, the debtor-in-possession[6] acquired exclusive power to "avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim…." 11 U.S.C. § 544(b). On commencement of its chapter 11 case, SemGroup's cause of action to avoid fraudulent transfers was property of its bankruptcy estate, as many authorities have held. *In re Moore*, 608 F.3d 253, 262 (5th Cir. 2010)

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[5] There is no dispute that the swap payment at issue in this appeal would have fallen within the safe harbor of section 546(g) if the debtor-in-possession had sought to avoid it. *Brief for Defendants-Appellees* at 9.

[6] As a debtor-in-possession, SemGroup's rights were the same as those of a bankruptcy trustee. 11 U.S.C. § 1107(a); *see Brief For Defendants-Appellees* at 6.

(claims under § 544(b) are estate property); *Fox v. Picard (In re Madoff)*, 848 F. Supp. 2d 469, 481 (S.D.N.Y. 2012) (same); *Picard v. Maxam Absolute Return Fund, L.P.*, *SIPC v. Bernard L. Madoff Inv. Sec., LLC*, 460 B.R. 106, 114 (Bankr. S.D.N.Y. 2011) (same); *In re Colonial Realty Co.*, No. 3:91-200X(JAC), 1991 WL 487192, *2 (D. Conn. Dec. 30, 1991) (Cabranes, C.J.) ("…fraudulent conveyance actions based upon pre-petition transfers of a debtor . . . are property of the estate as of the commencement of the bankruptcy case."), *aff'd on other grounds, FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125 (2d Cir. 1992); *In re Becker*, 136 B.R. 113, 116 (Bankr. D.N.J. 1992) ("The trustee's rights under the avoiding powers in Code [§§] 544 through 551 are property of the estate."); *see also Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013) (rejecting argument that fraudulently conveyed *property* becomes property of the estate prior to avoidance, even where parties agree that fraudulent transfer *claims* are property of the estate).

That a section 544(b) avoidance claim is "property of the estate" is the necessary consequence of the rest of the Bankruptcy Code. A cause of action is a species of property, *see* UCC Art. 9-102(42) ("general intangible" includes things in action, a form of personal property), and the Bankruptcy Code defines "property of the estate" broadly, to include "all legal or equitable interests of the debtor in property as of the commencement of the case," *see* 11 U.S.C.

§ 541(a)(1). This phrase coheres with Congress's grant to the bankruptcy trustee of the debtor's rights and powers "as of the commencement of the case." *See* 11 U.S.C. § 544(a). The trustee may assert an avoidance claim defensively, to resist a filed proof of claim, even after the statute of limitations has run, *see U.S. Lines, Inc. v. United States (In re McLean Indus., Inc.)*, 196 B.R. 670, 675–77 (S.D.N.Y. 1996). He may also settle and extinguish an avoidance claim over a creditor's objection. *See In re PWS Holding Corp.*, 303 F.3d 308, 315 (3d Cir. 2002). The powers to assert claims defensively and to settle them, and the fact that claim proceeds are estate property, all show that the claim itself is property of the estate.

This matters, as we show in section B of the argument, because of the limited means by which property of the estate may leave the estate. Ms. Whyte in her opening brief and *amicus* Weisfelner rely on lower-court decisions that hold, with little analysis (or even discussion), that when a trustee's collective avoidance claim is barred by the Bankruptcy Code's statute of limitations in section 546(a), that claim disaggregates to its pre-bankruptcy, creditor-by-creditor component claims, which then revert to state-law creditors, who may pursue state-law claims during the avoidance period remaining under state law. *Brief of Plaintiff-Appellant* at 26; *Brief of Amicus Curiae Edward S. Weisfelner, as Trustee of the LB Creditor Trust in Support of Plaintiff-Appellant* at 17-19.

*Trimble v. Woodhead* squarely contradicts Ms. Whyte's theory. The Supreme Court held that an avoidance claim that arose under state law prior to bankruptcy did not revert to a creditor after bankruptcy. 102 U.S. at 649. The creditor tried to bring a fraudulent conveyance claim under Kentucky law, suing a transferee after the bankruptcy statute of limitations had run on the claim in the hands of the "assignee."[7] Construing section 2 of the Bankruptcy Act of 1867, ch. CLXXVI, § 2 (repealed 1878), 14 Stat. 517 (1867) (the "1867 Act"), the Supreme Court affirmed dismissal of the claim. "We do not see on what principle the failure of the assignee to sue within two years transfers his right of action to the complainant," the Court concluded. 102 U.S. at 649; *see* 1867 Act at § 2; *see also Moyer v. Dewey*, 103 U.S. 301, 303 (1880) (stating that *Trimble* holds that "the right to bring such an action as this—the right to the property so fraudulently conveyed—is vested in the assignee alone, and that his failure to sue within the two years allowed by the bankrupt law does not transfer this right of property or right of action to a creditor of the bankrupt."). The running of the bankruptcy statute of limitations "would, if it had any effect on the title [to the real property that the debtor had transferred to the defendants], make good the title of the defendants." *Trimble*, 102 U.S. at 649.

[7] The "assignee" was the nineteenth-century analog of the modern bankruptcy trustee.

*Trimble* relied on the Court's earlier decision in *Glenny v. Langdon*, where a debtor concealed from the assignee a valuable cause of action. 98 U.S. at 22. He received a discharge in bankruptcy after the assignee sold the cause of action for a nominal sum to a straw (who then reconveyed it to the debtor). Creditors brought suit against the assignee for nonfeasance and the debtor for fraud. The case was dismissed on jurisdictional grounds, but the Court observed that the complaining creditors could sue *neither* defendant:

> [Creditors] can have no remedy which will reach [fraudulently conveyed] property except through the assignee, not only for the reasons already assigned, but because *their remedies are absorbed in the great and comprehensive remedy* under the commission by virtue of which the assignee is to collect and distribute among them the property of their debtor.

98 U.S. at 28 (emphasis added).

The "absorption" of fraudulent transfer claims into this "great and comprehensive remedy" helps ensure "equality of distribution of proceeds of the estate." *See In re Bd. of Dirs. of Hopewell Intern. Ins. Ltd.*, 238 B.R. 25, 55 (Bankr. S.D.N.Y. 1999) ("The ability to avoid … fraudulent transfers to ensure equality of distribution of proceeds of the estate is one of the most fundamental tenets of our bankruptcy system."); *In re Old CarCo LLC*, 435 B.R. 169, 189 n. 17 (Bankr. S.D.N.Y. 2010) (purpose of fraudulent transfer provisions of bankruptcy code, as opposed to state law, "is to provide equal distribution of a debtor's estate to the debtor's creditors.") Equal distribution of the debtor's property has always been a principal purpose of Bankruptcy law. *Buchanan v. Smith*, 83 U.S. 277, 301 (1873) ("Equal distribution of the property of the bankrupt … is the main purpose which the Bankrupt Act seeks to accomplish); *see Cunard S.S. Co. Ltd. v. Salen Reefer Servs. AB*, 773 F.2d 452, 459 (2d Cir. 1985) ("The guiding premise of the Bankruptcy Code, like its predecessor, the Bankruptcy Act, is the equality of distribution of assets among creditors.").

"Congress has fully 'occupied the field' of debtor-creditor relations in bankruptcy, and … preemption of state law concepts within bankruptcy cases is now comprehensive." *In re Pruitt*, 401 B.R. 546, 552 (Bankr. D. Conn. 2009). As the Ninth Circuit observed:

> [A] mere browse through the complex, detailed, and comprehensive provisions of the lengthy Bankruptcy Code ... demonstrates Congress's intent to create a whole system under federal control which is designed to bring together and adjust all of the rights and duties of creditors and embarrassed debtors alike. While it is true that bankruptcy law makes reference to state law at many points, the adjustment of rights and duties within the bankruptcy process itself is uniquely and exclusively federal.

*MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910, 914 (9th Cir.1996); *see Pruitt*, 401 B.R. at 554 ("once a bankruptcy case is commenced, there is allowance for the operation of State Law *only to the extent that Congress provides for its viability*.") (emphasis added).

*Trimble* remains the law today. While later statutes have superseded the 1867 Act, amendments to bankruptcy statutes do not overrule prior *precedent* except where Congress expressly provides. *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992); *Emil v. Hanley (In re John M. Russell, Inc.)*, 318 U.S. 515, 521 (1943); *Nostas Assocs. v. Costich (In re Klein Sleep Prods., Inc.)*, 78 F.3d 18 (2d Cir. 1996). Congress has made no such express provision since the 1867 Act, and section 2 of the 1867 Act was not, in relevant respects, different than section 546(a) of today's Bankruptcy Code. The former prohibited any "suit, either at law or at equity . . . between an assignee in bankruptcy and a person claiming an adverse interest touching any property . . . vested in such assignee, unless brought within two years . . . ," and contained no provision by which claims might revert to creditors. Section 546(a) provides today for a similar limitation on the trustee's avoidance powers, while no Bankruptcy Code provision provides for reverter, except where a title 11 case is dismissed.[8]

Neither the Supreme Court's cases nor subsequent statutes have ever deviated from *Trimble's* core propositions – that creditor rights to avoid transfers were *"absorbed in the great and comprehensive remedy"* upon the filing of the case, *see Glenny,* 98 U.S. at 28 (emphasis added), and that creditors thereafter have no means – to follow the Court's chemistry metaphor – to cause

[8] *See* discussion, *infra*, at 21-23.

those claims to precipitate from title 11's comprehensive "solution" and be restored to creditors. The successor statute to the 1867 Act, the Bankruptcy Act of 1898, ch. 541, §§ 1 *et seq.*, 30 Stat. 544 (1898) (the "1898 Act"), although often amended, remained the law for 70 years, and the Bankruptcy Code followed. Neither statute altered *Trimble's* analysis, except in cases of dismissal.

Confusion arose because the 1898 Act, like its 1867 predecessor, in one section speaks of the estate including the fraudulently-transferred property itself, *see* 1898 Act at § 67(e)[9], and in another of the trustee having the right to *avoid the prepetition transfer* of such property. *Id.* at § 70(e).[10] The notion that transferred *property* was in the estate before avoidance of the transfer was confusing, *see* 4a Collier on Bankruptcy ¶ 70.14[1] at 127-34 (James William Moore, 14th ed. 1967) ("Collier's 14th ed."), and later rejected in the 1978 enactment of section 541 of the Bankruptcy Code. *See Colonial Realty*, 980 F.2d at 131. But there was never any doubt under the 1898 Act that the cause of action to avoid fraudulent transfers continued, as it was in *Trimble*, to be

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9 "…[A]ll property of the debtor conveyed, transferred, assigned, or encumbered [with the intent and purpose to hinder, delay, or defraud creditors] shall … be and remain a part of the assets and estate of the bankrupt and shall pass to his said trustee…."

10 "The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided…."

property of the estate. *See* Collier's 14th ed. ¶ 70.14[1] at 127; *Moyer*, 103 U.S. at 303 (right to bring an avoidance action is "vested in the assignee alone"); *In re Rosen*, 15 F.Supp. 516, 517 (S.D.N.Y. 1936) (trustee's cause of action to recover property fraudulently transferred by bankrupt constituted "an asset of the estate").

That proposition remains clear today. While prior to an avoidance judgment, fraudulently transferred *property* is no longer "property of the estate," *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125 (2d Cir. 1992), the Court in *Colonial Realty* did not suggest that the bankruptcy trustee's *cause of action* to avoid the pre-petition transfer of that property was not, in its own right, property of the estate. 980 F. 2d at 129. The case involved a contest between a bankruptcy trustee and the Federal Deposit Insurance Corporation. After the bankruptcy and district courts held that certain avoidance claims were property of the bankruptcy estate (but acknowledged that the FDIC had superior rights in the proceeds), the trustee pivoted in this Court by arguing that the transferred *property* was property of the bankruptcy estate prior to avoidance of the transfer. 980 F.2d at 131. Then-Chief District Judge Cabranes held that the claim was property of the estate, *see Colonial Realty*, 1991 WL 487192, at *2, and this Court's affirmance does not question that ruling. 980 F.2d at 129-30.

Other courts within this circuit have reached the same conclusion. *See Fox*, 848 F. Supp. 2d at 481 ("[T]here ultimately is no substantive difference between the claims already asserted by the Trustee [under § 544] . . . and those claims asserted in the Florida Actions. . . . [T]he Bankruptcy Court correctly found that the claims asserted in the Florida Actions were the property of the estate."); *Maxam Absolute Return Fund, L.P.*, 460 B.R. at 114 (Property of the estate "includes … avoidance actions created on the petition date[.]").[11]

Nor did the 1898 Act overrule the second leg of *Glenny* and *Trimble* by "precipitating" discrete creditor claims from the "comprehensive remedy." *See Glenny*, 98 U.S. at 28. That the remedy remained a collective one, uniquely for the bankruptcy trustee, was well understood. For example, when pre-bankruptcy fraudulent transfer claims came to light after the bankruptcy proceeding was closed, the claims had not reverted to creditors. "With respect to a right of action to recover fraudulently transferred property it has been held that discharge of the trustee in bankruptcy and closing of the bankruptcy proceedings did not entitle a defrauded creditor to sue on the right." Collier's

[11] In *dictum* unnecessary to the decision, the *Tribune* Dismissal Order conflated property transferred prior to the bankruptcy case with the post-bankruptcy *claim* to avoid the transfer, incorrectly citing *Colonial Realty* for the proposition that the estate does not have a property interest in the latter. *Tribune* Dismissal Order at 10-11. The order does not discuss the authorities that contradict its reasoning, nor the distinction between claims and transferred property.

14th ed. ¶ 70.07 [2] at 99 (*citing Samuel H. Pardes, Inc. v. Henley Fashions, Inc.*, 118 N.Y.S.2d 578 (N.Y. Sup. Ct. 1953)). Rather, "[i]t was incumbent upon the [creditor] either to petition the bankruptcy court to compel an action by a trustee, or to obtain leave to prosecute the suit on behalf of the estate." *Pardes*, 188 N.Y.S. 2d at 579. The avoidance claim remained property of the estate, with no suggestion that the state-law creditor's pre-bankruptcy avoidance claim had somehow reverted to it.

That reverter was not the law is also shown by a debate about whether, under the 1898 Act, the bankruptcy trustee might convey avoidance claims by an *express* assignment. *See generally* Collier's 14th ed. ¶ 70.92[4] at 1062-66. Courts differed on whether he might make such an assignment. *Compare Webster v. Barnes Banking Co.*, 113 F.2d 1003, 1005 (10th Cir. 1940) ("the right of a trustee in bankruptcy to set aside a conveyance made in fraud of creditors vests in the trustee for the benefit of the creditors and is not assignable"),[12] *with Rosen*, 15 F.Supp. at 517 (trustee could assign to bankrupt's creditors cause of action to set aside debtor's allegedly fraudulent transfer, upon

[12] *See also Neuberger v. Felis*, 82 So. 172, 174 (Ala. 1919) (holding trustee did not have right to assign fraudulent transfer claim); *McMasters v. Campbell*, 2 N.W. 836, 837 (Mich. 1879) (the right to bring fraudulent conveyance action passes to the assignee in bankruptcy, does not automatically revert to state-law creditors after conclusion of bankruptcy proceedings, and may not be assignable to creditors under a general transfer of "all property and rights of action" of the assignee).

authorization of creditors and approval of court).[13] The debate was wide-ranging, but none of the participants suggested that claims might reach third parties without an express assignment. Were the law that creditor avoidance rights lay dormant during a case and later reverted to creditors, it would have been odd that no court raised the point in a debate about whether the claims were "assignable."

In short, the history of Bankruptcy legislation, from the 1867 Act through the 1898 Act down through the present, shows that there was no "right of reverter" from 1880, when the Supreme Court decided *Trimble*, until 1978, when Congress created, in 11 U.S.C. section 349, a *narrow* right of reverter, applicable only when title 11 cases were dismissed.[14] That means that no right of reverter arose when SemGroup merely failed to proceed with a claim. Holding otherwise would undermine the "primary object of the bankrupt law … to secure the equal distribution of the property of the bankrupt of every kind among his creditors." *Trimble*, 102 U.S. at 650.

The lower courts have rarely addressed *Trimble*. So far as *amica* is aware, only two published decisions have identified rationales for avoiding its

[13] *See also In re Downing*, 192 F. 683 (N.D.N.Y. 1912) (permitting trustee to assign fraudulent transfer action to creditor).

[14] *See* discussion, *infra*, at 21-23.

holding. Last month, the district court in *Tribune* reasoned in *dictum* that *Trimble* is inapposite because "unlike the modern Code, the Bankruptcy Act of 1867 explicitly treated fraudulent conveyance claims as property of the trustee once bankruptcy proceedings commenced." *Tribune* Dismissal Order at 11 n. 12. The district court did not discuss any of the many authorities, including those within this circuit, that hold or state that such avoidance claims remain today what they were in 1880: property of the estate. *Compare Tribune* Dismissal Order at 10, 11 n.12 *with* discussion, *supra*, at 6-8. And nothing under the 1867 Act, as *Trimble* recognized, nor under the Bankruptcy Code today causes the "great and comprehensive remedy" to disaggregate and revert once that period lapses. The district court's analysis in *Tribune* is incorrect.

In *Dixon v. Bennett*, 531 A.2d 1318 (Md. App. 1987), *overruled on other grounds by BAA, PLC v. Acacia Mut. Life Ins. Co.*, 929 A.2d 1 (Md. 2007), an intermediate appellate court advanced a different rationale for avoiding *Trimble*. The Maryland court ruled that the 1867 Act expressly barred a creditor's post-bankruptcy avoidance suit because, it thought, that act provided a statute of limitations against *any* creditor claim related to estate property, even one against a third party. *See* 531 A. 2d at 1324. This misreads both the decision and the statute. The Supreme Court in *Trimble* did not construe the statute of limitations to apply to the claim in the hands of the state-law creditor. It concluded that the claim never reverted to the creditor at all. *Trimble*, 102 U.S. at 649 ("We do not see on what principal the failure of the assignee to sue within two years transfers his right of action to the complainant."). Were *Dixon* correct, the Supreme Court would have ruled in *Trimble* that the statute of limitations itself barred the claim in the creditor's hand.

The decision also misreads the statute. Section 2 of the 1867 Act provided jurisdiction to the federal courts of suits

> brought by the assignee in bankruptcy against any person claiming an adverse interest, or by such person against such Assignee, touching any property or *rights of property of said bankrupt transferable to or vested in such Assignee*;

1867 Act at § 2 (emphasis added). The sentence continued, after the semicolon, as follows:

> but no suit … shall in any case be maintainable by or against such Assignee, or by or against any person claiming an adverse interest, *touching the property and rights of property aforesaid,* in any court whatsoever, unless the same shall be brought within two years from the time the cause of action accrued, for or against such Assignee.

*Id*. (emphasis added). The two clauses appear in the same sentence and must be read together. The second clause's reference to "the property and rights of property aforesaid" refers the reader to the "property or rights of property … vested in such an Assignee" in the first clause. Suits "by or against" the adverse party refer to disputes between him and the assignee about the

Assignee's claimed property. This is how the Supreme Court construed the same section 2 at the time, writing that "controversies, in order that they may be cognizable under that provision … must have respect to some property or rights of property of the bankrupt, *transferable to or vested in such assignee*." *Glenny*, 98 U.S. at 22-23 (emphasis added).

*Dixon* ignored this context and history, construing the provision as a blanket limitation applying to suits outside of bankruptcy, where a creditor pursues remedies under state law against third parties. 531 A. 2d at 1321-22. This reading is untenable. The clause refers only to suits in which the assignee, and a "person claiming an adverse interest" in estate property, both have interests.[15]

The lower-court cases upon which Ms. Whyte relies are also distinguishable for practical reasons. By permitting reverter, those courts enabled plaintiffs to recover on a cause of action that the estate representatives could have brought but did not file, to plaintiffs' detriment. *See, e.g.*, *Klingman*,

[15] *Dixon* also reasoned that "no case law or language in the Bankruptcy Code itself … prevents an unsecured creditor from bringing a state cause of action in state court once the trustee's two-year time limitation has passed," – a curious rationale. 531 A. 2d at 1324. A statute's silence leaves the *status quo* unchanged, and the *status quo* upon the filing of the title 11 case in *Dixon* – as in SemGroup – was that the trustee or debtor owned the exclusive right to prosecute fraudulent transfer claims. 11 U.S.C. § 544(b).

158 B.R. at 111-12 (former client swindled by embezzling debtor could proceed on avoidance claims after trustee failed to do so); *Munson v. Rinke*, 395 Ill. App. 3d 789, 794 (Ill. App. Ct. 2009) (fraudulent transfer action by judgment creditor of the debtor for the debtor's transfer of vehicles to his wife); *Dixon*, 531 A.2d at 1323 (fraudulent transfer action by former partner of the debtor for the debtor's transfer of assets away from the partnership). SemGroup could never have brought this action, because it was barred by section 546(g).

In short, except under circumstances discussed below, the concept of reverter, which is integral to Ms. Whyte's state-law fraudulent transfer claims, is contrary to law.

**B. The Swap Avoidance Claims Remain Subject To The Limitations In Section 546(g).**

Defendants-Appellees have pointed out that the structure of the plan and other assignments was such that any claim that reached Ms. Whyte came burdened with the safe harbor limitation, if it came at all. *See Brief for Defendants-Appellees* at 6-9; 46. The Court may affirm for a simpler reason: if the title 11 case was not dismissed, then as a matter of law the swap avoidance claim could never have reached Ms. Whyte free and clear of the safe harbor of section 546(g). The Bankruptcy Code establishes only one means by which the estate's "great and comprehensive remedy" is disaggregated into the discrete component claims held by individual creditors prior to bankruptcy: dismissal.

Congress provided several routes by which estate property may leave the estate. It may be sold, *see* 11 U.S.C. § 363, or distributed under a plan of reorganization, *see* 11 U.S.C. § 1129, and cases may be dismissed, *see* 11 U.S.C. § 349. But case dismissal is the only route that strips a claim of section 546's limitations. Section 349(b)(1)(B) provides that when a title 11 case is dismissed, transfers avoided under section 544 are reinstated. Section 349(b)(3) goes on to provide, "[u]nless the court, for cause, orders otherwise, the dismissal of a case … revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title." This "property of the estate" would include the state-law avoidance claims. When a case is dismissed, it is as though sections 544 and 550, and the limitations imposed by section 546, never applied. But that is true only because Congress created a special provision for dismissals.

That is, Congress knew how to alter the character of section 544(b)'s comprehensive remedy, by disaggregating the claim into the pre-bankruptcy claims of creditors, and revesting those claims in them. That means that it intended the estate's comprehensive avoidance claim to retain its character – and the limits of section 546 – when a case is *not* dismissed. Because Congress expressly provided for the reinstatement of creditor avoidance claims only upon the dismissal of a bankruptcy case, it plainly did not intend the estate's comprehensive claim to disaggregate and "revest" in individual creditors where, as here, the chapter 11 case resulted in confirmation of a plan. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 (1994) ("[I]t is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another, and that presumption is even stronger when the omission entails the replacement of standard legal terminology with a neologism.") (internal citation and quotation marks omitted).

Because the chapter 11 case was not dismissed, SemGroup's avoidance claims could not escape section 546(g). If the claims left the estate, they did so in the same character as they existed within it. *In re New Haven Projects Ltd. Liab. Co.*, 225 F.3d 283, 289 n. 4 (2d Cir. 2000) (noting the "unremarkable proposition that 'an assignee takes all of the rights of the assignor, no greater and no less.'" (*quoting Beal Bank, SSB v. Nassau County*, 973 F. Supp. 130 (E.D.N.Y.1997))); *see In re Ames Dep't Stores*, 287 B.R. 112, 115 (Bankr. S.D.N.Y. 2002) ("[T]he Court notes that a sale of designation rights with respect to leases cannot and does not result in an exemption from the requirements of section 365 . . . as to which the rights of lessors necessarily must be honored[.]"); *cf. In re Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 337 (2d Cir. 2011) (fraudulent transfer claims prosecuted by reorganized company were limited by section 546(e)).

The "great and comprehensive remedy," *see Glenny*, 98 U.S. at 28, has always been a powerful one. Perhaps for that reason, Congress in section 546 created safe harbors to limit its reach, and in section 349 unwound them only where a title 11 case is dismissed. As *Trimble* holds, Ms. Whyte cannot avoid the safe harbor through the artifice used here. If the avoidance claims reached her, they did so still limited by section 546(g).

## CONCLUSION

The judgment of the District Court should be affirmed.

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**CERTIFICATE OF COMPLIANCE**

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 5,799 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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