

Current Issues in Avoidance Actions

Assignment of Avoidance Actions and Tolling Agreements

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I. Introduction

A. Avoidance Actions are Not Property of the Estate Which Can be Assigned Under Section 1123(a)(5) of the Bankruptcy Code.

Section 1123(a)(5) of title 11 of the United States Code (the “Bankruptcy Code”) provides for various ways in which property of a debtor’s estate may be distributed, sold and retained under the debtor’s chapter 11 plan without any limits on assignability. 11 U.S.C. §1123(a)(5). Courts have held that a debtor’s avoidance powers are not property of the estate for various reasons. For example, in *Harstad v. First Am. Bank*, 39 F.3d 898 (8th Cir. 1994), the court held that avoidance actions were not property of the estate because section 1123(b)(3)(B) requires that a debtor’s chapter 11 plan specifically reserve the ability to commence avoidance actions. Other courts reason that the right to commence an avoidance action is a statutory right as opposed to a property right. *See, e.g., Sweetwater*, 55 B.R. 724 (D. Utah), *superseded on other grounds by* 884 F.2d 1323 (10th Cir. 1989) (explaining the difference between property of the estate and avoidance powers as being that property of the estate belonged to the debtor first and was acquired by the estate, whereas avoidance powers were never the debtor’s property and are powers that Congress gave to the trustee specifically).

B. Section 1123(b) Governs Assignment of Avoidance Actions.

Section 1123(b) provides that a plan of reorganization “may provide for the *retention and enforcement* by the *debtor*, by the *trustee*, or by a *representative* of the estate appointed for such a purpose, of any such claim or interest.” 11 U.S.C. §1123(b) (emphasis added). Given the express language of section 1123(b), courts have held that section 1123(b) governs who can pursue avoidance actions in a post-confirmation setting. *See, e.g., In re Sweetwater*, 884 F.2d 1323 (concluding that in adopting section 1123(b)(3)(B), Congress decided to provide for flexibility in the use of avoidance actions).

II. Assignment of Avoidance Actions Under 1123(b)

A. An Assignee Must Qualify as a Representative of the Estate under a Plan of Reorganization.

Under section 1123(b), the trustee, debtor, or a representative of the estate may pursue avoidance actions. The cases addressing section 1123(b) fall under two categories – cases where the debtor is the assignee of the avoidance powers and cases where a third party is the assignee of the avoidance powers.

1. Debtor Assignee

Section 1123(b) clearly provides for the debtor’s right to bring post-confirmation avoidance actions. However, the statute is unclear as to the capacity in which the debtor may bring the avoidance actions. Generally, courts will not allow a debtor to bring an avoidance action solely for his own benefit.

i. *In re Calvanese*, 169 B.R. 104 (Bankr. E.D. Pa. 1994). The court refused to confirm a plan in which the debtor retained the right to bring all chapter 5 causes of action and where any recoveries would belong to the debtor and not the estate for the benefit of creditors.

ii. *In re Sapolin Parts, Inc.*, 11 B.R. 930 (Bankr. E.D.N.Y. 1981). The purchaser of the debtor’s assets brought suit to require the debtor to bring an avoidance action. The purchaser based its suit on the purchase agreement which provided that the debtor was required to take all necessary steps to vest, perfect, or confirm the purchaser’s title to the debtor’s assets. The court refused to require the debtor to institute the preference action where only the purchaser of the debtor’s assets would have benefited from any recovery as opposed to the debtor’s creditors.

2. Third Party Assignee

The framework for determining whether a non-debtor party may bring an avoidance action under 1123(b)(3) was set forth in *In re Texas General Petroleum Corp.*, 52 F.3d 1330 (5th Cir. 1995). In that case, the court held that the party seeking to assert the avoidance action must show that it is an appointed representative of the estate. The primary test for whether a party is a representative of the estate is whether the pursuit of the avoidance actions would benefit the debtor’s estate and primarily, the debtor’s unsecured creditors. The party bringing the claim need not necessarily be a “representative” of the entire estate, but in that case, courts will strive to find additional benefits to the unsecured creditors from the assignment.

i. *In re Sweetwater*, 884 F.2d 1323 (10th Cir. 1989). The court upheld an assignment of the avoidance powers to a representative of only the administrative claimants, finding that the chapter 11 plan appointing the representative was approved by all creditors and that the avoidance action proceeds would be used to satisfy administrative claims thus making more funds available to unsecured creditors.

ii. *In re Churchfield Mgmt. & Invest. Corp.*, 122 B.R. 76 (Bankr. N.D. Ill. 1990). The court approved a chapter 11 plan giving a party the right to bring avoidance actions in exchange for the party's prior payment of money into two estate funds, one for the estate's creditors and the other for the estate's administrative expenses. The plan specifically stated that the party was the representative of the estate for the sole purpose of continuing the actions assigned to it in the settlement agreement.

iii. *In re Mako, Inc.*, 120 B.R. 203 (Bankr. E.D. Okla. 1990). The court refused to permit the purchaser of the debtor's assets (including certain avoidance actions) from pursuing such avoidance actions. The court reasoned that because the purchaser was not required to distribute any of the proceeds from the prosecution of the avoidance actions to the debtor's creditors, the purchaser could not be a representative of the estate entitled to assert the actions.

3. Appointment as Representative

Appointment of a representative must be approved by the court and cannot be accomplished by a unilateral declaration by the debtor in possession. Courts have generally agreed that approval of a chapter 11 plan that provides for the appointment of the representative by the creditors and the court is sufficient. *Sweetwater*, 55 B.R. 724 (D. Utah 1985), *superseded on other grounds by* 884 F.2d 1323 (10th Cir. 1989).

When the chapter 11 plan does not expressly provide for the retention of avoidance powers, some courts have found that the avoidance powers are lost. On the other hand, some courts do not require a clear and unequivocal retention of avoidance powers and will look at parol evidence to determine the intent of the chapter 11 plan. *See Texas General Petroleum Corp.*, 52 F.3d 1330 (5th Cir. 1995) (finding that the plan was ambiguous as to who retained the right to pursue avoidance actions after confirmation and holding that the bankruptcy court correctly considered parol evidence to determine the parties' intent).

B. Pursuit of the Avoidance Actions Must Benefit the Estate.

1. Benefit May Occur Before the Avoidance Recovery

The benefit to the estate need not occur after the avoidance recovery. Some courts are mindful that "the benefit may come directly from the transfer of the claim itself" rather than from the recovery. *I. Appel Corp. v. Val Mode Lingerie, Inc.*, 2000 WL 231072, *4 (S.D.N.Y. 2000).

i. *In re Maxwell Newspapers, Inc.*, 189 B.R. 282 (Bankr. S.D.N.Y. 1995). The court held there was a benefit to the estate where the creditors withdrew their \$93 million claim in exchange for the assignment of certain avoidance claims.

ii. *In re Churchfield Mgmt. & Inv. Corp.*, 122 B.R. 76 (Bankr. N.D. Ill. 1990). The court approved a chapter 11 plan in which the avoidance claim was exchanged for a direct payment to the creditors and the estate's administrative expenses.

2. Where the Only Benefit to the Estate is the Proceeds of the Sale

Courts are split as to whether an avoidance action may be sold where the only benefit to the estate is the proceeds of that sale.

i. *In re Prof'l Inv. Props.*, 955 F.2d 623 (9th Cir. 1992). The court allowed an assignee to pursue avoidance actions he bought from the trustee. Although the assignee was not specifically identified for the purpose of enforcing the debt pursuant to a chapter 11 plan, the court concluded that he could “best be identified as a representative appointed to enforce the debt in line with section 1123(b)(3)(B).” *Id.* at 626. The court also noted that the trustee had originally asserted the avoidance powers and that refusing to allow the assignee to stand in the trustee’s shoes would frustrate the “obvious wish of the bankruptcy court to end its participation in the matter.” *Id.*

ii. *In re Metal Brokers Int'l, Inc.*, 255 B.R. 920 (Bankr. E.D. Wis. 1998). A creditor sought to avoid prepetition transfers, basing his standing on an order authorizing the assignment of three adversary proceedings to the creditor by the chapter 7 trustee and on *Prof'l Inv. Props.* *Id.* at 921. The *Metal Brokers* court stated that the order was approval of a mere quitclaim assignment and did not guarantee the assignability of the rights. *Id.* at 923. Further, the court relied on *North Atlantic Millwork Corp.*, 155 B.R. 271 (Bankr. D. Mass 1993), a case reaching the exact opposite conclusion than *Prof. Inv. Prop.*, rejecting the creditor’s argument that the assignment benefited all the creditors because the assignee’s payment of \$15,000 to the trustee would be distributed as a dividend to all creditors. *Id.*

iii. *In re North Atlantic Millwork Corp.*, 155 B.R. 271, 276 (Bankr. D. Mass. 1993). Before this chapter 11 case was converted to a chapter 7 case, the court approved a sale of the debtor’s assets and rights to bring all causes of action of the debtor’s estate to a creditor under an asset purchase agreement. The assignee argued that had the debtor’s assets not been sold, there would have been no distribution to the general unsecured creditors compared to the \$125,000 distribution of the proceeds of the sale. *Id.* at 279. First, the court held that a sale order does not satisfy the first part of the test – the appointment of a representative *under a plan of reorganization*. Second, the court held that even if the sale order qualified as an appointment, the creditor was not a representative of the estate, as there was no benefit, at least at that point, to the unsecured creditors of the estate. *Id.* at 284. It is important to note, however, that some aspects of the payment were likely influential in the court’s decision that the unsecured creditors received no benefit. The \$125,000 payment was made by note that was neither guaranteed nor secured, and since payment under the note was not payable until some time in the future, no benefit had reached the unsecured creditors at the time. *Id.* at 284.

C. Decisions Vary Regarding the Extent to Which Avoidance Actions Must Benefit the Estate.

Courts are divided as to the amount of benefit the estate must receive to satisfy the requirement that the party bringing the avoidance action is a representative of the estate and section 550(a)'s requirement that recovery of property pursuant to an avoided transfer be "for the benefit of the estate."

1. Benefit/Indirect Benefit Cases

Some courts allow an assignee to assert an avoidance action so long as there is some benefit to the estate. The benefits in these cases have been indirect, as they are not tied to the successful recovery under the avoidance actions. Courts applying this standard have included as a benefit to the estate anything that positively influences the debtor's general financial health and increases the likelihood that the debtor will meet its post-confirmation obligations to creditors.

i. *In re Tenn. Wheel & Rubber Co.*, 64 B.R. 721 (Bankr. M.D. Tenn. 1986). The debtor pledged avoidance recoveries to secure a post-confirmation line of credit. The court found that this was a sufficient benefit to justify the debtor's retention of the avoidance powers, since without the line of credit, unsecured creditors would have received no distribution.

ii. *In re Churchfield Mgmt. & Invest. Corp.*, 122 B.R. 76 (Bankr. N.D. Ill. 1990). The court held the assignee had standing to pursue the avoidance actions, even though the only benefit to the estate was given in exchange for the assignment of avoidance actions and any recovery was to go to the assignee alone. In exchange for the assignment of the avoidance actions, the assignee made a direct distribution to the estate's creditors and the estate's administrative expenses under a settlement agreement incorporated into the chapter 11 plan.

iii. *In re Burlington Motor Holdings, Inc.*, 2002 WL 73490, *2 (D. Del. 2002). The court permitted a successor corporation to pursue avoidance actions where the successor corporation had given \$3.8 million to the debtor's unsecured creditors and taken on liability for the estate's administrative claims in exchange for all of the debtor's assets, which included the avoidance actions. The court looked at the total bargain under the chapter 11 plan and concluded that the total bargain benefited the estate.

iv. *In re Furrs*, 294 B.R. 763 (Bankr. D.N.M. 2003). Where trustee had agreed to pay two thirds of the net proceeds from avoidance recoveries to lenders, actions still constituted a benefit to the estate.

v. *Mellon Bank N.A. v. Dick Corp.*, 351 F.3d 290 (7th Cir.2003). The court permitted lenders that advanced funds to keep the debtor afloat pending its sale to assert avoidance actions even though the first thirty million dollars of preference recoveries would go to those lenders.

2. Creditors Converted to Equity after Confirmation

Courts have approved the right of former creditors, who were given equity interests in the successor corporation for their claims against the debtor corporation, to bring avoidance actions where the recoveries go to the successor corporation.

i. *In re Amarex, Inc.*, 96 B.R. 330 (W.D. Okla. 1989). The debtor's unsecured creditors received stock in the parent company of the reorganized debtor. The court found that recovery on the avoidance actions brought by the creditors would increase the financial assets of the debtor's successor-in-interest and would thus increase the value of the ownership rights of the unsecured creditors.

ii. *In re P.A. Bergner & Co. Holding Co.*, 187 B.R. 964 (Bankr. E.D. Wis. 1995). The bankruptcy court confirmed a preference judgment in favor of the reorganized debtor, where the shareholders of the reorganized debtor were investors who bought fully or partially secured bank debt and received stock of the reorganized company in satisfaction of their claim.

iii. *In re Kroh Bros. Dev. Co.*, 100 B.R. 487 (Bankr. W.D. Mo. 1989). The debtor and an outside party formed a partnership in which the debtor's contribution to the partnership was avoidance actions. The other party contributed capital loans and operational assistance. The funds generated by the debtor's interest in the partnership were to be distributed to the debtor's creditors. The court held that this split of proceeds was allowable.

3. Direct Benefit to the Estate

The least controversial scenario is when a party is assigned the right to pursue avoidance actions under a plan of reorganization and the assignment directly benefits the estate. Such situations fall squarely within section 1123(b)(3)(B)

D. Assignment of Avoidance Actions Outside of a Plan of Reorganization.

Although section 1123(b) specifically provides that an assignment be made under a chapter 11 plan, not all courts have required that the assignment of an avoidance action be made under a plan.

1. Cases Allowing Assignment Outside of a Plan of Reorganization

i. *In re Prof'l Inv. Props. of Am.*, 955 F.2d 623 (9th Cir. 1992). The chapter 7 trustee sold its avoidance powers to a creditor. The court held that this was nevertheless permissible under section 1123(b)(3)(B) so long as the creditor was pursuing interests common to all creditors, because although he was not specifically identified for the purpose of pursuing a debt in line with section 1123(b)(3)(B), he could "best be identified as a representative."

ii. *In re P.R.T.C.*, 177 F.3d 774 (9th Cir. 1999). The court held that avoidance actions may be assigned in chapter 7 cases. In this case, the debtor's estate was

entitled to receive 50% of the net proceeds from the avoidance action recoveries. Absent the assignment, the estate would not have been able to pursue the actions because it did not have sufficient funds to pursue the claims.

III. Applicability of Tolling Agreement to Assignees of Avoidance Actions

A. Tolling Agreements Are Enforceable.

Section 546(a) specifies the time period limitations for avoiding powers. Courts have concluded that section 546(a) is a true statute of limitations. As such, tolling agreements with respect to preference actions are enforceable.

i. *In re Outboard Marine Corp.*, 299 B.R. 488, 498 (Bankr. N.D. Ill. 2003) (“In addition to the weight of authority finding that § 546(a) is a statute of limitations and the lack of persuasive analysis in support of the jurisdiction position, the plain language of the provision, the statutory arrangement, and the legislative history all strengthen the conclusion that § 546(a) is a true statute of limitations that can be waived.”).

ii. *In re Commercial Fin. Servs.*, 294 B.R. 164, 175 (Bankr. N.D. Okla. 2003) (“[T]he analysis of the relevant law in this area leads the Court to the inescapable conclusion that § 546(a) is a statute of limitations and not a statute of repose that may be waived or extended by an agreement between the parties”).

B. Assignees Generally Succeed to the Statute of Limitations Applicable to the Assignor Under Non-Bankruptcy Law.

Generally, an assignee will succeed to the limitations applicable to the assignor. *In re Boyajian*, 367 B.R. 138 (B.A.P. 9th Cir. 2007). Specifically, an assignee’s time to sue is the limitation period applicable to the assignor, as he does not obtain a right greater than that of the assignor by taking a new limitation upon obtaining the right to sue. *St. Louis Union Trust Co., v. Hunt*, 169 S.W.2d 433 (Mo. Ct. App. 1943). Courts have held this to be the rule because “the statute of limitations is directed to the *claims* sought to be asserted, not to the *parties* seeking to assert them.” *McCloskey & Co., Inc. v. Wright*, 363 F. Supp. 223, 227 (E.D. Va. 1973) (emphasis added).

C. The Two-Year Statute of Limitations For Avoidance Actions Applies to Estate Representatives.

Parties bringing avoidance actions as estate representatives are subject to the two-year statute of limitations running from the appointment of the debtor in possession at the entry of the order for relief.

i. *Starzynski v. Sequoia Forest Indus.*, 72 F.3d 816 (10th Cir. 1995) (holding that the estate representative did not obtain an extension of the initial two-year limitation period of the debtor-in-possession).

D. Tolling Agreements Should Pass With the Assignment of the Avoidance Rights.

As a tolling agreement is just a contract between the assignor (usually the trustee) and a potential preference defendant, traditional contract rules should apply and the tolling agreement, if executed by the trustee, will pass to the assignee of the avoidance actions (the estate representative).

i. *Citibank, N.A. v. Tele/Resources, Inc.*, 724 F.2d 266, 269 (2d Cir. 1983) (“[A]n assignment does not modify the terms of the underlying contract. It is a separate agreement between the assignor and assignee which merely transfers the assignor's contract rights, leaving them in full force and effect as to the party charged. Insofar as an assignment touches on the obligations of the other party to the underlying contract, the assignee simply moves into the shoes of the assignor.”).