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# Client Alert

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## SDNY BANKRUPTCY COURT HOLDS FRAUDULENT CONVEYANCE RECOVERY NOT LIMITED TO VALUE OF CREDITOR CLAIMS, BUT CONFIRMS SOME LIMITS

The Bankruptcy Court for the Southern District of New York held recently that § 550 of the Bankruptcy Code does not limit the potential recovery on fraudulent transfer claims to the amount of unpaid creditor claims against a debtor's estate. According to the Court, the language in § 550(a) that states that a plaintiff in an avoidance action can recover the property transferred or the value of the property "for the benefit of the estate" provides a "floor" rather than a "ceiling" on recovery. Although potentially opening the floodgates for fraudulent transfer plaintiffs to seek damages that exceed the value of their claims, the Court's simultaneous rejection of the argument that successful plaintiffs are automatically entitled to recover the full value of the property transferred may avoid a complete deluge.

### Background

In *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, Bankr. No. 09-10156(ALG), Adv. No. 09-1198, 2012 WL 164926 (Bankr. S.D.N.Y. Jan. 20, 2012), Chapter 11 debtor Tronox Inc. and its affiliates ("Tronox") brought an adversary proceeding against Anadarko Petroleum Corp. and certain of its subsidiaries ("Anadarko"), alleging intentional or constructive fraudulent conveyance under 11 U.S.C. § 548 or 11 U.S.C. § 544(b). According to the complaint, the debtors undertook a multi-stage "spin-off" transaction in which valuable oil and gas assets were placed in a new corporate entity and thereby isolated from billions of dollars of environmental and tort liability. Five months later, Anadarko acquired the new corporate entity (and the oil and gas assets) for \$18 billion, leaving Tronox allegedly insolvent, undercapitalized, and with billions of dollars in liabilities.

The parties cross-moved for summary judgment on the issue of damages. At one extreme, Anadarko argued that the environmental and tort creditors should only be allowed to recover the value of their claims as of the date of Tronox's Chapter 11 petition, an estimated \$2 billion, of which \$500 million had already been paid. Otherwise,

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Anadarko argued, the environmental and tort creditors could recover as much as \$15.5 billion, walking away with a \$14 billion windfall. Anadarko relied on the language of § 550(a) of the Bankruptcy Code, stating that “to the extent that a transfer is avoided . . . the trustee may recover, *for the benefit of the estate*, the property transferred, or, if the court so orders, the value of such property . . .” At the other extreme, Tronox argued that it should be able to recover the full value of the property transferred. The Court disagreed with both positions.

## Holding

The Court held that the “for the benefit of” language in § 550 provides a minimum for recovery in an avoidance action—meaning that the recovery must provide some benefit to the estate—but does not limit recovery “*to the extent of benefit to the estate*.” The Court stated that this interpretation of § 550(a) is “virtually universal among courts that have substantively considered the issue.” The Court confirmed that, consistent with the language of the Code, the phrase “benefit of the estate” should be interpreted broadly to include both direct benefits to the estate, such as an increase in assets available for distribution, and indirect benefits, such as improved chances for a successful reorganization.

In this case, the Court found that the mere prospect of recovery in the adversary proceeding provided a benefit to the Tronox estate. During the Chapter 11 proceedings, the debtors reached a settlement with the unsecured creditors and environmental and tort creditors, whereby the environmental and tort creditors agreed to accept all proceeds from the adversary proceeding against Anadarko (in addition to certain cash consideration) in satisfaction of their claims against Tronox, and the unsecured creditors would receive all of the stock of the reorganized companies free of any legacy liabilities. The Court found that the transfer of stock to the unsecured creditors provided a benefit to the estate. Additionally, the settlement agreement with the environmental and tort creditors proved to be the “cornerstone” of the plan of reorganization, which likely would not have been approved without it. According to the Court, “[o]nce this benefit was obtained, § 550’s ‘for the benefit of the estate’ requirement was satisfied” and any limits to recovery must be found elsewhere in the law.

However, the Court also rejected Tronox’s assertion that there is no limit on fraudulent transfer recovery other than the value of the property transferred. The Court identified specific limitations on recovery set forth in § 550 and other sections of the Code, including the provision for good faith transferees to retain the value of any improvement in the property and resulting increase in value after the transfer.

Perhaps most significantly, the Court recognized that beyond any specific limitations on recovery in the Code, the guiding bankruptcy principle that fraudulent conveyance law is remedial, not punitive allows bankruptcy courts to use their equitable powers to reduce an estate’s recovery, even in cases of intentional fraudulent transfers. In a telling statement about the strength of these statutory and equitable limits on recovery, the Court concluded its analysis by noting that “the existence of limitations on recovery outside of the ‘for the benefit of the estate’ clause in § 550(a) makes speculative Anadarko’s contention that failure to impose its cap will create a multi-billion dollar ‘windfall’ to creditors if they are successful in establishing liability at trial.”

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any member of our Financial Restructuring and Litigation & Arbitration groups listed below.

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