



# ***GREED INC.:*** **THE ALARMING TREND OF BUYING & SELLING PREFERENCE ACTIONS**

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# LAYING THE FOUNDATION AVOIDANCE POWERS

## SUBCHAPTER III—THE ESTATE

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§ 542. Turnover of property to the estate

§ 543. Turnover of property by a custodian

§ 544. Trustee as lien creditor and as successor to certain creditors and purchasers

§ 545. Statutory liens

§ 546. Limitations on avoiding powers

**§ 547. Preferences**

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§ 550. Liability of transferee of avoided transfer

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# LAYING THE FOUNDATION PREFERENCES

Effective: December 27, 2022

11 U.S.C.A. § 547

## § 547. Preferences

(b) Except as provided in subsections (c) and (i) of this section, the trustee may, based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c), avoid any transfer of an interest of the debtor in property--

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made--

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if--

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

# LAYING THE FOUNDATION PROPERTY OF THE ESTATE

Effective: December 27, 2021

11 U.S.C.A. § 541

## § 541. Property of the estate

(a) The commencement of a case under [section 301](#), [302](#), or [303](#) of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

- (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
- (2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is--
  - (A) under the sole, equal, or joint management and control of the debtor; or
  - (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.
- (3) Any interest in property that the trustee recovers under [section 329\(b\)](#), [363\(n\)](#), [543](#), [550](#), [553](#), or [723](#) of this title.
- (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under [section 510\(c\)](#) or [551](#) of this title.
- (5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the

# LAYING THE FOUNDATION SELLING ASSETS IN CHAPTER 11

11 U.S.C.A. § 363

## § 363. Use, sale, or lease of property

**(b)(1)** The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless--

# LAYING THE FOUNDATION AVOIDANCE ACTIONS AS ESTATE PROPERTY

462 U.S. 198, 76 L.Ed.2d 515  
UNITED STATES, Petitioner

v.

WHITING POOLS, INC.

No. 82-215.

Argued April 19, 1983.

Decided June 8, 1983.

Both the congressional goal of encouraging reorganizations and Congress' choice of methods to protect secured creditors suggest that Congress intended a broad range of property to be included in the estate.

The statutory language reflects this view of the scope of the estate. As noted above, § 541(a)(1) provides that the "estate is comprised of all the following property, wherever located: ... all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1) (1976 ed., Supp. V).<sup>8</sup> The House and Senate Reports on the Bankruptcy Code indicate that § 541(a)(1)'s scope is broad.<sup>9</sup> Most important, in the context of this case, § 541(a)(1) is intended to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code. See H.R.Rep. No. 95-595, p. 367 (1977). Several of these provisions bring into the estate property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced.<sup>10</sup>

Section 542(a) is such a provision. It requires an entity (other than a custodian) holding any property of the debtor that the trustee can use under § 363 to turn that property over to the trustee.<sup>11</sup> Given the broad scope of the reorganization estate, property of the debtor repossessed by a

# MATTER OF SOUTH COAST SUPPLY COMPANY, 91 F.4TH 376 (5TH CIR. 2024)

- The Fifth Circuit is now the third circuit court (in addition to numerous lower courts) to allow for third parties to **buy preference claims and be granted standing to pursue the claims**
  - *In re Simply Essentials, LLC*, 78 F.4th 1006 (8th Cir. 2023)
  - *In re Lahijani*, 325 B.R. 282 (B.A.P. 9th Cir. 2005)
- The Fifth Circuit includes Texas, one of the most popular venues for filing large Chapter 11 cases
  - *This is a significant decision!*
- The Court held that a single insider preference claim could be sold to the Debtor's secured lender
  - The lower courts dealt with a subset of other claims
- It is unclear whether the Court would have reached the same result if:
  - the preference claim was against a trade creditor and not an insider (former CFO),
  - the debtor was seeking to sell multiple preference claims instead of one, or
  - the debtor was seeking approval to sell a turnover claim under Bankruptcy Code Section 542, a fraudulent transfer claim under Section 548, or a claim for an improper post-petition transfer under Section 549, among other potential estate claims and causes of action.

# **MATTER OF SOUTH COAST SUPPLY COMPANY, 91 F.4TH 376 (5TH CIR. 2024)**

- The Fifth Circuit was careful to state that the issue needed to be decided on a case by-case basis, meaning an argument can be made that the decision should be limited to the specific facts before the Court and narrowly construed.
- An undercapitalized debtor or a post-confirmation trust established to pursue causes of action now has additional precedent to rely upon to monetize, instead of dismissing or abandoning, insider preference claims (at a minimum).
- This flexibility could allow for more timely closure of bankruptcy cases and a reduction of administrative costs, including the payment of United States Trustee fees.
- ***However, this could provide an additional headache for unsecured creditors who, despite the popularity of contingency counsel to pursue preference claims against trade vendors, otherwise may not have had to worry about the filing of such claims due to a lack of estate resources.***
  - In a contingency scenario, the estate is entitled to receive a percentage of recoveries after contingency counsel takes its fee (usually 20-40%).



# I FACTUAL BACKGROUND

- South Coast Supply Company, an industrial products distributor, began experiencing financial difficulties in 2016.
- In response, South Coast's then-chief financial officer, Robert Remmert, extended an \$800,000 loan to the Company that was memorialized in a loan agreement.
- Consistent with the terms of the loan agreement, South Coast made weekly payments to Remmert commencing on June 15, 2016, repaying Remmert a total of \$320,628.04 through 47 separate checks.
- South Coast stopped making payments when Remmert resigned in October 2017.
- Following his resignation, Remmert sent a demand letter to South Coast requesting payment of \$405,261.87, less than the balance due under the loan agreement.
- Three days later, on October 20, 2017, South Coast filed for Chapter 11 relief in the United States Bankruptcy Court for the Southern District of Texas

# I FACTUAL BACKGROUND

- South Coast's only secured creditor was Briar Capital Working Fund Capital LLC, which asserted a secured claim exceeding \$2.5 million.
- Approximately five months after the bankruptcy filing date, the Bankruptcy Court authorized South Coast to obtain debtor-in-possession (DIP) financing from Solstice Capital, LLC.
- On April 23, 2018, South Coast filed a preference action against Remmert under Section 547 of the Bankruptcy Code, seeking to recover the \$320,628.04 he had received under the loan agreement within the one-year period prior to the bankruptcy filing.
- After plan negotiations among South Coast, Solstice, and Briar Capital, South Coast filed a second plan of reorganization embodying a settlement that included a provision authorizing the transfer of South Coast's interest in the preference claim against Remmert to the prepetition secured lender, Briar Capital.

# | THE LOWER COURTS' DECISIONS

## The Bankruptcy Court Decision

- Remmert objected to confirmation of the plan, arguing that it should only provide for the preference action to be assigned to Briar Capital and no other potential claims, including, but not limited to, claims for breach of fiduciary duty and fraudulent transfer.
  - The Fifth Circuit's decision did not address these other claims.
- Over Remmert's objection, the Bankruptcy Court confirmed the plan, including the settlement and the sale of the preference action and other potential claims.
- The confirmation order explicitly addressed the assignment of claims to Briar Capital.
- The confirmation order also permitted Briar Capital to prosecute the claims on South Coast's behalf and retain any and all amounts recovered, even if those amounts exceeded the amount owed on account of its secured claim.

# | THE LOWER COURTS' DECISIONS

## The District Court Decision

- The District Court granted Remmert's motion to dismiss the preference claim on the ground that Briar Capital did not have standing to pursue the claim because a successful recovery would solely benefit Briar Capital and not South Coast's bankruptcy estate or unsecured creditors generally.

# | THE FIFTH CIRCUIT'S DECISION

## Holding:

- Preference claims arising under Section 547 of the Bankruptcy Code are property of the estate that may be sold.
  - Preference claims fall under the expansive definition of property of the estate in Section 541(a)(1) of the Bankruptcy Code, and as applied by the United States Supreme Court in *Whiting Pools*
  - Preference claims represent a right of action established by federal bankruptcy law to avoid and recover a transfer of property of the estate.
  - Preference actions also constitute property of the estate under Section 541(a)(7) of the Bankruptcy Code, which provides that estate property includes “any interest in property that the estate acquires after the commencement of the estate.”
    - Preference claims under § 547, by definition, only arise **after** a debtor files for bankruptcy (although the underlying facts exist)

# | THE FIFTH CIRCUIT'S DECISION

- In further support of its conclusion, the Court relied on decisions from the Eighth Circuit and Ninth Circuit Bankruptcy Appellate Panel, which had previously held that avoidance actions are property of the estate that can be sold.
- Eighth Circuit decision in *In re Simply Essentials, LLC*
  - The debtor's estate had insufficient funds to pursue avoidance actions against certain creditors, which resulted in the debtor seeking to sell the avoidance actions to a non-estate representative under Section 363(f) of the Bankruptcy Code.
  - A creditor objected to the sale, contending that avoidance actions are not estate property that can be sold under Section 541(a) of the Bankruptcy Code.
  - The Eighth Circuit relied on the Supreme Court's decision in *Whiting Pools* and emphasized that a debtor's lack of possessory interest of property prior to the petition date does not negate the property's inclusion in the estate.
  - Due to the debtor's right to (i) file for bankruptcy, and (ii) file avoidance actions to recover property, the debtor had an inchoate interest in avoidance actions prior to the petition date.
  - The court also observed that even if the debtor lacked a prepetition interest in avoidance actions, such actions would still be property of the estate under Section 541(a)(7), which encompasses any property interest acquired post-petition by the estate.

# | THE FIFTH CIRCUIT'S DECISION

- Ninth Circuit Bankruptcy Appellate Panel - *In re Lahijani*
  - Held that avoidance actions (i) are property of the estate under Sections 541(a)(1) and 541(a)(3) of the Bankruptcy Code, and (ii) therefore may be sold under Section 363 of the Bankruptcy Code.
  - The appellate panel rejected the creditor's argument that the estate did not receive a benefit because there was no carve-out of future recoveries preserved for the estate.
  - The court also adopted a broad view of what benefits the estate, finding that the sale price for the avoidance actions **alone** constituted a benefit to the estate irrespective of whether future recoveries would inure to the benefit of the estate.
- The Fifth Circuit also rejected Remmert's policy contentions that selling a preference action would (i) breach a debtor's fiduciary duty and (ii) undermine the intent of avoidance actions.
  - The Fifth Circuit emphasized that South Coast was obligated to maximize the estate's value, which in certain instances can require the sale of a preference claim.
  - Based on this broad interpretation, the Court determined that Briar Capital's purchase of the preference action was appropriate where it was waiving certain recovery rights under the confirmed plan, notwithstanding that the estate is not receiving a percentage of future recoveries from the preference action, as it would in a contingency scenario.

# | THE FIFTH CIRCUIT'S DECISION

- In addition, the Fifth Circuit rejected Remmert's argument that the sale of the preference action was inappropriate because Briar Capital would potentially recover more than the amount of its claim as the preference action was being pursued solely for its own benefit.
  - The Court observed that, to the contrary, the sale of preference claims should be addressed on a case by-case basis and the extent of recovery is only one fact to look at.
  - Courts also need to look at whether approval of a sale could result in more flexibility in asset distribution, maximize the value of the estate, and allow for a more equitable asset distribution.
- Finally, the Fifth Circuit determined that a plaintiff does not need to be a "representative of the estate" to have standing to pursue a validly purchased preference claim
  - In overruling Remmert's argument that the "representative of the estate" requirement is dispositive, the Fifth Circuit held that purchasers of such actions have standing to pursue the actions, regardless of whether they are estate representatives.
  - The Fifth Circuit held that while Section 1123(b) of the Bankruptcy Code may empower an estate representative to pursue estate claims, there are other Bankruptcy Code provisions that allow non-estate representatives to purchase and liquidate estate assets, including causes of action.
  - For example, Section 363 of the Bankruptcy Code, governing the sale of estate property, after notice and a hearing, does not require the purchaser to be a representative of the estate, and the purchaser is oftentimes not such a representative and oftentimes purchases causes of action.



# | TRADE CREDITOR TAKEAWAYS

- Many distressed companies that should have filed chapter 11 in 2020-2023 were instead able to refinance or extend their secured debt with . . .
  - Cheap rates,
  - Light or nonexistent covenants,
  - Paid-in-Kind (PIK) interest, and
  - In many cases, *even more principal borrowings*.
- Covid-era refinancing maturities are beginning to arrive.
- All of this adds up to the one defining characteristic of larger chapter 11 filings we've seen in 2022-2024 (and will see even more of in 2025):

## **Mindboggling, eye-popping amounts of secured debt**

- Where secured lenders are deeply underwater, expect them to press to monetize any asset they can to offset their losses—including preferences

**The role of the creditors' committee is more important than ever!**

■ **QUESTIONS?**



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**Education**

Seton Hall University School of Law (J.D. 2009), magna cum laude; Order of the Coif

University of Missouri-Saint Louis (B.S. 2005), Business Administration-Finance and Accounting; Beta Gamma Sigma

**Bar Admissions**

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Andrew Behlmann leverages his background in corporate finance and management to approach restructuring problems, both in and out of court, from a practical, results-oriented perspective. With a focus on building consensus among multiple parties that have competing priorities, Andrew is equally at home both in and out of the courtroom, and he has a track record of turning financial distress into positive business outcomes. Clients value his counsel in complex Chapter 11 cases, where he represents debtors, creditors' committees, purchasers, and investors.

Andrew writes and speaks frequently about bankruptcy matters and financial issues. Before becoming a lawyer, he worked in senior financial management at a midsize, privately held company.



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Brooklyn Law School (J.D.  
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**Bar Admissions**

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# ERIC CHAFETZ

Eric Chafetz is a trusted advisor to creditors' committees and individual trade creditors, debtors, and plan/liquidating trustees involved in complex Chapter 11 bankruptcies throughout the United States.

He advises clients across a wide range of industries on all aspects of the Chapter 11 process, from pre-filing negotiation and preparation of first day pleadings, including financing and sale documents; through the drafting and negotiation of plans of reorganization and all related ancillary documentation.

Eric also has a strong track record in bankruptcy-related litigation, including investigating and prosecuting actions against officers, directors, and lenders, as well as in prosecuting and defending preference/fraudulent transfer actions.

Eric is a frequent speaker on current bankruptcy and creditors' rights topics, including previously serving as a guest lecturer at the Columbia University School of Professional Studies, where he has lectured on such subjects as the intersection of bankruptcy and construction law. He participated in the American Bankruptcy Institute (ABI) Commission's Avoidance Power Subcommittee's study of aspects of the Bankruptcy Code involving preferences, creditors' reclamation rights, and creditors' rights under Section 503(b)(9). Eric is also a prolific author, and has published numerous articles addressing various cutting-edge issues geared toward trade and other categories of creditors, including publications by the National Association of Credit Management and Credit Research Foundation, as well as the ABI, *New York Law Journal*, and *Bloomberg Law*.

Active in the firm's pro bono efforts, Eric has represented several individuals who filed for Chapter 7 bankruptcy protection and numerous non-profits seeking to dissolve.



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