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Introduction

Section 544 of title 11 of the United States Code (the "Bankruptcy Code") grants a trustee the power to "avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by" certain classes of secured creditors, unsecured creditors, and bona fide purchasers.[1] When seeking to avoid a transfer a trustee can look to various other provisions of the Bankruptcy Code, including: 11 U.S.C. § 545 (statutory liens), 11 U.S.C. § 547 (preferences), 11 U.S.C. § 548 (fraudulent transfers), 11 U.S.C. § 549 (post-petition transactions), 11 U.S.C. § 553(b) (impermissible setoffs), and 11 U.S.C. § 724(a) (specific liens that secure 11 U.S.C. § 726(a)(4) claims). However, once avoided, recovery to the estate is not guaranteed. A trustee's ability to recover funds is limited by section 550(a), which provides:

> Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, *for the benefit of the estate*, the property transferred, or, if the court so orders, the value of such property, from--

[1] 11 U.S.C. § 544 (2012).

> **(1)** the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
> **(2)** any immediate or mediate transferee of such initial transferee.[2]

This provision limits a trustee's ability to recover pre-petition transfers by placing a bar on the recovery of all transfers that do not "benefit the estate."[3]

In *In re Incare*, the Bankruptcy Court for the Eastern District of Pennsylvania held that the trustee could not recover pre-petition transfers found to be actually fraudulent when the funds were reimbursed to the debtor company pre-petition.[4] In that case, Dr. Nikparvar was the principal of both the debtor corporation, Incare, and the corporation that received the fraudulent funds, Advanced Urgent Care.[5] Dr. Nikparvar admitted in his testimony that he purposely transferred funds to Advanced Urgent Care, totaling $1,779,191.51, in order to prevent a judgment creditor from seizing Incare's bank account for a second time.[6] The record revealed that Advanced Urgent Care had transferred funds, totaling $1,779,738.95, back to Incare prior to the commencement of the bankruptcy case.[7] The Bankruptcy Court applied section 550 to preclude recovery, stating "where there was no diminution of Incare's assets as a result of the Advanced Urgent Care Transfers, the Trustee is not entitled to recover under 11 U.S.C. § 550(a)."[8]

This memorandum addresses the question of whether a trustee may recover an actual fraudulent transfer when the funds have effectively been returned to the estate. In short, the answer is no. Section I discusses how a survey of jurisdictions reveals that there is a general consensus among circuits that the

[2] 11 U.S.C. § 550(a) (emphasis added).
[3] *See generally In re* Incare, 2018 WL 2121799, *15-*16 (May 7, 2018).
[4] *Id.* at 16.
[5] *Id.* at *1–*2.
[6] *Id.* at *13, *4.
[7] *Id.* at *4.
[8] *Id.* at *16.

"benefit of the estate" provision serves as a bar on the trustee's ability to recover funds. Section II talks about Bankruptcy Courts' strong policy against double dipping. Section III explains how bankruptcy courts are equitable tribunals and, as such, there is no place for punitive recoveries.

Discussion

I. Benefit of the Estate: A Jurisdictional Breakdown

A trustee's ability to recover funds from avoided transfers is limited by the "benefit of the estate" provision found in section 550 of the Bankruptcy Code.[9] While circuits have characterized the limitation differently, the general consensus is that there are two ways to prove a "benefit" of the estate: (1) increased payment to creditors, and (2) increased likelihood of a successful reorganization.[10]

Courts in the Second Circuit have characterized the provision "benefit of the estate" as a floor for recovery, not a ceiling.[11] The Southern District of New York has repeatedly defined the term "benefit" to encompass "both direct benefits to the estate, such as increased distribution, and indirect ones, such as increase in probability of a successful reorganization."[12] In *In re Tronox*, the Southern District used the Bankruptcy Code's definition of estate to affirm the expansive reading of the "benefit of the estate" provision, finding that the estate formed at the start of the bankruptcy case includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[13] This establishes that the interests of the estate stretch beyond repayment of creditors.[14] However, despite this seemingly expansive reading of "benefit

[9] 11 U.S.C. § 550.
[10] *In re* Tronox, 464 B.R. 606, 613–14 (Bankr. S.D.N.Y. 2012).
[11] *Id.* at 611–12.
[12] *Id.* at 613–14.
[13] *Id.* at 613 (internal citations omitted) (citing 11 U.S.C. § 541).
[14] *Id.*

of the estate," the Southern District has opined that a trustee may not pursue recovery of funds if the only party that would benefit from such a recovery would be the debtor.[15]

Courts in the Third Circuit frame "benefit" more strictly. Bankruptcy courts in this Circuit have opined: "[i]f there is no reorganized entity or creditors to receive post-confirmation payment, there may be no benefit to the estate, just benefit to the owners of the debtor."[16] Going further, the Eastern District of Pennsylvania explicitly found no reason to invoke the avoidance power when the debtor has received the transferred property back because the creditors have not been prejudiced.[17] This strict construction was affirmed in *In re Incare*.[18] Despite finding that thirteen transfers were made with an actual intent to hinder and delay the payment of creditors, the court found there was no "diminution of the estate" because the transferee had reimbursed Incare pre-petition, and, as a result section 550 precluded recovery.[19]

The Ninth Circuit, however, uses broader language to interpret the "benefit of the estate" provision. It notes that section 550 governs the extent that the trustee can recover.[20] The Ninth Circuit goes on to opine that "[c]ourts construe the 'benefit of the estate' requirement broadly, permitting recovery under section 550(a) even in cases where distribution to unsecured creditors is fixed by a plan of reorganization and in no way varies with recovery of avoidable transfers."[21] Notwithstanding this seemingly all-encompassing language, in practice, the court applies the

[15] HSBC Bank USA, Nat. Ass'n v. Calpine Corp., 2010 WL 3835200 (S.D.N.Y. 2010).
[16] *In re* GGI Props., LLC, 568 B.R. 231, (Bankr. D.N.J. 2017) (citing *In re* New Life Adult Med. Day Care Ctr., Inc., 2014 WL 6851258, at *6 (Bankr. D.N.J. 2014); *In re* Trans World Airlines, Inc., 163 B.R. 964, 972 (Bankr. D. Del. 1994)).
[17] *In re* Polichik, 506 B.R. 405, 435 (Bankr. E.D. Pa. 2014) (holding § 550 acts as a bar against a transfer that has already been reimbursed).
[18] *See generally In re* Incare, 2018 WL 2121799.
[19] *Id.* at *16.
[20] *In re* Acequia, Inc., 34 F.3d 800, 809 (9th Cir. 1994).
[21] *Id.* at 811.

provision similarly to both the Second and Third Circuits.[22] For example, in In re Acequia, the court found that recovery would benefit the estate although all creditors had already been paid.[23] Recovery would ensure the debtor company could fulfill its post-confirmation obligations pursuant to the reorganization plan by reimbursing the estate for fraudulent conveyance litigation costs.[24] This rationale is similar to the other circuits because it recognizes successful reorganization as another way to establish a "benefit of the estate."[25]

Accordingly, despite the varying formulations across jurisdictions, the outcomes are consistent—if the trustee can prove that recovery will result in additional payments to creditors or a more successful reorganization process, then courts will deem the funds sought to be recoverable. This is true regardless of whether the transfer was made as a result of actual fraud or not.

II. Strong Policy Against Double Dipping

Under section 550(d) a trustee only has the right to a "single satisfaction" of claims arising under section 550(a).[26] "Section 550(d) empowers courts to prohibit a trustee from recovering under [s]ection 550(a) from a transferee that has already returned to the estate that which was taken in violation of the Code."[27] The purpose of this provision is to prevent a windfall to the estate.[28] The affect is a strict bar on double recovery.[29] Accordingly, a trustee

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[22] *Id.* (citing *In re* Trans World Airlines, Inc., 163 B.R. 964, 973 (Bankr. D. Del. 1994) ("[T]he unsecured creditors will benefit from the enhanced value of reorganized [debtor corporation] by reason of being shareholders of the reorganized debtor.") (quoting *In re* Centennial Indus., 12 B.R. 99 (Bankr. S.D.N.Y. 1981) (finding when there was a five-year post-petition payment plan, "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.")).
[23] *In re* Acequia, Inc., 34 F.3d at 812.
[24] *Id.*
[25] *Id.*; *see e.g., In re* GGI Props., LLC, 568 B.R. at 231 (application in Third Circuit); *In re* Tronox, 464 B.R. at 613–14 (application in Second Circuit).
[26] 11 U.S.C. §§ 550(a), (d).
[27] *In re* Sawran, 359 B.R. 348, 352 (Bankr. S.D. Fla. 2007).
[28] *See id.*
[29] HBE Leasing Corp. v. Frank, 48 F.3d 623, 640 (2d Cir. 1995).

cannot recover both transferred property and damages; and a trustee may not recover transferred property if it has already been returned to the estate by the transferee.[30]

Still, in *Whitlock v. Lowe* the "single satisfaction" provision did not bar the chapter 7 trustee from recovering funds.[31] In *Whitlock*, the debtor fraudulently transferred funds into his sister-in-law's bank account.[32] Following this transfer, and pursuant to the debtor's request, the sister-in-law: (1) transferred $200,000 to a third-party company in order to pay off a debt for the debtor, and (2) transferred $32,000 to the debtor's wife.[33] The funds from the two subsequent transfers were spent pre-petition.[34] As such, the court found that because the funds were not available to distribute to creditors there was a harm to the bankruptcy estate and the recovery of the funds was proper.[35] However, *Whitlock* is currently being appealed to the Court of Appeals for the Fifth Circuit.[36]

Conversely, the Third Circuit found that recovery of actual fraudulent transfers is improper if the estate has been reimbursed, irrespective of whether the funds were actually available to distribute to creditors.[37] In *Incare*, the principal of the debtor company, Incare, made a series of transfers from itself to another company, Advanced, in order to avoid paying a judgment against Incare.[38] However, later payments from Advanced back to Incare compensated the estate for the initial fraudulent transfers.[39] Unlike *Whitlock*, the court in *In re Incare* did not

[30] *See e.g. In re* Sickels, 392 B.R. 423 (Bankr. N.D. Iowa 2008) (trustee could not avoid a mortgage lien and pursue a money judgment); *In re* Sawran, 359 B.R. at 355 (trustee could not recover funds paid back to debtor pre-petition).
[31] Whitlock v. Lowe, 569 B.R. 94, 104–05 (W.D. Tex. 2017).
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] Whitlock v. Lowe, 569 B.R. 94 (W.D. Tex. 2017), *appeal docketed*, No. 18-50335 (5th Cir. 2018).
[37] *In re* Incare, 2018 WL 2121799 at *13–*14.
[38] *Id.*
[39] *Id.* at *4.

consider whether the funds were actually available to distribute to creditors.[40] The court in *Incare* stopped the inquiry once it determined that the funds were effectively reimbursed to the debtor—finding any recovery would constitute double dipping.[41]

Under the *Incare* inquiry the *Whitlock* Court's decision to allow the trustee to recover the $200,000.00 transfer, despite being used to pay off a debt for the debtor, would likely have a different result.[42] This is because whether the payment went from debtor to creditor, or from debtor to third-party to creditor, the payment was made to fulfill a debt of the estate. Thus, if the Fifth Circuit, on appeal, follows *In re Incare*'s logic, it will most likely apply an equitable credit to the claim against the transferee for the $200,000 payment to the creditor.[43]

In sum, the Court may apply a strict bar to a trustee's recovery under section 550 if such recovery would constitute double dipping.[44] However, the Court may also choose to apply an equitable credit for the portion already received and hold the transferee responsible for the remaining sum to ensure the estate is reimbursed for the full amount of the fraudulent transfers.[45]

III. Bankruptcy Courts are Courts of Equity

"Bankruptcy courts have long had broad equity power to manage the affairs of debtors, a power now codified in Section 105 of the Bankruptcy Code."[46] The purpose of the Bankruptcy Code is remedial, not penal.[47] A bankruptcy court may apply "equitable principles to reduce or

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[40] *Id.* at *13–*14.
[41] *Id.*
[42] *See Whitlock*, 569 B.R. at 104–05.
[43] *Id.* at *16 ("In this case, I consider it appropriate to give [the transferee] an equitable credit for the money it returned to Incare.").
[44] *See In re* Sawran, 359 B.R. at 355.
[45] *See In re* Incare, 2018 WL 2121799, at *16.
[46] Adelphia Recovery Tr. v. Bank of Am., N.A., 390 B.R. 64, 74, fn. 13 (S.D.N.Y. 2008), *adhered to on reconsideration*, No. 05 CIV. 9050 (LMM), 2008 WL 1959542 (S.D.N.Y. May 5, 2008) (quoting *In re* Croton River Club, Inc., 52 F.3d 41, 45 (2d Cir.1995) (citation omitted)).
[47] *In re* Incare, 2018 WL 2121799, at *16 (citing *In re* Kingsley, 518 F.3d 874, 877–78 (11th Cir. 2008); *In re* Tronox, Inc., 464 B.R. at 618; ASARCO, LLC v. Ams. Mining Corp., 396 B.R. 278 (S.D. Tex. 2008); *In re* Jackson, 318 B.R. 5, 27–28 (Bankr. D.N.H. 2004), *aff'd*, 459 F.3d 117 (1st Cir. 2006)).

eliminate the amount of the trustee's recovery" in instances where recovery of the transfer "would result in an inequitable windfall to the bankruptcy estate."[48]

In *In re Kingsley*, the Eleventh Circuit affirmed the bankruptcy court's decision to apply an equitable credit to the transferee because of payments made to the estate after the transferee's acceptance of an intentionally fraudulent transfer.[49] As such, the equitable principles embodied by the Bankruptcy Code force the conclusion that funds already reimbursed to the estate are not recoverable by the trustee, regardless of actual fraud.

Conclusion

A trustee may only recover funds for the "benefit of the estate," regardless of whether the transfer is deemed actually fraudulent. Generally, in order to prove "benefit" to the estate, the trustee must show that recovery will either result in a higher payout for creditors, or a more successful reorganization.[50] Trustees are further limited in their ability to recover via the single satisfaction rule.[51] Under this rule, courts can bar recovery or issue equitable credits to limit the trustee to a "single recovery."[52] These limiting provisions are justified because bankruptcy courts are premised on equitable, not penal remedies.[53]

[48] *In re* Kingsley, 518 F.3d at 877–78.
[49] *See id.*
[50] *See In re Tronox*, 464 B.R. at 613–14.
[51] *In re H & S Transp. Co.*, 939 F.2d at 358.
[52] *In re Kingsley*, 518 F.3d at 877–78.
[53] *In re Incare*, 2018 WL 2121799, at *16 (citation omitted).