December 1996

Recovering Avoidable Transfers under Section 550 of the Bankruptcy Code: Defining for the Benefit of the Estate

Jonathan A. Carson

Follow this and additional works at: https://scholarship.kentlaw.iit.edu/cklawreview

Part of the Law Commons

Recommended Citation
Available at: https://scholarship.kentlaw.iit.edu/cklawreview/vol72/iss2/17
RECOVERING AVOIDABLE TRANSFERS UNDER SECTION 550 OF THE BANKRUPTCY CODE: DEFINING "FOR THE BENEFIT OF THE ESTATE"

JONATHAN A. CARSON*

INTRODUCTION

A hallmark of our nation’s bankruptcy system is avoidability; that is, avoiding certain transfers of property that the debtor made prior to the bankruptcy process.1 The trustee’s use of the avoidance powers facilitate the Code’s goals of preservation of the estate and collective treatment of claims.2 While avoidance issues constitute a staple in bankruptcy proceedings,3 controversial issues exist regarding § 550’s scope and application. In particular, bankruptcy courts struggle to interpret the extent to which the avoidance powers can be exercised consistently with the language and underlying policies of the Code.

* 1997 J.D. Candidate, Chicago-Kent College of Law, B.A. University of Michigan, 1994. The author has accepted a two-year clerkship with the Honorable Geraldine Mund, Bankruptcy Judge, Central District of California. The author wishes to thank Richard T. Reibman and Gerald F. Munitz for their insightful guidance and support throughout the writing of this Article and Michael Malinzak for his invaluable assistance in the editing process.

1. In determining whether such transfers are avoidable, either applicable state law or the Bankruptcy Code may govern. See, e.g., 11 U.S.C. §§ 544, 545, 547, 548, 549, 553(b), 724(a) (1994). In either case, however, once a transfer has been deemed avoidable in a bankruptcy case, § 550 of the Bankruptcy Code is the vehicle a trustee uses to recover such property. 11 U.S.C. § 550.

2. In many cases, the debtor’s bankruptcy is preceded by a time of financial crisis in which creditors attempt to obtain any advantage possible via collection activities and the debtor, in many cases, responds to such pressure by making payments to particular creditors or by disposing of property. Much of the activity occurring in this period could be abnormal or contrary to regular business practice, as well as dishonest and manipulative. By permitting the debtor-in-possession to go back and avoid these prebankruptcy transfers, the debtor-in-possession is able to recover the property or value of the property transferred. In addition to restoring value to the estate so as to ensure a greater distribution to creditors, the avoidance powers, when invoked, deprive the creditor transferee of the unfair advantage obtained in the period preceding bankruptcy and brings the creditor into bankruptcy’s collective process. In doing so, the avoidance powers serve to facilitate that goal of the Bankruptcy Code to ensure the fair treatment of creditors and the collective treatment of claims. See generally ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS (1991).

3. Avoidance suits are core proceedings, and are therefore central to the bankruptcy process and within the jurisdiction of the bankruptcy courts. See 28 U.S.C. § 157(b)(2)(F)-(H) (1994). These suits take the form of adversary proceedings—essentially civil lawsuits within the bankruptcy case. Typically, the debtor-in-possession is the plaintiff in the proceeding and the creditor, who is recipient of the potentially avoidable transfer, is the defendant.
The avoidance powers contained in the Bankruptcy Code enable the trustee or debtor-in-possession to set aside certain transactions entered into by the debtor prior to the filing of the bankruptcy petition.\(^4\) By enabling the trustee to avoid certain prepetition transfers, the Code allows the bankruptcy estate to recover property interests that the debtor relinquished prior to bankruptcy.

Section 550 imposes a limit on avoidance actions by permitting recovery “for the benefit of the estate.”\(^5\) This facially ambiguous language, contained in § 550(a), is the source of a conflict among bankruptcy courts concerning the extent to which recovery can be pursued in avoidance actions. To permit pursuit of recovery, a credible link must exist between avoidance recovery and the ensuing benefit to creditors. The dispositive issue is: how direct and substantial must the link be to satisfy the ambiguous limitation imposed by § 550(a)?

The following three hypothetical situations illustrate the different factual scenarios in which a bankruptcy court is likely to confront the issue of whether an avoidance action is pursued for the “benefit of the estate.”

**Hypothetical 1: The Easy Cases**

In an easy case, proceeds from an avoidance action benefit only the debtor, in which case the debtor receives a windfall and the creditors are not benefitted directly or indirectly. Because the estate does not benefit from recovery, the trustee lacks standing to pursue the avoidance action under § 550.

**Hypothetical 2: The Direct-Creditor-Benefit Cases**

In a direct-creditor-benefit case, the proceeds of the avoidance action are allocated directly to the creditors. Liquidation bankruptcies are a clear example of creditors benefitting directly from avoidance actions because once the estate recovers all the property, creditors share in the appropriate distribution hierarchy provided by § 726.\(^6\) Such a direct-creditor benefit constitutes a benefit to the estate and allows the trustee to pursue the avoidance action consistent with § 550.

\(^4\) In a reorganization under Chapter 11 of the Bankruptcy Code, typically a trustee is not appointed. Instead, the debtor exercises the trustee’s function as debtor-in-possession, subject to the supervision of the bankruptcy court and creditors’ committees. See 11 U.S.C. § 1107(a). In order to avoid any confusion, I will use the term trustee throughout the course of this Note.


**Hypothetical 3: Indirect-Creditor-Benefit Cases**

In an indirect-creditor-benefit case, creditors ultimately benefit from recovery, albeit indirectly. For example, in a reorganization under Chapter 11, the debtor typically retains estate property to aid it in completing a successful reorganization and meet its obligations pursuant to its plan. Here, proceeds recovered into the estate from avoidance actions may not be transferred directly to creditors according to their respective positions on the distribution hierarchy. Rather, such proceeds serve to assist the debtor in reorganizing and ultimately benefit creditors in a more indirect fashion.\(^7\) Courts may find that the indirect-creditor benefit constitutes a benefit to the estate and therefore allows the trustee to pursue the avoidance action in accordance with § 550.

This Note examines the controversial split among the bankruptcy judiciary regarding the extent to which recovery can be pursued in a Chapter 11 reorganization in light of the requirement that recovery of avoidable transfers be pursued “for the benefit of the estate.”\(^8\) In exploring the potential effects the different interpretations of § 550’s requirement may have on future reorganizations under Chapter 11 of the Bankruptcy Code, this Note ultimately concludes that courts adopting a narrow interpretation of the requirements imposed by § 550 fail to recognize the importance of the debtor’s ability to maximize the success of its reorganization. Also, while an extremely broad definition of “for the benefit of the estate” is overreaching and impractical, an “honest liberal” approach is required in order to equip debtors with the necessary tools to attain a successful reorganization.

---

7. An example will further illustrate the issue. Suppose unsecured creditors receive, as part of their distributions under the debtor's plan, shares of stock in the reorganized debtor. If the estate ultimately recover proceeds from avoidance actions, then that recovery may not be paid directly to creditors, but would instead help the debtor complete a successful reorganization, thereby increasing the value of the shares received by unsecured creditors, which would benefit creditors in an indirect manner. See Trans World Airlines, Inc. v. Travellers Int'l A.G. (In re Trans World Airlines, Inc.), 163 B.R. 964, 973 (Bankr. D. Del. 1994); DuVoisin v. East Tenn. Equity Ltd. (In re Southern Indus. Banking Corp.), 59 B.R. 638, 641 (Bankr. E.D. Tenn. 1986). While creditors will ultimately profit from the increased value in their equity stake in the reorganized debtor, such a benefit is far more tenuous and unquantifiable than the benefit creditors receive from recovery of avoidable transfers in Chapter 7 cases.

I. Avoidance Actions in Bankruptcy Courts: § 550—Recovery “for the Benefit of the Estate”

While many state avoidance statutes provide that recovery of avoidable transfers under state law is limited to the extent necessary to satisfy creditors, the Bankruptcy Code provides no such limitation for recovery of avoidable transfers in bankruptcy cases.9 Instead, the Code requires that recovery be pursued “for the benefit of the estate.” Defining the meaning and scope of this facially ambiguous phrase has been the source of inconsistent case law.10

In 1994, in In re Acequia, Inc., the Court of Appeals for the Ninth Circuit confronted the issue of whether state avoidance statutes limit recovery under § 550.11 The Magistrate Judge permitted avoidance under § 544(b), but imposed a cap on the debtor’s potential recovery limiting recovery to the amount of unsecured claims paid on the distribution date identified in the debtor’s plan of reorganization.12 The Court of Appeals disagreed with the imposition of such a cap.13 As grounds for its position, the court noted the separate concepts of avoiding a transfer under applicable state law and recovering from the transferee under § 550 of the Bankruptcy Code:

... [A]fter demonstrating the right to recover conveyances under section 544(b), a trustee must then establish the amount of recovery under section 550(a) of the Bankruptcy Code, ... “to the extent that a transfer is avoided under section 544 ... the trustee may recover for the benefit of the estate, the property transferred.”14

Accordingly, the Court of Appeals permitted the debtor-in-possession to pursue recovery above and beyond the amount of allowed unsecured claims, and held that “[w]hile the transfer or obligation

9. While several state courts have addressed the issue of the extent to which recovery is permitted in avoidance proceedings under applicable state laws, because these cases are outside the federal bankruptcy context, the state courts do not have to consider the effect of the avoidance on the bankruptcy estate. For this reason, the precedential weight of these cases to a bankruptcy court is minimal. See, e.g., Bergquist v. Theisen (In re Theisen), 45 B.R. 122, 126-27 (Bankr. D. Minn. 1984). Without the presence of a bankruptcy estate, the only parties implicated by recovery are the debtor and the debtor’s creditors. Inside the bankruptcy world, however, the bankruptcy estate is affected by any recovery of avoidable transfers insofar as its ability to meet its obligations and ultimately consummate a plan or reorganization in a Chapter 11 case. For this reason, the effect of recovery of avoidable transfers in a bankruptcy setting, and particularly in the context of a Chapter 11 reorganization, extends beyond merely the debtor and its creditors to the bankruptcy estate, therefore differentiating the issue of recovery from state court avoidance actions.
11. 34 F.3d 800 (9th Cir. 1994).
12. See id. at 808.
13. See id. at 809.
must be voidable as against a creditor holding an allowable claim, the measure and distribution of recovery is not limited by the creditor's right."15 The court stated that, although "section 544(b) gives the trustee an unlimited right to invoke state-law avoidance powers . . . [t]he extent of the trustee's ability to exercise that right is, in turn, governed by section 550(a)."16 The court then noted that case law also recognizes the distinction between the ability to recover under § 544(b) and the extent to which recovery is permitted under § 550.17 Because of this innate separation, the court determined that the extent to which avoidable transfers can be recovered is limited only by § 550's requirement that recovery be pursued "for the benefit of the estate":

Our conclusion that Acequia has a right under section 544(b) to avoid transfers in excess of the amount of unsecured claims does not lead inexorably to the conclusion that Acequia may actually recover every transfer avoidable under that provision. Rather, the extent of Acequia's recovery is governed by section 550(a), which enables the corporation to pursue section 544(b) actions where recovery will accrue "for the benefit of the estate."18

Therefore, it is well established that § 550 governs recovery in bankruptcy proceedings rather than applicable state law,19 the issue arises, however, in determining the extent to which § 550 permits recovery. Although the words of the statute mandate that recovery be pursued "for the benefit of the estate," significant differences exist as to the meaning of this language. Courts, however, do agree that whether the estate will benefit from recovery "depends on a case-by-case, fact-specific analysis."20 Accordingly, our attention must turn to analyzing what constitutes a benefit to the estate.

15. Id. (citing 4 COLLIER ON BANKRUPTCY ¶ 544.03[1], at 544-17 n.12 (15 ed. 1994)(emphasis added)).
16. Id.
17. See id., citing Harris v. Huff, 160 B.R. 256, 261 (Bankr. M.D. Ga. 1993) ("A transaction that is voidable by a single, actual unsecured creditor may be avoided in its entirety, regardless of the size of the creditor's claim."); Abramson v. Boedeker, 379 F.2d 741, 748 n.16 (5th Cir. 1967) (if a transfer is avoidable at all by any creditor, "it is avoidable in full for all creditors regardless of the dollar amount of the prevailing claim."); see also Moore v. Bay, 284 U.S. 4 (1931).
18. Acequia, 34 F.3d at 811.
II. MISPLACED CREDITOR RELIANCE ON THE "EASY CASES"

Defendants in avoidance proceedings rely on cases where courts prevented trustees from pursuing recovery on the grounds that only the debtor would benefit from recovery; therefore, because recovery is not pursued "for the benefit of the estate," the trustee lacks standing under § 550.21 Often, however, reliance on these cases is misplaced because very few cases contain fact patterns which clearly suggest that the only party to benefit from recovery would be the debtor, and reliance on those should be reserved for defendants whose cases bear a striking resemblance to these "easy" cases.

In bankruptcy avoidance proceedings, defendants frequently cite Wellman v. Wellman's22 definition of "for the benefit of the estate." In that case, a Chapter 11 debtor gave selected creditors conditional, nonrecourse notes that were to be paid only out of the net recovery or settlement of actions pursued under § 550.23 As the district court noted:

If there is no net recovery, or if [the debtor-in-possession] chooses to abandon the lawsuits (as he has already done with one of them) he owes his creditors nothing more. Only if he chooses to pursue the lawsuit(s) and obtains a net recovery, or if he receives a settlement offer acceptable to his creditors which he rejects, does he owe these creditors anything.24

The district court, granting the transferee's motion for summary judgment, held that the debtor-in-possession lacked standing to pursue recovery because the debtor brought the avoidance action on its own behalf, not for the benefit of the estate.25 The district court reached this conclusion because it found that the debtor-in-possession attempted to create a claim in the estate so that it could obtain a "massive surplus recovery."26

The Court of Appeals for the Fourth Circuit upheld the district court's decision because the "debtor in possession may not recover the property transferred or its value when the result is to benefit only the debtor rather than the estate."27 Because the debtor's plan did

22. 933 F.2d 215.
23. See id. at 216.
24. Id. at 217.
25. See id. at 219.
26. See id.
27. Id. at 218; see also Weisman v. Eastlake Dev. Co. (In re Weisman), 112 B.R. 138, 141 (Bankr. W.D. Penn. 1990) ("[U]nder the scheme of the Bankruptcy Code, the debtor may assert rights on behalf of his creditors, but, especially in the case of an action to recover a fraudulent
not mention pursuit of avoidance actions in order to distribute proceeds to creditors, the debtor could use the proceeds as it pleased and thus, the recovery sought created a windfall for the debtor.

Although it is rare that only a debtor benefits from recovery, this precise situation recently resurfaced in *In re Dunes Hotel Associates*. In that case, a debtor-in-possession brought an avoidance action seeking recovery of real-estate transferred prepetition. A creditor challenged the proceeding, arguing that the debtor could not demonstrate any benefit to creditors from avoidance of the real-estate transfer. During the course of the case, the court found that the debtor had more than sufficient funds to satisfy all claims against the estate, with a substantial amount of equity remaining. Acknowledging this fact, the debtor-in-possession argued that "for the benefit of the estate" was not a concept strictly tied to or limited to providing any specific benefit to individual creditors. The bankruptcy court disagreed:

Where no creditors can benefit from the avoidance action, or where creditors benefit solely at the discretion of a debtor, the debtor does not have standing to bring the avoidance action . . . a debtor may not use an avoidance action to create a windfall for itself where there is no creditor benefit.

The court concluded that, because the debtor-in-possession had not met its burden of demonstrating a benefit to creditors, the estate would not benefit from recovery and, therefore, the debtor-in-possession lacked standing to bring the avoidance action. Like *Wellman*, *Dunes Hotel* was an "easy" case in that the estate had paid all the claims in full, and the only apparent reason the debtor sought recov-

---

28. See id. at 216.
29. See id. at 219.
31. See id. at 977.
32. See id. at 984.
33. See id. at 986 n.23.
34. See id. at 985.
35. Id.; see also Vintero Corp. v. Corpacion Venezolana de Formento (*In re Vintero Corp.*), 735 F.2d 740, 742 (2d Cir. 1984).
36. See id. at 987.
ery was to improve its own financial condition. The court reached the only logical holding: recovery would be inconsistent with § 550.

Courts must be reminded, however, that Wellman and Dunes Hotel represent extremely rare cases where only the debtor benefits from recovery, and therefore § 550's "for the benefit of the estate" requirement is not satisfied. While these holdings were appropriate considering the unusual circumstances before the respective courts, few cases arise where there is no legitimate dispute over who will benefit from recovery of avoidable transfers. For this reason, a creditor's reliance on cases such as Wellman and Dunes Hotel is almost always misplaced. When the facts do not establish a windfall for the debtor, courts determining who will benefit from recovery differ significantly in their interpretations of § 550 requirement that recovery be pursued "for the benefit of the estate." 38

III. THE NARROW SCHOOL

Those courts comprising the "narrow school" interpret § 550 to require that recovery of avoidable transfers result in a direct benefit to creditors. Such an interpretation of the Code's recovery provision is underinclusive because when the Code requires that recovery be pursued "for the benefit of the estate," it does not necessarily follow that recovery must directly benefit creditors. That is, a creditor may benefit secondary to the estate as long as the link between the estate's recovery and the creditors' benefit, as reflected in the ultimate distribution, is sufficient. For this reason, such a narrow reading of § 550, whereby creditors must receive a direct benefit in order for a trustee to be permitted to pursue recovery, is inconsistent with the underlying policies of the Code.

37. See id.

38. The Code does not specifically explain what happens when there is a surplus from recovery once creditors have received payment from the proceeds recovered in avoidance actions. The Court of Appeals for the Seventh Circuit, in In re FBN Food Services, Inc., 82 F.3d 1387, 1396 (7th Cir. 1996), recently noted that, in the context of a fraudulent conveyance action, "[o]nce the whole transfer has been pulled into the estate, the money is distributed according to the priorities established by the Code and the debtor's own commitments... But neither §§ 548 or 550] says, or implies, what happens if there is a surplus after all debts have been paid." Because of the factual uncertainty as to what may have happened to the surplus after the debtor's debts had been satisfied, however, the Seventh Circuit Court of Appeals remanded this issue back to the Bankruptcy Court for further factual findings not inconsistent with its opinion. See id. at 1397.

A case illustrating the narrow interpretation of § 550 is *In re Harstad*. After confirmation of the debtor's plan, the debtor-in-possession sought to avoid and recover an alleged preference. The transferee argued that the debtor-in-possession lacked standing to pursue the cause of action under § 550 because recovery would not have benefitted creditors of the estate.

The court first explained the specifics of the debtor's plan of reorganization: "The [debtor's] plan provides for a payment to creditors from a pot of money which will be unaffected by any preference recoveries. That payment will not increase if they were successful in recovering those preferences." While the debtor's plan seemingly implied that creditors would not directly profit from recovery, the debtor-in-possession argued that the preference recoveries would have nonetheless provided a benefit to the estate in that recovery would have assisted the debtor in paying its creditors pursuant to its plan.

The court, referring to the phrase "for the benefit of the estate," stated that "Congress carefully articulated its desire in section 550, artfully making sure it was the estate, i.e. creditors, and not the debtor who benefits from any preference recovery." The court, rejecting the debtor's argument, held that because the specifics of the debtor's plan were such that any proceeds obtained as a result of avoidance litigation would not directly benefit creditors, recovery would not benefit the estate, and therefore could not be pursued under § 550. As to the debtor's argument that recovery was essential to its ability to perform its obligations under its plan, the court reasoned that such an interpretation of § 550 incorrectly focus[es] on feasibility . . . [and] assume[s] that any increase in wealth to the reorganized debtor will benefit the creditors. I do not agree. After all, the debtors, not committing recoveries to their creditors, are in no way obligated to segregate or even keep the recoveries. That is, once preferences are recovered, the debtors have sole unrestricted authority to dispose of the preference recov-

40. 155 B.R. 500.
41. See id. at 503. For a definition and explanation of preferences, see 11 U.S.C. § 547 (1994).
42. Harstad, 155 B.R. at 511.
43. Id.
44. See id. at 512. The debtor's argument was made in reliance on *Tennessee Wheel & Rubber Co. v. Capton Corp. Air Fleet (In re Tennessee Wheel & Rubber Co.),* 64 B.R. 721, 725-26 (Bankr. M.D. Tenn. 1986). This argument and the reasoning underlying it will be examined and critiqued herein. See infra notes 70-76 and accompanying text.
45. Harstad, 155 B.R. at 511 (emphasis added).
46. See id.
They can spend, invest or even burn the recoveries. These actions do not benefit creditors. *Creditors must be meaningfully and measurably benefitted.* The amorphous benefits the plaintiffs claim here do not and will not suffice.47

While this decision may seem harsh in its rigidity, had the court found that the debtor would use the proceeds to help fund consummation of the plan, the bankruptcy court may have allowed the debtor-in-possession to proceed, deeming recovery under those circumstances consistent with § 550 of the Code.

In *In re Jennings, Inc.*, a bankruptcy court implemented the reasoning speculated above and held that, because proceeds from the avoidance action would ultimately be directed to help pay creditors pursuant to the debtor’s plan, recovery could be pursued consistently with § 550.48 In *In re Jennings*, the debtor’s Chapter 11 plan specifically provided that unsecured creditors were to receive twenty percent on their allowed claims; the plan, however, did not address whether the amount paid would be affected by recovery of avoidable transfers.49

The transferee, attempting to preclude the debtor from pursuing recovery, argued that all assets of the estate revest in the debtor upon confirmation of a plan.50 As a result, the transferee contended that any postconfirmation recovery would create a “windfall” to the debtor because the proceeds would not be distributed to creditors.51 The court agreed with this legal principle, but held that such a proposition is valid only if the debtor’s plan does not contain language indicating otherwise.52 Because of the debtor’s intention for the bankruptcy

47. *Id.* at 512 (emphasis added).
49. *Id.* at 169.
50. *See id.* at 169-70.
51. *See id.* at 170.
52. *See id.* The court noted that § 1141(b) of the Code allows a debtor to insert language in its plan and order of confirmation permitting the Bankruptcy Court to retain jurisdiction over some or all of the estate’s assets postconfirmation. *See id.* Section 1141(b) provides, in relevant part:

> "Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor."


The court noted that the debtor’s plan and order of confirmation expressly provided for retention of jurisdiction by the bankruptcy court over actions pending at the time of confirmation and those arising post-confirmation. *Jennings*, 46 B.R. at 170. The court further noted that the debtor also intended for the bankruptcy court to retain jurisdiction over any assets received as a result of those actions. *See id.* The specific provision of the debtor’s plan referenced by the court reads as follows:

> "Subject to Article VII hereof, the Bankruptcy Court will retain jurisdiction until this Plan has been fully consummated, including, but not limited to, the following purposes:
court to retain jurisdiction over postconfirmation actions, such as actions to recover preferences, the court allowed pursuit of recovery finding "if the debtor-in-possession has the powers of a trustee and if jurisdiction is specifically retained in the plan, the order of confirmation should not be the occasion for a windfall to the preferential transferee." Therefore, the court upheld the debtor-in-possession's right to pursue such causes of action because "recovery . . . would be beneficial to creditors even after confirmation by providing additional assets for fulfillment of the plan."

While it appears that the decision in In re Jennings reflects a broader construction of § 550 than does the reasoning employed in In re Harstad, both courts read into § 550 an unwritten requirement that, in order to pursue recovery of avoidable transfers consistently with § 550, some direct benefit to creditors must ensue. Even though the Jennings court permitted pursuit of recovery, it did so because any proceeds obtained ultimately would be used to pay creditors pursuant to the debtor's plan—a direct benefit to creditors.

Courts such as Jennings and Harstad that adhere to a narrow interpretation of § 550 zealously defend their position that creditors must receive a direct benefit in order for recovery to be pursued in accordance with § 550. Yet this interpretation of § 550 ignores an important goal of the Bankruptcy Code—allowing debtors to equip themselves with sufficient assets to emerge from bankruptcy protection alive and thereafter meet their obligations under their plan. By implementing such stringent standards in order to pursue recovery, the narrow school’s construction may preclude debtors from attaining this goal. For this reason, such a narrow interpretation of § 550 frustrates this central objective of the Code.

. . . (2) The determination of all questions and disputes regarding title to the assets of the estate, and determination of all causes of action, controversies, disputes, or conflicts, whether or not subject to action pending as of the date of confirmation, between the Debtors and any other party, including but not limited to, any right of the Debtors to recover assets pursuant to the provisions of the Code."

Id. The court finally stated that courts have consistently upheld postconfirmation jurisdiction by a bankruptcy court to recover avoidable transfers where the plan provided for retention of jurisdiction. See id. at 170-71.

53. Jennings, 46 B.R. at 171.

54. Id. Query whether an installment plan is enough to satisfy the Jennings court's rending of § 550.

55. Harstad, 155 B.R. at 512; Jennings, 46 B.R. at 170.

IV. The Broad School

Courts that broadly construe §550 differ in their liberal approaches to defining "for the benefit of the estate." Some courts take a more extreme position that pursuit of recovery should be allowed even if the creditors' ultimate benefit is indirect and remote; while other courts permit pursuit of recovery if there is a credible link between recovery and a benefit to the creditors. The extreme view, however, allows debtors-in-possession to abuse the privilege of recovering avoidable transfers. It is an "honest liberal" construction that allows debtors to utilize the Code's recovery provision so as to maximize the success of their reorganizations without abusing the statute's purpose.

A. The Extremist View

An example of an extreme interpretation of § 550 is the Court of Appeals for the Ninth Circuit's decision in *In re Acequia, Inc.* In that case, a Chapter 11 debtor brought a postconfirmation avoidance proceeding against its former controlling shareholder to avoid transfers made to the shareholder on the eve of the debtor corporation's bankruptcy filing. The transferee argued that the debtor-in-possession should be precluded from pursuing recovery in the fraudulent conveyance action because the debtor corporation paid all unsecured creditors in its plan of reorganization, and recovery would provide no benefit to the estate. The court rejected that argument and permitted pursuit of recovery.

In determining whether the estate would benefit as a result of recovery, the court held that "[f]irst, recovery would secure performance of Acequia's post-confirmation obligations under the plan of reorganization. . . . [S]econd, recovery would reimburse the bankruptcy

57. See, e.g., Acequia v. Travellers Int'l (In re Acequia, Inc.), 34 F.3d 800 (9th Cir. 1994).
59. 34 F.3d 800 (9th Cir. 1994).
60. See id. at 803.
61. See id. For a definition and explanation of fraudulent transfers, see 11 U.S.C. § 548 (1994). While a lone reader of an earlier draft of this article queried whether there was a different standard for fraudulent conveyances as opposed to preference or other avoidance litigation, I noted no discernable pattern.
62. See Acequia, 34 F.3d at 812.
estate for the costs of pursuing fraudulent conveyance litigation.”

What is significant is that the court not only deemed sufficient the debtor’s enhanced financial condition to satisfy the requirements imposed by § 550, but the court also hinted that the fact that recovery would assist the debtor in reimbursing the bankruptcy estate for the costs of pursuing avoidance actions constituted a benefit to the estate. The court’s pro-debtor stance can be summarized as follows: “[E]ven if the recovery did constitute a ‘windfall,’ . . . [w]e think it better to err on Acequia’s side.” In this case, the court suggests a radical expansion of § 550 by suggesting that where recovery would aid the debtor in reimbursing the bankruptcy estate for costs in litigating the avoidance action, the estate would benefit from recovery.

If the Acequia court’s reading of § 550 is followed, debtors may falsely believe that, within the legal confines of the code, recovery of any and all avoidable transfers can be pursued because, at the very least, recovery may assist the bankruptcy estate in funding the avoidance litigation. Such a construction dangerously implicates every transaction entered into by contracting parties.

B. The “Honest Liberal” View

Courts following the “honest liberal” approach find indirect “benefits” sufficient to satisfy the requirements of § 550, without overextending the section’s outer limits, because those courts find that the indirect benefits constitute a credible link between recovery and a benefit to the estate. An example of such a case is In re Centennial Industries, Inc., where the debtor’s plan of reorganization provided for fixed payments to unsecured creditors over a five-year period. The court permitted the debtor to pursue avoidance actions, reasoning that “any recovery by [the debtor] will increase the likelihood of the creditors receiving their future payments.... The recovery of [a] preference will be additional security for the fulfillment of the debtor’s plan.” Although the debtor-in-possession did not establish that re-

63. Id. (emphasis added).
64. See id.
65. Id.
66. See id. It is important to remember, however, that Acequia involved a fraudulent conveyance. See id. at 813. Therefore, the precedential value of the decision in a preference case is uncertain.
69. Id.
covery was absolutely essential to the debtor's ability to successfully meet its obligations under its plan, the court reasoned that, because recovery would increase the likelihood that the debtor would be able to meet its obligations under its plan, § 550 was satisfied.\textsuperscript{70}

Five years later, in \textit{In re Tennessee Wheel & Rubber Co.}, a bankruptcy court faced a similar issue.\textsuperscript{71} The debtor-in-possession sought to pursue recovery in avoidance proceedings even though unsecured creditors received a fixed distribution under the plan and stood to gain no tangible benefit from the § 550 litigation.\textsuperscript{72} The bankruptcy court nonetheless found that a benefit to the estate existed because the debtor funded its plan with a line of credit secured by postconfirmation assets, and, absent such financing, "unsecured claim holders would have received no distribution. The retention of power to pursue avoidance actions . . . was the consideration for [the] post-petition and post-confirmation advances to th[e] debtor. No reorganization was possible without [the] new advances."\textsuperscript{73} Thus, the court held that recoveries from the avoidance actions were essential to the debtor's ability to pay its creditors pursuant to the confirmed plan.\textsuperscript{74} The court determined that § 550 was satisfied by ensuring an enhanced financial condition of the debtor and that, even though unsecured creditors would not benefit directly, recovery was essential to the debtor's ability to perform its obligations under its plan.\textsuperscript{75}

In both cases the courts adopted a liberal construction of the requirements imposed by § 550, without over-extending the reach of the Code. In \textit{In re Tennessee Wheel & Rubber Co.}, the court determined that reorganization was not possible without allowing pursuit of recovery in avoidance actions.\textsuperscript{76} In \textit{In re Centennial Industries, Inc.}, however, the court adopted a more liberal position, reasoning that an increase in the financial condition of the debtor necessarily provided additional security that payments under the plan could be achieved, and the increased likelihood that recoveries would enhance the probability of a successful reorganization constituted a benefit to the

\textsuperscript{70} \textit{See id.}
\textsuperscript{71} \textit{64 B.R. 721 (Bankr. M.D. Tenn. 1986).}
\textsuperscript{72} \textit{See id. at 726.}
\textsuperscript{73} \textit{Id.}
\textsuperscript{74} \textit{See id.; see also Citicorp Acceptance Co. v. Robison (In re Sweetwater), 884 F.2d 1323, 1329 (10th Cir. 1989) ("Preference claims may be a source of future cash that can eventually pay administrative claims.").}
\textsuperscript{75} \textit{See Tennessee Wheel & Rubber Co., 64 B.R. at 726.}
\textsuperscript{76} \textit{Id.}
RECOVERING AVOIDABLE TRANSFERS

estate satisfying § 550. Together these cases present classic illustrations of situations where debtors are able to maximize their potential to emerge from bankruptcy protection alive and complete a successful reorganization through the recovery provision of the Bankruptcy Code, without a bankruptcy court having to jeopardize traditional notions of statutory construction in order to attain such a goal.

Presented with a different set of circumstances, the bankruptcy court in In re Southern Industrial Banking, Inc., also adhered to the "honest liberal" philosophy in construing § 550 so as to allow a debtor-in-possession to pursue recovery in an avoidance proceeding. In that case, the debtor's plan provided that all general unsecured creditors would receive, as part of their distribution, either actual shares of stock or certain rights to purchase shares of stock in the successor-in-interest. The debtor brought an avoidance action post-confirmation seeking recovery of fraudulent conveyances under § 550, and the court allowed pursuit of recovery, stating:

Clearly, to the extent that plaintiff's recovery of fraudulent transfers and preferences operates to increase the assets and financial health of the successor-in-interest, it also operates to proportionally increase the value of those ownership rights in the successor-in-interest which constitute a portion of the unsecured creditors' distribution under the plan.

Thus, the bankruptcy court determined that because recovery under § 550 may increase the value of the reorganized debtor, and because the general unsecured creditors received, as part of their distribution, ownership interests or the right to acquire such interests in the reorganized debtor, recovery may therefore increase the value of the distribution to general unsecured creditors. As a result, the link between

77. See Centennial Indus., Inc. v. NCR Corp. (In re Centennial Indus., Inc.), 12 B.R. 99, 102 (Bankr. S.D.N.Y. 1991). The Bankruptcy Court of the Southern District of New York is not alone in interpreting § 550 in such a broad fashion. See Greenbelt Cooperative, Inc. v. Werres Corp. (In re Greenbelt Cooperative, Inc.), 124 B.R. 465, 473 (Bankr. D. Md. 1991), where the court wrote: "A recovery by Debtor in this [avoidance] proceeding will improve Debtor's financial health to the extent of the recovery. . . . It will thereby increase the likelihood that Debtor's reorganization will be successful and that Debtor will be able to make its deferred plan payments." The court continued: "since avoidance will enhance the likelihood of Debtor's successful reorganization, avoidance . . . does not constitute a windfall to Debtor without benefit to creditors, and equitable principles do not bar avoidance." See id. at 474; see also Funding Sys. Asset Management Corp. v. Chemical Bus. Credit Corp. (In re Funding Sys. Asset Management Corp.), 111 B.R. 500, 523 (Bankr. W.D. Pa. 1990) ("All that is required is that recovery by Debtor will increase its assets and improve its financial health to the extent that the likelihood is improved of its being able to satisfy its obligations to its creditors under the Plan.").

79. See id. at 640-41.
80. Id.
81. See id.
recovery and creditors’ benefit was sufficient to constitute a benefit to the estate, and therefore the debtor-in-possession could pursue recovery consistent with § 550.82

This precise issue was relitigated two years ago in a Delaware bankruptcy court.83 In In re Trans World Airlines, Inc., as in In re Southern Industrial Banking, Inc., the bankruptcy court’s interpretation of § 550 permitted pursuit of recovery in avoidance actions where distribution to unsecured creditors was fixed by a confirmed plan of reorganization and the amount distributed would remain unaffected by any recovery of avoidable transfers.84 The debtor-in-possession argued that it should be entitled to pursue § 550 actions postconfirmation since recovery would benefit the estate. The recovery would increase the value of the reorganized debtor and the value of the shares held by the unsecured creditors would increase accordingly; and “while the recovery will not be paid out in kind to general unsecured creditors, it will indirectly benefit them by enhancing the value of a company in which they now have debt claims and equity interests.”85

The court agreed with the debtor-in-possession and held that pursuit of recovery would be consistent with § 550 because the litigation would benefit the estate if the recovery would increase the value of the reorganized debtor.86 The court stated:

Section 550(a) requires a benefit to the “estate,” not to creditors. “Estate” is a broader term than “creditors.” There is no requirement that an avoidance action recovery be distributed (or “committed”) in whole or in part to creditors. . . . [T]he Code clearly contemplates the use of avoidance action recoveries in the operation of the business in a manner which only indirectly benefits creditors.87

The court then explained the specific implications of the case at bench:

TWA argues, and I agree, that the unsecured creditors will benefit from the enhanced value of the reorganized TWA by reason of being shareholders of the reorganized debtor. . . . While these benefits

82. See id.
84. Id. at 969. In a case almost factually identical to In re Southern Industrial Banking Corp., In re Trans World Airlines, Inc., the court awarded unsecured creditors, in full satisfaction of their claims, a pro-rata dollar amount as well as over three million shares of new preferred stock in the reorganized debtor. See id.
85. Id.
86. See id. at 972.
87. Id.
may not be “committed” to the creditors or be quantifiable as to them, the benefits are nevertheless real. More importantly, the benefit to the estate is quantifiable, and the estate is the focus of §550, not individual creditors. How, in any particular case, a recovery is used and whether any of it is distributed to creditors is a function of the conduct of the case and the negotiations of the plan of reorganization. The basic purpose of a recovery pursuant to §550 is to enlarge the estate for the benefit of creditors. Any recovery by TWA here will do that.88

The bankruptcy courts in In re Trans World Airlines, Inc. and In re Southern Industrial Banking, Inc., both adopting the “honest liberal” approach, construed the Code’s recovery provision broadly so as to allow pursuit of recovery even though creditors of the bankruptcy estates would not directly benefit from such recovery, but refrained from over-extending § 550’s reach so as to undermine the policies of the Code. In each situation, it was not difficult for the courts to reason that postconfirmation recovery of avoidance actions constituted “benefits” to the estate because the enhanced financial condition of the debtor increased the value of the ownership rights in the reorganized debtor, which the unsecured creditors received as part of their distribution under the respective plans. In other words, in both cases, a credible link existed between recovery of the avoidable transfers and an improved financial condition of the unsecured creditors; this credible link was all the courts needed to conclude that the requirements imposed by § 550 had been satisfied.89

This position, assumed by those courts adopting the “honest liberal” approach, accurately reflects the appropriate reach of the Code’s recovery provision, without stretching the outer limits so far as to inhibit the furtherance of the underlying objectives of the Bankruptcy Code. By allowing enough flexibility to pursue recovery of avoidable transfers in situations where, although creditors may not directly benefit, the interests of the bankruptcy estate are enhanced, debtors are in a better position to complete a successful reorganization without disturbing the Code’s resolute interest in protecting the fair treatment of creditors and ensuring a fair distribution on all claims.

88. Id. at 973.
V. PRESERVING THE CODE'S TRADITIONAL OBJECTIVES WITHOUT VIOLATING ITS ESTABLISHED BOUNDARIES

Courts adopting a narrow construction of § 550 may inhibit debtors from maximizing the potential of their reorganization efforts. Requiring a direct-financial benefit to creditors from recovery of avoidable transfers is a clear illustration of bankruptcy courts creating delays on the debtor's road to a successful reorganization. On the other hand, courts interpreting § 550 too broadly may provide a windfall to debtors at creditors' expense. If too liberal a construction is accorded, courts could afford debtors the means to legally undo every avoidable transfer. This result would tilt the system too far in the debtors' favor and disturb a basic aim of the Bankruptcy Code: protecting the fair treatment of creditors.

A formulaic approach best summarizes the controversy of recovering avoidable transfers under § 550. The following diagram represents the possible flow of proceeds from a successful recovery in a typical avoidance action. The transferee returns the subject property, or the value thereof, to the estate, which allocates the proceeds according to the debtor's plan of reorganization. The diagram illustrates how proceeds may be allocated directly to the reorganized debtor (arrow X) or directly to the creditors (arrow Y). As illustrated, proceeds may ultimately be channeled to creditors indirectly (arrow Z), in the form of payments or other benefits.

To illustrate the practical application of the table, the values X, Y, and Z will be given values depending on the factual scenario before the court. No benefit will be designated by "0" (zero), and any value equaling some benefit above "0" (zero), albeit an unspecified amount, will be designated by "> 0".

Transferee

\[
\text{Estate} \\
\text{Y} \quad \text{X} \\
\text{Creditors} \quad \text{Reorganized Debtor} \\
\text{Z}
\]
First, in the "easy" cases discussed in Part II, the court encounters a possible flow of recovered proceeds to the reorganized debtor, without any subsequent benefit to creditors. This is designated in the diagram by $X > 0$, $Y = 0$, and $Z = 0$. In this case, the court makes the logical decision of deeming recovery inconsistent with the Code's objectives because recovery merely constitutes a windfall to the debtor.

In a typical liquidation bankruptcy, the proceeds enter the estate, therefore enlarging the creditors' respective distributions, and, ultimately, are allocated to creditors pursuant to their respective positions on the distribution hierarchy. In this situation, $X = 0$, $Y > 0$, and $Z = 0$, because there is no reorganization. This is also the view adopted by the "narrow school." Courts construing § 550 in a narrow fashion purport that creditors must directly benefit from recovery of avoidable transfers in order for recovery to be pursued consistently with the Code.

Courts adopting the "broad school" approach would allow pursuit of recovery even when $Y = 0$, so long as both $X > 0$ and $Z > 0$. The dispositive inquiry becomes how large must $Z$'s probable value be in order for a court to find a credible link and therefore allow the debtor-in-possession to pursue recovery. According to the extremist view, it appears that a court would allow a debtor-in-possession to pursue avoidance actions where $Z$'s value is extremely minimal; that is, even where creditors' indirect distribution may be insignificant. In this case, while creditors receive no direct benefit from recovery, and any indirect benefit is insignificant, the court may determine that § 550 is satisfied because even a slight indirect benefit to creditors constitutes a benefit to the estate.

Courts adopting the "honest liberal" view, on the other hand, require not only that $Z > 0$, but that $Z$'s value is high enough to establish the credible link therefore justifying pursuit of recovery. In this case, the court determines that the eventual benefit that will accrue to

---

91. One reader of an earlier draft even suggested that, ideally, upon recovering avoidable transfers, the estate should designate a specific account for the proceeds and allocate those proceeds directly to creditors. I discovered no case law supporting this proposition, but, nonetheless, such a theory would represent an extremely narrow reading of § 550.
92. While some will question how the court should determine whether $Z$'s value is such that pursuit of recovery is justifiable under § 550, I would suggest that, as the Bankruptcy Court for the Central District of Illinois stated, "the answer to that question depends on a case-by-case, fact specific analysis." Barber v. McCord Auto Supply, Inc. (In re Pearson Indus., Inc.), 178 B.R. 753, 758 (Bankr. C.D. Ill. 1995) (discussing whether the estate will benefit from recovery).
creditors, albeit indirect, is significant enough that recovery can be pursued in accordance with the Code's underlying policies.

CONCLUSION

The debate over how to interpret § 550 of the Bankruptcy Code requires prompt resolution. Armed only with the knowledge that recovery of avoidable transfers can be pursued "for the benefit of the estate," bankruptcy courts attempting to construe this ambiguous language lack the necessary guidance to correctly adjudicate difficult issues arising in avoidance litigation. Because of the obvious differences which exist among the bankruptcy judiciary, the U.S. Supreme Court must ultimately determine the precise scope of § 550. If the Supreme Court decides to tackle this controversial statutory-construction issue, it should confirm the "honest liberal" approach. The Court should preserve the Code's innate objective to provide debtors the opportunity to maximize the success of their reorganizations without creating an unnecessary and dangerous pro-debtor bias in the system which could ultimately undermine the Code's longstanding policies.

Debtors reorganizing under Chapter 11 must be allowed to maximize the success of their reorganizations and equip themselves with an adequate arsenal of assets to emerge from bankruptcy protection alive. For this reason, an "honest liberal" approach of permitting recovery of avoidable transfers should be confirmed, thereby preserving the Code's primary objectives. Somewhat strict and consistent standards must be applied in determining whether recovery can be pursued, and trustees must not be allowed to pursue recovery when it would serve no substantial purpose except to provide the debtor with a windfall. Ultimately, when properly interpreted, recovery of avoidable transfers under § 550 of the Bankruptcy Code should be permitted when a credible link exists between recovery and creditor benefit.