Recovering Under § 549

By Andrea Dobin and Ross J. Switkes
When trustees wax eloquent about their ability to recover funds for estates using their “avoiding powers,” they are almost always speaking of the preference and fraudulent transfer causes of action established by §§ 544, 547, and 548 of the Bankruptcy Code. The stepstis to these popular causes of action, however, is § 549. By its terms, § 549 seeks the recovery of unauthorized post-petition transfers of property of the estate. Although it appears to be a very clear path to recovery by Chapter 7 trustees, the way in which it has been applied creates unexpected barriers to success.

Generally, voluntary Chapter 7 cases arise in two procedural postures: (i) filing as a Chapter 7 or (ii) conversion from another chapter. The application of § 549 in a case initially filed as a Chapter 7 is quite straightforward. The facts usually involve a debtor either transferring title to, or granting a security interest in, property of the estate without the knowledge and/or consent of the Chapter 7 trustee or the Bankruptcy Court. These claims fit easily within the language of § 549, which provides in relevant part that, subject to certain limited defenses:

(a) . . . the trustee may avoid a transfer of property of the estate
(1) that occurs after the commencement of the case; and
(2) (A) that is authorized only under Section 303(f) or 542(c) of this title; or
(B) that is not authorized under this title or by the court.

11 U.S.C. § 549. In situations where, for example, an individual debtor transfers non-exempt liquid assets to support his/her lifestyle, or to family to avoid liquidation by the trustee, the trustee’s path to recovery is clear. The trustee can either (i) ignore the fact of the transfer and file a motion for turnover against the debtor resulting in an order which, if the debtor disobeys, puts his/her discharge at issue under 11 U.S.C. § 727(a)(6)(A); or (ii) sue the recipient of the transfer for recovery under 11 U.S.C. §§ 549 and 550. See e.g., Brown v. Pyatt (In re Pyatt), 486 F.3d 423, 427-30 (8th Cir. 2007) (analyzing the interplay of §§ 542 and 549 and finding that § 549 can address issues concerning defendant’s possession of property trustee was seeking to recover).

In a case involving a corporate debtor, the options are more limited. A motion for turnover against the corporate debtor will be ignored because there will be no penalty for non-compliance (no discharge will ever issue, so contempt is irrelevant) and the debtor has no future existence. Instead, the trustee is only able to seek recovery of the transfer from the non-debtor recipient pursuant to 11 U.S.C. § 550. Although the statutory defenses to such a cause of action appear to be limited, the trustee may face unexpected common law defenses that have developed over time. Being aware of these defenses will enable a trustee to avoid wasting time and resources on litigation doomed to fail.

Can the Trustee Establish Harm?
A cause of action under § 549 is rooted in the belief that a §

459 cause of action is designed to restore the bankruptcy estate to its pre-transfer state. “The purpose of § 549 is to allow the trustee to avoid those postpetition transfers which deplete the estate while providing limited protection to transferees who deal with the debtor.” ETS Payphones, Inc. v. AT&T Card (In re PSA, Inc.), 335 B.R. 580, 584 (Bankr. D.Del. 2005). Some courts have taken this purpose and used it to create a judge-made standard to be applied to § 549 causes of action which cannot be found in the Bankruptcy Code and, in fact, is not uniformly applied. To wit, in the absence of a demonstrable “injury,” trustees may be denied standing to pursue a § 549 claim at all.

For example, in Abbott v. Arch Wood Protection, Inc. (In re Wood Treaters, LLC), 479 B.R. 122, 129 (Bankr. M.D.Fla. 2012), the Bankruptcy Court explicitly held that in the absence of an injury to the estate, the trustee lacks the constitutional right to bring a § 549 action. See also, Dill v. Brad Hall & Associates, Inc. (In re Indian Capitol Distributing, Inc.), 2011 WL 4711895, at *8 (Bankr. D.New Mexico 2011) (Starzynski, J.) (“Even a plaintiff that relies on a statute must always have suffered a distinct and palpable injury to himself that is likely to be redressed if the requested relief is granted.”) (citations omitted). Thus, although the Bankruptcy Code does not contain a statutory requirement that the estate be injured as a result of the transfer for a § 549 cause of action to lie, a court may impose the requirement utilizing its broad jurisdictional requirement.

No Harm/No Foul
Even if an injury can be articulated, trustees must be aware of the “No Harm/No Foul” rule that is drawn from the decision in Fleet Nat’l Bank v. Gray (In re Bankvest Capital Corp.), 375 F.3d 51 (1st Cir. 2004) and recently amplified in the decision of In the Matter of C. W. Mining Co., 749 F.3d 895 (10th Cir. 2014). In both of those cases, a trustee sought to recover funds which were transferred to a secured creditor post-petition without Bankruptcy Court authority. The trustee asserted claims under the authority of §§ 549 and 550. In both cases, the transfer involved a transfer of estate property to a secured creditor that had a pre-petition lien on the property transferred. Although it may appear simple in retrospect, the secured creditor’s defense to the claim arose, not from the statutory defenses outlined in § 549 itself.

1. It is possible to be able to prove all of the elements of an improper post-petition transfer, yet be unable to prevail.
2. Injury to the Estate may be required to be proven – separate and apart from the transfer.
3. If recovery of an improperly transferred asset also resurrects a lien on that asset under §502(h), recovery may be denied.

Key Points

1. It is possible to be able to prove all of the elements of an improper post-petition transfer, yet be unable to prevail.
2. Injury to the Estate may be required to be proven – separate and apart from the transfer.
3. If recovery of an improperly transferred asset also resurrects a lien on that asset under §502(h), recovery may be denied.

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or another failure, but from § 502(h).

Section 502(h) provides a defendant returning assets to the estate pursuant to § 550 (thus applicable to all avoidance actions), has a claim against the estate which is “the same as if such claim had arisen before the date of the filing of the petition.” In other words, a secured creditor will have its lien revived on any of property returned to the estate if it had a pre-petition lien.

Both the C. W. Mining and the Bankvest opinions hold that since the lien will re-attach upon recovery by the trustee, there is no purpose served by returning the funds to the estate; there is no benefit to unsecured creditors. Once the funds return to the estate, the secured creditor/defendant’s lien will reattach and it will be entitled to stay relief to, once again, recover its own collateral. Accordingly, the courts found, there is reason to authorize the recovery.2 3

A similar theory, although rooted principally in equity, was applied to deny a trustee recovery in the case of Dobin v. Presidential Fin. Corp. (In re Cybridge Corp.), 312 B.R. 262 (D.N.J. 2004). In Cybridge, the chapter 11 debtor had engaged in unauthorized post-petition factoring. It obtained financing from the defendant by “selling” its receivables and receiving immediate cash as a result. When the trustee discovered the unauthorized post-petition transfer of the receivables, she sought to avoid the transfer of the receivables and allow the defendant a chapter 11 administrative claim in its place to address the fact that the defendant had extended cash to the debtor (in an amount less than the face value of the receivables). The Bankruptcy Court denied the trustee relief.4 The District Court affirmed the Bankruptcy Court’s holding that although the trustee met all of the elements required by § 549, the defendant’s loans to the debtor during the chapter 11 period created a complete defense to the cause of action. Id. at 274. The court “netted out” the cash advances as against the receivables collected and determined that the estate was not harmed by the unauthorized post-petition lending.

Section 549 Right is Absolute

Contrary to those courts that insist that a detriment to the estate must be found before a § 549 cause of action is successful are the lines of cases that very specifically hold otherwise. For example, in Aalfs v. Wirum (In re Straightline Investments, Inc.), 525 F.3d 870, 878-9 (9th Cir. 2008) the United States Court of Appeals for the Ninth Circuit surveyed the law at the time and specifically concluded that “[a]lthough the primary purpose of 11 U.S.C. § 549 is to allow the trustee to avoid post-petition transfers of property which deplete the estate, the plaintiff’s failure to demonstrate a measurable depletion of the estate is not enough to allow a transfer to stand when it is otherwise avoidable under § 549 because it satisfies all of the explicit requirements of an avoidable postpetition transfer.”

Id. at 878-9 (citations omitted); see also, In re Delco Oil, Inc., 599 F.3d 1255, 1262 (11th Cir. 2010) (“a ‘harmless’ exception to a trustee’s Section 549(a) avoiding powers does not exist.”).

Conclusion

Trustees who approach an avoidance action under § 549 as they would approach a preference action under § 547 may find themselves unpleasantly surprised to discover that there are defenses that exist outside those enumerated in the Bankruptcy Code. Before embarking on an attempt to recover a post-petition transfer, trustees should (i) determine whether their district requirements a showing of injury in order to have standing to pursue such a claim; and (ii) be prepared to articulate how the estate was depleted by virtue of the transaction(s) being attacked. Without this information, a trustee may find herself wasting time and money pursuing a cause of action doomed to failure.

FOOTNOTES:

1 Unless § 547, a secured creditor does not have an absolute defense to a demand for recovery of a post-petition transfer based solely upon the language of the statute.

2 In these fact patterns, not only was the defendant potentially liable for a § 549 recovery, but also for a willful stay violation. Neither cause of action was successful. Query: Whether this analysis removes the defendant’s incentive to file a motion for relief from the automatic stay before taking its collateral.

3 See also LifeStore Bank v. Crawford (In re Krumm), 534 B.R. 142, 146-49 (W.D.N.C. 2015) (post-petition debtors executed deed in lieu of foreclosure for real property with equity to oversecured creditor; when trustee sold real property, secured creditor still entitled to payment in full pursuant to 11 U.S.C. § 502(h); trustee retained excess).

4 Section 502(h) of the Bankruptcy Code which protected the defendants in C.W. Mining and Bankvest, could not have been used as a defense by the Cybridge defendant because it did not hold a pre-petition claim against the debtor

5 The Ninth Circuit may have been moved by the fact that the debtor and creditor in Straightline willfully violated the Bankruptcy Court’s ruling that expressly prohibited the transfer of the accounts receivable as part of the court-approved post-petition financing.