Recent Cases on the Sale of Avoidance Actions

Hon. James J. Robinson, U.S. Bankr. Judge, N.D. Ala.[1]

Briar Capital Working Fund Capital, L.L.C. v. Remmert (In the Matter of South Coast Supply Co.), 91 F.4th 376 (5th Cir. Jan. 22, 2024), *petition for cert. filed* (U.S. Apr. 24, 2024) (No. 23-1157); and *Teras Breakbulk Ocean Navigation Enters., LLC v. Angueira (In re Teras Breakbulk Ocean Navigation Enters., LLC)*, 658 B.R. 611 (S.D. Fla. Mar. 31, 2024), *appeal docketed* (11th Cir. Apr. 30, 2024) (No. 24-11352).

A district court's recent opinion in *Teras Breakbulk Ocean Navigation Enters., LLC v. Angueira (In re Teras Breakbulk Ocean Navigation Enters., LLC)*, 658 B.R. 611 (S.D. Fla. Mar. 31, 2024), affirmed the bankruptcy court's ruling allowing the sale of § 544 avoidance claims, but disallowing the sale of §§ 547, 548, and 549 claims, in the context of jointly administered chapter 7 proceedings. The trustee for the jointly administered cases moved under § 363 to sell certain of the debtors' avoidance actions (claims the debtors held against their principal and against entities under the principal's control) to a company created by one of the debtors' secured lenders. The trustee had unsuccessfully sought outside counsel to pursue the claims on behalf of the estate but could not find an attorney willing to do so. The trustee also asked the court to extend the deadline for filing the avoidance actions until some time after the court ruled on the sale motion.

With no binding Eleventh Circuit authority on point, the bankruptcy court agreed that the avoidance actions were estate property and approved the sale, as well as approving the extension of time for the purchaser to file suit. The sale terms were a total purchase price of approximately $153,200.00 but additional consideration was also given as the purchaser / secured lender waived any claim against the sale proceeds and the counsel for the former trustee would waive its

[1] Judge Robinson wishes to acknowledge his law clerk, Alyssa Ross, for preparing these materials.

administrative fee claim, while the current trustee was also capping his fees to ensure at least $100,000.00 of the sales price would remain available for the other creditors in the case. Upon reconsideration, the bankruptcy court clarified that only the avoidance actions brought under § 544 could be sold. The avoidance claims that arose under §§ 547, 548, and 549 could not be sold by the trustee. The district court affirmed on appeal.

First, the district court agreed that the concept of estate property was broad enough to encompass avoidance actions. It cited the Fifth Circuit case of *In re Moore*, 608 F.3d 253, 257 (5th Cir. 2010) for the broad proposition that "[a]s a general matter, a trustee may sell causes of action belonging to the estate." The Fifth Circuit in *Moore* did not answer the question, however, of whether avoidance actions in particular are estate property, nor did it address whether such actions may be transferred if they are indeed estate property. The Third Circuit had ruled in *In re Cybergenics Corp*., 226 F.3d 237 (3d Cir. 2000) that avoidance actions under § 544 are not estate property, although a later Third Circuit case has described *Cybergenics* as not foreclosing the possibility that the trustee could nonetheless transfer causes of action. *See In re Wilton Armetale, Inc.*, 968 F.3d 273, 285 (3d Cir. 2020). The district court agreed with the bankruptcy court's analysis, which made much of the distinction between avoidance actions that exist under common law and may be pursued under § 544 and those that exist by virtue of the Bankruptcy Code by virtue of §§ 547, 548, and 549. The court cited several bankruptcy courts that had held that avoidance actions under § 544 are estate property and may be transferred by the trustee under § 363. The district court also agreed with the bankruptcy court that avoidance claims under §§ 547, 548, and 549 were correctly excluded from the trustee's sale authority "because those claims were uniquely created for the [t]rustee, unlike common law claims arising under § 544." 658 B.R. at 618.

The district court then examined the sale of the § 544 claims under "business judgment test" that applied to sale motions. The trustee's judgment is entitled to some deference once the trustee shows a sound business reason for the sale and its terms. The bankruptcy court's findings that the trustee had used sound judgment and that the sale was in the best interest of the estate were factual findings reviewed for clear error. Here, there was no clear error. It did not matter that the secured lender who purchased the avoidance claims had objected to the consolidation of the cases. There was no evidence of a bad intent, nor of how any such intent impacted the sale terms. Also, the trustee had tried and failed to find a lawyer who would pursue the claims for the estate, which made them virtually worthless outside the deal with the secured lender (including the administrative fee holders' agreement to eliminate or cap their fees). The district court also affirmed the order extending the time for filing the § 544 actions after the transfer.

Interestingly, although it cited the Fifth Circuit's broad statement in *Moore*, the district court in its March 2024 opinion in *Teras Breakbulk* made no mention of the Fifth Circuit's ruling in January 2024 that expanded *Moore* to cover the very scenario at issue in the Florida case. It appears that may have been a fluke of timing, with the appeal being filed and briefs likely submitted to the district court before the Fifth Circuit's January 2024 decision issued. In any event, the Fifth Circuit took the opportunity in *Briar Capital Working Fund Capital, L.L.C. v. Remmert (In the Matter of South Coast Supply Co.)*, 91 F.4th 376 (5th Cir. Jan. 22, 2024), to rule that preference claims under § 547 were estate property under § 541(a)(7), which was entitled to a broad reading under that circuit's precedent, and that preference claims could be sold under § 363. The Fifth Circuit

expressly considered and rejected limiting the authority to transfer avoidance actions to those brought under § 544 (as the district court below had done).

The issue arose in a chapter 11 case in which Briar Capital was the sole secured lender, holding a claim in excess of $2.5 million secured by property worth $3.9 million. A DIP financing agreement between the DIP (South Coast Supply) and Solstice Capital, LLC gave Briar Capital a junior lien on certain collateral where the DIP lender was allowed to prime Briar Capital's first-lien position. Around the same time, South Coast, as the DIP, filed a preference action against Remmert seeking to avoid approximately $300,000.00 of transfers under § 547 and to claw back the value of the transfers under § 550. Once the DIP loan was finalized, South Coast proposed a plan that provided for the sale of all intangible assets to Solstice in exchange for $500,000.00 and the payment by Solstice of up to an additional $200,000.00 toward administrative claims. Some property would also be transferred to Briar Capital (accounts receivable worth perhaps $400,000.00 or less per the testimony at confirmation).

After negotiation, the plan was amended to abandon Briar Capital's security interest in $700,000.00 of the sales proceeds that would now go to the unsecured creditors instead, and included a provision that Briar Capital would waive its administrative expense claim, in exchange for the transfer to Briar Capital of the pending preference action against Remmert. The plan expressly allowed Briar Capital to retain whatever it recovered from the preference action, even if the total recovery under the plan and from the preference action exceeded its debt. Remmert objected to confirmation, and the court confirmed the plan over his objection. Briar Capital was then substituted as the plaintiff in the preference action, and Remmert moved to dismiss arguing

that Briar Capital lacked standing to pursue the § 547 claims. The district court agreed and, much like the district court in the *Teras Breakbulk* case in Florida, ruled that a preference action under § 547 could not be sold. The Fifth Circuit reversed on appeal.

Authority from the Eighth and Ninth Circuits supported the Fifth Circuit's ruling that avoidance powers that are unique to the trustee (claims under §§ 547, 548, and 549) can be assigned and sold as can claims under § 544 that are not statutorily created under the Bankruptcy Code. The Fifth Circuit said a trustee's duty as fiduciary to maximize the estate's value may in some cases *require* the sale of an avoidance action under one of those sections. 91 F.4th at 383 (c*iting In re Simply Essentials, LLC,* 78 F.4th 1006, 1010 (8th Cir. 2023)). Similarly, the Ninth Circuit has ruled that avoidance actions, including preference actions, may be sold. *See In re P.R.T.C., Inc.,* 177 F.3d 774 (9th Cir. 1999). And a Ninth Circuit BAP has rejected the argument that some portion of the recovery on the preference action must be preserved for the estate, in addition to whatever sales price or consideration is given the estate for the transfer. *See In re Lahijani,* 325 B.R. 282 (B.A.P. 9th Cir. 2005). "The benefit to the estate in such circumstances is the sale price, which might or might not include a portion of future recoveries for the estate." *Lahijani*, 325 B.R. at 287.

The Fifth Circuit explained why even avoidance actions unique to the trustee are capable of being sold:

> In rejecting these arguments, the courts took a broad view of what benefits the estate, which we adopt here. This logic of maximization of the estate applies even under circumstances like these, where a creditor is not pursuing the claim for the benefit of all creditors. In this case, Briar Capital waived the right to recover administrative expenses and its security interest in $700,000 of sales proceeds, in exchange for the right to pursue this preference claim. Although Briar Capital does not owe any percentage of the possible recovery in this case to the estate, its waiver

> of the right to collect administrative expenses and its release of its claim to $700,000 are concrete benefits to the estate. Interpreting the Bankruptcy Code to allow the sale of preference actions does not undermine the purpose of avoidance actions. Rather, it is consistent with the trustee's duty to maximize the estate.

South Coast Supply, 91 F.4th at 383. This is particularly true when the estate may not be able to pursue the claims itself because it has no funds to pay counsel to do so (as was the case in *Teras Breakbulk*). In the case before it, the Fifth Circuit noted that Briar Capital gave concrete benefit to the estate by the release of its $700,000.00 claim as well as its waiver of any administrative expenses, even though it was not required to contribute any of its potential recovery on the preference action to the estate. *Id*. Further, the Fifth Circuit held that as a purchaser of the preference claim at issue, Briar Capital had standing to pursue the claim and whether it could be considered an "estate representative" under § 1123(b)(3)(B) was irrelevant:

> There is no requirement in 11 U.S.C. § 363 that the purchaser of a piece of the estate's property also be a representative of the estate, only that the debtor-in-possession give notice and hold a hearing. These requirements were met in this case and the bankruptcy court found that the plan complied with the Bankruptcy Code, was proposed in good faith, and maximized the value of the estate. There is no additional requirement on the purchaser of a preference claim to qualify as a representative of the estate to have standing to pursue the validly purchased claim. In holding that preference claims may be sold, we also hold that the purchasers of preference claims have standing to pursue them.

Id. at 385.