

2008

## Categorizing Categories: Property of the Estate and Fraudulent Transfers in Bankruptcy

Michael R. Cedillos  
*University of Michigan Law School*

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Bankruptcy Law Commons](#), [Courts Commons](#), [Jurisprudence Commons](#), and the [Property Law and Real Estate Commons](#)

---

### Recommended Citation

Michael R. Cedillos, *Categorizing Categories: Property of the Estate and Fraudulent Transfers in Bankruptcy*, 106 MICH. L. REV. 1405 (2008).

Available at: <https://repository.law.umich.edu/mlr/vol106/iss7/5>

This Note is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact [mlaw.repository@umich.edu](mailto:mlaw.repository@umich.edu).

## NOTE

### CATEGORIZING CATEGORIES: PROPERTY OF THE ESTATE AND FRAUDULENT TRANSFERS IN BANKRUPTCY

*Michael R. Cedillos\**

*11 U.S.C. § 541 defines “property of the estate” in bankruptcy, but courts have not interpreted that section uniformly. The Fifth Circuit has read the term broadly to include both interests in property that the trustee recovers under § 541(a)(3) and legal or equitable interests under § 541(a)(1) that have purportedly been fraudulently transferred but which the trustee has not yet recovered. The Second Circuit, however, has taken a more restrained approach, holding that fraudulently transferred property that the trustee has not yet recovered does not constitute property of the estate. This Note argues that courts should adopt the Second Circuit’s restrained approach to “property of the estate.” Canons of construction indicate that fraudulently transferred property is “property of the estate” only once the trustee has recovered it. Moreover, although the Fifth Circuit’s expansive approach to § 541 attempts to equitably protect creditors, including fraudulently transferred property as “property of the estate” prior to its recovery is problematic for the administration of bankruptcy proceedings, potentially clouding title to property of the estate and thereby contravening bankruptcy’s twin goals of giving the debtor a fresh start and efficiently and equitably distributing the debtor’s property to its creditors.*

#### TABLE OF CONTENTS

INTRODUCTION.....	1406
I. THE CONTROVERSY SURROUNDING § 541 .....	1408
II. STATUTORY INTERPRETATION AND REALIZING § 541’S PURPOSE.....	1415
A. <i>The Plain Meaning Approach</i> .....	1415
B. <i>The Rule Against Surplusage</i> .....	1418

---

\* J.D. candidate, May 2008. Many thanks to J. Pablo Manriquez Zambrano and to my family for their unflagging support of my law school endeavors. I would also like to thank Professor James J. White, Robert A. Sullivan Professor of Law at the University of Michigan Law School, and my Note Editor, Brittany Parling, for their comments and suggestions on this matter.

III. AVOIDING PRACTICAL AND LEGAL PROBLEMS UNDER § 541.....	1421
CONCLUSION.....	1425

### INTRODUCTION

A key portion of the general Bankruptcy Title, 11 U.S.C. § 541, defines “property of the estate.”<sup>1</sup> This section includes a long list of property interests, including both equitable and legal interests and causes of action,<sup>2</sup> “wherever located and by whomever held.”<sup>3</sup> As present concerns about the real estate market and potential mortgage foreclosures lead us into uncertain times, defining what qualifies as “property of the estate” is of particular import. Indeed, as more of the credit extended to borrowers turns into debt to be discharged in bankruptcy, having a clear sense of what is properly “property of the estate”—the property that the bankruptcy trustee or debtor-in-possession<sup>4</sup> distributes on behalf of the debtor’s creditors—will become increasingly important. Such a definition is by no means clear under current interpretations of the Bankruptcy Code.

In *In re MortgageAmerica Corp.*,<sup>5</sup> the Fifth Circuit read § 541’s definition of “property of the estate” expansively to include not only “[a]ny

1. 11 U.S.C. § 541 (2000). Section 541 reads, in relevant part:

§ 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.

*Id.*

2. *Id.* § 541(a)(1), (2)(B); see also S. REP. NO. 95-989, at 83 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5868. The Senate Report provides the following:

Under paragraph (1) of subsection (a), the estate is comprised of all legal or equitable interest of the debtor in property, wherever located, as of the commencement of the case. The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, causes of action . . . .

S. REP. NO. 95-989, at 82.

3. 11 U.S.C. § 541(a).

4. Although this Note refers only to the bankruptcy trustee, Chapter 11 debtors-in-possession have the same rights as the trustee. *Id.* § 1107(a).

5. *Am. Nat’l Bank of Austin v. MortgageAmerica Corp.* (*In re MortgageAmerica Corp.*), 714 F.2d 1266 (5th Cir. 1983).

interest in property that the trustee recovers” under § 541(a)(3)<sup>6</sup> but also legal or equitable interests under § 541(a)(1) that have purportedly been fraudulently transferred but which the trustee has not yet recovered.<sup>7</sup> Imputing to the debtor an equitable interest in purportedly fraudulently transferred property was well intentioned: the Fifth Circuit wanted to prevent debtors from skirting the law and to protect creditors’ interests even though the trustee had not yet recovered the property.<sup>8</sup> The Fifth Circuit has confirmed its approach in subsequent cases.<sup>9</sup>

Meanwhile, the Second Circuit explicitly rejected *In re MortgageAmerica Corp.*’s statutory analysis in favor of a more restrained approach. It held that fraudulently transferred property that the trustee has not yet recovered does not constitute property of the estate under § 541(a)(1).<sup>10</sup> In so doing, the court followed *In re Saunders*,<sup>11</sup> a Florida Bankruptcy Court decision. The Fourth Circuit has highlighted the circuit split, with at least one of its lower courts approving of the Second Circuit’s approach.<sup>12</sup>

While this particular distinction may seem esoteric, including purportedly fraudulently transferred property as property of the estate prior to its recovery is significant because it generates uncertainty regarding whether a trustee can properly distribute such property to a debtor’s creditors. This uncertainty can wreak havoc on the bankruptcy process by clouding title to the property and prolonging the process. Such a result contravenes bankruptcy’s twin goals of giving the debtor a fresh start and efficiently and equitably distributing the debtor’s property to its creditors. The Fifth Circuit’s approach admirably seeks to prevent debtors from skirting the law and to protect creditors’ interests; however, the resulting uncertainty makes the court’s expansive approach to property of the estate more trouble than it is worth.

---

6. 11 U.S.C. § 541(a)(3).

7. *In re MortgageAmerica Corp.*, 714 F.2d at 1275; see also 11 U.S.C. § 541(a)(1) (stating that property of the estate includes “all legal or equitable interests of the debtor in property as of the commencement of the case”).

8. *In re MortgageAmerica Corp.*, 714 F.2d at 1275.

9. See, e.g., *Cullen Ctr. Bank & Trust v. Hensley (In re Criswell)*, 102 F.3d 1411, 1417 (5th Cir. 1997); *Sherk v. Tex. Bankers Life & Loan Ins. Co. (In re Sherk)*, 918 F.2d 1170, 1175–76 (5th Cir. 1990); *S.I. Acquisition, Inc. v. Eastway Delivery Serv. (In re S.I. Acquisition, Inc.)*, 817 F.2d 1142, 1149–50 & n.8 (5th Cir. 1987).

10. *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125, 131 (2d Cir. 1992).

11. 101 B.R. 303 (Bankr. N.D. Fla. 1989); see also, e.g., *Dunes Hotel Assocs. v. Hyatt Corp.*, 245 B.R. 492, 504 (D.S.C. 2000); *United States v. Alfano*, 34 F. Supp. 2d 827, 841 (E.D.N.Y. 1999); *Bank Brussels Lambert v. Credit Lyonnais (Suisse) S.A.*, 192 B.R. 73, 76 (S.D.N.Y. 1996); *Corporate Food Mgmt., Inc. v. Suffolk Cmty. Coll. (In re Corporate Food Mgmt., Inc.)*, 223 B.R. 635, 643 (Bankr. E.D.N.Y. 1998).

12. *In re French*, 440 F.3d 145, 151 n.2 (4th Cir. 2006) (noting that “[t]he circuits are divided as to whether ‘property of the estate’ encompasses property that a debtor has fraudulently transferred” and that while “the Fifth Circuit’s conclusion that ‘property of the estate’ includes property that could be, but has not yet been, recovered,” the Second Circuit and other courts “have concluded that property held by third-party transferees only becomes ‘property of the estate’ after it has been avoided and recovered”); *Dunes Hotel Assoc. v. Hyatt Corp.*, 245 B.R. 492, 504 (D.S.C. 2000) (finding “sound” creditor reliance on *In re Colonial Realty* and *In re Saunders* for the proposition that “[u]ntil a judicial determination has been made that the property was, in fact, fraudulently transferred, it is not property of the estate” (quoting *In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989))).

This Note argues that courts should adopt the Second Circuit's restrained approach to "property of the estate" and hold that § 541 does not include fraudulently transferred property that the trustee has not yet recovered. Part I provides background and describes key cases dealing with the interaction between property of the estate and fraudulent conveyances. Part II argues that § 541's language and structure strongly suggest that fraudulently transferred property is property of the estate only after it has been recovered. Finally, Part III maintains that, while the Fifth Circuit's expansive approach to "property of the estate" attempts to equitably protect creditors, including fraudulently transferred property as "property of the estate" prior to its recovery has the potential to cloud title to property of the estate. Part III concludes that such a result is problematic in terms of bankruptcy administration and that policy concerns also argue against including in the estate fraudulently transferred property that the trustee has not yet recovered.

### I. THE CONTROVERSY SURROUNDING § 541

Courts disagree over the interpretation of § 541 and the definition of "property of the estate."<sup>13</sup> This Part discusses the two seminal cases addressing the issue of including purportedly fraudulently transferred property as property of the estate prior to the trustee's recovery of such property: *In re MortgageAmerica Corp.*<sup>14</sup> and *In re Colonial Realty Co.*<sup>15</sup> Determining the effect each decision has on the bankruptcy process and the extent to which each decision conforms to the most plausible reading of the statute requires an understanding of the reasoning behind each of these decisions and the statutory text upon which the courts relied.

Sections 548 and 550 allow the trustee to make a claim on property transferred by the debtor under certain circumstances. Section 548 allows the trustee to avoid any transfer of an "interest of the debtor in property, or any obligation . . . incurred by the debtor" that meets certain criteria on or within two years of filing for bankruptcy protection.<sup>16</sup> The trustee may avoid

13. See, e.g., *In re Colonial Realty Co.*, 980 F.2d 125; *In re MortgageAmerica Corp.*, 714 F.2d 1266. This Part discusses both cases in greater depth.

14. *In re MortgageAmerica Corp.*, 714 F.2d at 1275 (holding that § 541 broadly includes property that a debtor has allegedly fraudulently transferred but which the trustee has not yet recovered).

15. *In re Colonial Realty Co.*, 980 F.2d at 131 (reaching the opposite conclusion from *In re MortgageAmerica Corp.* and holding that fraudulently transferred property that the trustee has not yet recovered does not constitute property of the estate).

16. 11 U.S.C. § 548(a)(1) (2000). Section 548 reads, in relevant part:

§ 548. Fraudulent transfers and obligations

(a) (1) The trustee may avoid any transfer . . . of an interest of the debtor in property, or any obligation . . . incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after

transfers the debtor made with “actual intent to hinder, delay, or defraud any entity to which the debtor was or became . . . indebted.”<sup>17</sup> However, a transferor need not voluntarily create a fraudulent transfer for the trustee to be able to avoid the transfer.<sup>18</sup> The trustee may also avoid transfers and obligations for which the debtor “received less than a reasonably equivalent value in exchange”<sup>19</sup> and that were made while the debtor was insolvent,<sup>20</sup> that left the debtor with an unreasonably small amount of capital for his business dealings,<sup>21</sup> that the insolvent debtor intended to be or believed “would be beyond the debtor’s ability to pay as such debts matured,”<sup>22</sup> or that benefited an insider under an employment contract.<sup>23</sup>

Once a trustee has avoided a transfer under § 548, she may recover the property under 11 U.S.C. § 550.<sup>24</sup> Section 550 requires the transferee to

- 
- the date that such transfer was made or such obligation was incurred, indebted; or
- (B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
- (ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
- (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;
- (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor’s ability to pay as such debts matured; or
- (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S.C. § 548 (2000 & Supp. V 2005).

17. 11 U.S.C. § 548(a)(1)(A) (2000).

18. *Id.* § 548(a)(1) (allowing the trustee to avoid the transfer whether the debtor acted “voluntarily or involuntarily”).

19. *Id.* § 548(a)(1)(B)(i).

20. *Id.* § 548(a)(1)(B)(ii)(I).

21. *Id.* § 548(a)(1)(B)(ii)(II).

22. *Id.* § 548(a)(1)(B)(ii)(III).

23. 11 U.S.C. § 548(a)(1)(B)(ii)(IV) (2000 & Supp. V 2005). Note, however, that § 548(c) provides an exception for bona fide purchasers and good faith givers of value. *Id.* § 548(c).

24. 11 U.S.C. § 550 (2000). Section 550 reads, in relevant part:

§ 550. Liability of transferee of avoided transfer

- (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section . . . 548 . . . 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) 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.

*Id.*

disgorge the property received or its equivalent value<sup>25</sup> and to return it to the § 541 "estate," the general pot from which all creditors are paid.<sup>26</sup> Property recovered under § 550 is therefore property of the estate under § 541(a)(3).<sup>27</sup> The transferee can then attempt to recover the property through the bankruptcy proceeding. But because the trustee manages the property pot for the benefit of all creditors,<sup>28</sup> the disgorging transferee will likely receive at the end of the bankruptcy proceeding less than what the trustee forced him to return to the estate.<sup>29</sup> Transferees whose transactions are subject to attack by a bankruptcy trustee under § 548, often creditors, thus have an incentive to fight the trustee's assertion of authority and to keep the property out of the § 541 bankruptcy estate.

In *In re MortgageAmerica Corp.*,<sup>30</sup> the Fifth Circuit held that purportedly fraudulently transferred property under § 548 qualifies as property of the estate under § 541(a)(1) even prior to its recovery by the trustee. The court reasoned that

[t]he transferee may have colorable title to the property, but the equitable interest—at least as far as the creditors (but not the debtor) are concerned—is considered to remain in the debtor so that creditors may attach or execute judgment upon it as though the debtor had never transferred it.<sup>31</sup>

In *In re MortgageAmerica Corp.*, Joe R. Long was the sole shareholder of RJF, Inc., which in turn was the sole shareholder of MortgageAmerica Corporation.<sup>32</sup> Previously, American National Bank of Austin had filed suit and received a \$192,554.40 judgment against MortgageAmerica in Texas state court for breach of contract.<sup>33</sup> The bank then attempted to collect on that judgment from Long personally, rather than from his insolvent company, on the grounds that Long was personally liable for the company's obligations because he had deliberately stripped MortgageAmerica of assets

---

25. *Id.* § 550(a).

26. *See id.* § 541.

27. *Id.* § 541(a)(3) (including as property of the estate "[a]ny interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title").

28. *Am. Nat'l Bank of Austin v. MortgageAmerica Corp. (In re MortgageAmerica Corp.)*, 714 F.2d 1266, 1275 (5th Cir. 1983). Note, however, that not all transferees are creditors. For example, a business owner may transfer business assets to his son, to whom the businessman owes no money.

29. By definition, fraudulent and preferential transfers require that the transferee has received more than he or she otherwise would have under bankruptcy proceedings. *See* 11 U.S.C. §§ 547(b), 548. Therefore, in the example from note 28, the non-creditor son would get nothing at the end of the bankruptcy proceeding. Nonetheless, an event such as the debtor winning the lottery or landing a profitable business deal after a creditor-transferee has already disgorged the funds may enable the creditor-transferee to receive at the end of bankruptcy proceedings more than he or she initially had received via the avoided transfer.

30. 714 F.2d 1266.

31. *Id.* at 1275.

32. *Id.* at 1268.

33. *MortgageAmerica Corp. v. Am. Nat'l Bank of Austin*, 651 S.W.2d 851 (Tex. App. 1983).

to benefit himself while defrauding the company's creditors.<sup>34</sup> Specifically, American National alleged that Long made three fraudulent transfers in May and June 1981 totaling \$2.3 million.<sup>35</sup> By August 1981, MortgageAmerica had entered into involuntary bankruptcy under Chapter 7, which provides for liquidation of the company's assets.<sup>36</sup>

American National argued that the causes of action against Long for the purportedly fraudulent transfers did not constitute property of MortgageAmerica's estate.<sup>37</sup> The bank wanted all its money back; it did not want the money to get into the hands of the bankruptcy trustee. If MortgageAmerica "owned" the causes of action against Long and those causes of action constituted property of the estate, the bankruptcy trustee would be responsible for both the suit and the division among all creditors of any property recovered.<sup>38</sup> But if the causes of action against Long belonged to American National, they would not constitute property of the estate. American National could thus try to remove the automatic stay under 11 U.S.C. § 362<sup>39</sup> and move forward in pursuit of a judgment against Long that it would not have to share. However, the Fifth Circuit ruled against American National and held that the causes of action against Long were property of MortgageAmerica's estate under § 541(a)(1).<sup>40</sup> The court applied the stay under § 362(a)(3), preventing American National from pursuing its state court action against Long.<sup>41</sup>

In addition, the court held that fraudulently conveyed and recoverable property remains property of the estate despite the fact that the trustee has not yet recovered it.<sup>42</sup> The court reasoned that "it makes the most sense to consider the debtor as continuing to have a 'legal or equitable interest[]' in the property fraudulently transferred within the meaning of section 541(a)(1)."<sup>43</sup> Therefore, the trustee need not recover the debtor's equitable interest because it "remain[s] in the debtor so that creditors may attach or

---

34. *In re MortgageAmerica Corp.*, 714 F.2d at 1268.

35. *Id.*

36. *See* 11 U.S.C. §§ 701–66 (2000).

37. *In re MortgageAmerica Corp.*, 714 F.2d at 1268 ("The bank's principal argument on this appeal is that under state law the three causes of action in issue all accrue solely to creditors in their individual capacities, not to the company, and that these particular causes of action thus cannot be considered 'property of the estate' . . .").

38. *Id.* at 1275 (noting that the trustee "acts for the benefit of all creditors, not just those who win a race to judgment" (citing 4B COLLIER ON BANKRUPTCY, ¶ 70.71, at 788–89 (James W. Moore ed., 14th ed. 1978))).

39. The automatic stay prevents creditors from pursuing most kinds of suits for recovery against the bankrupt or the property of his or her estate. *See* 11 U.S.C. § 362.

40. *In re MortgageAmerica Corp.*, 714 F.2d at 1275.

41. *Id.* at 1277–78.

42. *Id.* at 1277.

43. *Id.* at 1275 (alteration in original).

execute judgment upon it *as though the debtor had never transferred it*.”<sup>44</sup> The Fifth Circuit’s decision allowed the trustee to consider the purportedly fraudulently transferred property as part of the estate without having to recover it under § 548’s fraudulent transfer provision. As a result, American National could not bring suit to recover the property on its own.

In the face of criticism of *In re MortgageAmerica Corp.*, the Fifth Circuit sought to affirm its position in *In re Criswell*.<sup>45</sup> *In re Criswell* relied heavily on both *In re MortgageAmerica Corp.*<sup>46</sup> and *Begier v. IRS*,<sup>47</sup> a Supreme Court case that—like *In re Criswell*—dealt with “property of the debtor” under § 547, the preferential transfer statute.<sup>48</sup> While recognizing that the phrase “property of the debtor” under § 547 is notably different from “property of the estate” under § 541,<sup>49</sup> the *Begier* court turned to § 541 for guidance on the grounds that it serves as “the postpetition analog to § 547(b)’s ‘property of the debtor.’”<sup>50</sup> It held that “‘property of the debtor’ subject to the preferential transfer provision [of § 547(b)] is best understood as that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings.”<sup>51</sup> In evaluating § 547(b), *Begier* noted that § 541(a) includes all of the debtor’s legal or equitable interests in property as of the commencement of the case.<sup>52</sup> Although this statement is merely axiomatic, the court in *In re Criswell* cited *Begier*, along with an Eighth Circuit case and a bankruptcy case from the Eastern District of Virginia,<sup>53</sup> for a different proposition: that § 547(b)’s “interest of the debtor in property”<sup>54</sup> is “synonymous with the term ‘property of the estate’ under § 541.”<sup>55</sup> The *In re Criswell* court then applied *In re MortgageAmerica Corp.*’s principles to the

44. *Id.* at 1275 (emphasis added) (“The transferee may have colorable title to the property, but the equitable interest . . . is considered to remain in the debtor so that creditors may attach or execute judgment upon it *as though the debtor had never transferred it*.” (emphasis added)).

45. *Cullen Ctr. Bank & Trust v. Hensley (In re Criswell)*, 102 F.3d 1411 (5th Cir. 1997).

46. *In re MortgageAmerica Corp.*, 714 F.2d 1266; *see In re Criswell*, 102 F.3d at 1418 (“In sum, we hold, relying on *Begier*, on the other property definition cases, and on *MortgageAmerica*, that . . . the term ‘interest of the debtor in property’ under § 547(b) includes ‘all legal or equitable interests of the debtor as of the commencement of the case’ . . . .” (quoting 11 U.S.C. § 541(a)(1) (2000))).

47. *Begier v. IRS*, 496 U.S. 53 (1990).

48. 11 U.S.C. § 547. Section 547 is similar to § 548 in that § 547 deals with transfers subject to avoidance and recovery by the trustee; however, § 547 deals with preferential transfers instead of fraudulently transferred property.

49. *Begier*, 496 U.S. at 58–59.

50. *Id.* at 59; *see also id.* at 59 n.3.

51. *Id.* at 58.

52. *Id.* at 59 (citing 11 U.S.C. § 541(a)(1)).

53. *Cullen Ctr. Bank & Trust v. Hensley (In re Criswell)*, 102 F.3d 1411, 1416 (5th Cir. 1997) (citing *Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275 (8th Cir. 1988), and *Gen. Office Furniture Wholesalers, Inc. v. U.S. Furniture Indus., Inc. (In re Gen. Office Furniture Wholesalers, Inc.)*, 42 B.R. 232 (Bankr. E.D. Va. 1984)).

54. 11 U.S.C. § 547(b).

55. *In re Criswell*, 102 F.3d at 1416.

facts of the case, holding that *In re MortgageAmerica Corp.*'s conclusion—that courts should consider the debtor as retaining an equitable interest that qualifies as property of the estate under § 541(a)(1) in property purportedly fraudulently transferred under § 548—applies equally to purportedly preferential transfers under § 547(b).<sup>56</sup> However, even if *Begier* stands for the proposition for which the Fifth Circuit cited it, neither *Begier*'s nor *In re Criswell*'s interpretation of § 547(b) can be dispositive of § 548's meaning or its relationship to § 541. Thus, despite the court's efforts, *In re Criswell* never justifies *In re MortgageAmerica Corp.*<sup>57</sup>

*In re Colonial Realty Co.* sets out the competing proposition that fraudulently transferred property does not constitute property of the estate before its recovery.<sup>58</sup> Prior to *In re Colonial Realty Co.*, the Second Circuit had cited *In re MortgageAmerica Corp.* with approval.<sup>59</sup> In *In re Colonial Realty Co.*, however, instead of following *In re MortgageAmerica Corp.*'s lead and focusing on who owned a cause of action for fraudulently transferred property—the debtor or the creditors—the Second Circuit focused on the target of the lawsuit: the debtor in its capacity as the party alleged to have fraudulently transferred property.<sup>60</sup>

In *In re Colonial Realty Co.*, the Federal Deposit Insurance Corporation ("FDIC") appealed the bankruptcy court's ruling that its lawsuit to recover fraudulently conveyed property was property of the estate and therefore subject to the automatic stay of 11 U.S.C. § 362.<sup>61</sup> In the 1980s, Colonial Realty Company had been involved in the formation and syndication of a number of real estate limited partnerships.<sup>62</sup> When the company (along with its general partners Jonathan Googel and Benjamin Sisti) entered involuntary bankruptcy in September 1990, thousands of investors suffered huge losses and creditors' claims totaled billions of dollars.<sup>63</sup> These losses caused the failure of several banks that had loaned money to Colonial. The FDIC acted as receiver for five

---

56. *Id.* at 1417 ("[W]hen a soon-to-be-bankrupt debtor (like Criswell) fraudulently transfers property to shield it from his creditors, that debtor/transferor should be considered to have retained an equitable interest in the property so that it will continue to be considered 'property of the estate.'").

57. *See id.* at 1417 n.27 ("Even though a Second Circuit decision, *In re Colonial Realty Co.*, has criticized part of our reasoning, the *MortgageAmerica* decision remains binding precedent in this circuit." (citation omitted)).

58. FDIC v. Hirsch (*In re Colonial Realty Co.*), 980 F.2d 125 (2d Cir. 1992).

59. *Id.* at 131 (citing *In re Crysen/Montenay Energy Co.* (Crysen/Montenay Energy Co. v. Esselen Assocs., Inc.), 902 F.2d 1098, 1101 (2d Cir. 1990); *St. Paul Fire and Marine Ins. Co. v. Pepsico, Inc.*, 884 F.2d 688, 696–97 (2d Cir. 1989); *Cumberland Oil Corp. v. Thropp*, 791 F.2d 1037, 1042 (2d Cir. 1986), *cert. denied*, 479 U.S. 950 (1986); *Mitchell Excavators, Inc. v. Mitchell*, 734 F.2d 129, 131 (2d Cir. 1984)).

60. *See id.* (rejecting *In re MortgageAmerica Corp.*'s analysis despite having previously cited the case with approval); *see also infra* notes 68–76 and accompanying text.

61. *In re Colonial Realty Co.*, 980 F.2d at 129–30.

62. *Id.* at 127.

63. *Id.*

of these banks between January and September 1991.<sup>64</sup> In this role, the FDIC sought to avoid the transfer of and to recover approximately \$10 million that Sisti allegedly had fraudulently transferred to his wife and another company.<sup>65</sup> Like American National in *In re MortgageAmerica Corp.*, the FDIC asserted that the state law cause of action belonged exclusively to the FDIC as receiver and that it was neither property of the estate nor subject to the automatic stay.<sup>66</sup> Meanwhile, the trustee argued that the court should follow *In re MortgageAmerica Corp.* and hold that the transferred property was property of the estate, even though the trustee had not yet recovered it, subjecting the property to the automatic stay.<sup>67</sup>

The Second Circuit concluded that, while *In re MortgageAmerica Corp.* reached the correct result in staying the suit, the Fifth Circuit had analyzed the statute inappropriately.<sup>68</sup> The *In re Colonial Realty Co.* court reasoned that considering fraudulently transferred property to be property of the estate under § 541(a)(1) prior to its recovery would render § 541(a)(3) superfluous. In other words, including fraudulently transferred property under § 541(a)(1) prior to its recovery on the grounds that the debtor retained an equitable interest in the property renders § 541(a)(3)—which makes any interest in property that the trustee recovers property of the estate—“meaningless with respect to property recovered pursuant to fraudulent transfer actions.”<sup>69</sup>

The *In re Colonial Realty Co.* court’s analysis relied heavily on a Northern District of Florida bankruptcy court decision, *In re Saunders*, that rejected *In re MortgageAmerica Corp.*’s broad approach.<sup>70</sup> In *In re Saunders*, creditor Professional Savings Bank (“Professional”) sought to recover funds that the debtor had allegedly transferred for the purpose of hindering, delaying, or defrauding creditors.<sup>71</sup> The trustee in *In re Saunders* relied on the broader *In re MortgageAmerica Corp.* approach and asserted that the transferred assets were still property of the estate.<sup>72</sup> However, the *In re Saunders* court disagreed with *In re MortgageAmerica Corp.*’s conclusion, finding it inconsistent with other provisions of the Bankruptcy Code because it would render § 541(a)(3) “meaningless with respect to property recovered pursuant to fraudulent transfer actions.”<sup>73</sup> The court also noted that applying the *In re MortgageAmerica Corp.* principle would create problems with respect to

---

64. *Id.*

65. *Id.* at 127–28.

66. *Id.* at 130.

67. *Id.* at 131.

68. *Id.*

69. *Id.* at 131 (quoting *In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989)).

70. See *In re Colonial Realty Co.*, 980 F.2d at 131 (citing *In re Saunders*, 101 B.R. at 305).

71. *In re Saunders*, 101 B.R. at 303; see also 11 U.S.C. § 548(a)(1)(A) (2000).

72. *In re Saunders*, 101 B.R. at 304. The trustee also relied on *S.I. Acquisition, Inc. v. Eastway Delivery Service, Inc.* (*In re S.I. Acquisition, Inc.*), 817 F.2d 1142 (5th Cir. 1987), but *In re S.I. Acquisition, Inc.* followed the *In re MortgageAmerica Corp.* line of reasoning and is not particularly distinct for these purposes.

73. *In re Saunders*, 101 B.R. at 305.

other aspects of bankruptcy practice.<sup>74</sup> For example, if courts could hold that purportedly fraudulently transferred property is property of the estate prior to a judicial determination that it was in fact fraudulently transferred, the trustee could circumvent the statutes of limitations under various sections providing for recovery of property.<sup>75</sup> Thus, the *In re Saunders* court held—and the Second Circuit in *In re Colonial Realty Co.* agreed—that purportedly fraudulently transferred property is not property of the estate until a court determines it was fraudulently transferred.<sup>76</sup>

## II. STATUTORY INTERPRETATION AND REALIZING § 541'S PURPOSE

While the Fifth and Second Circuits both lay out plausible arguments for their respective interpretations of § 541, this Part argues that various canons of statutory interpretation support the Second Circuit's conclusion in *In re Colonial Realty Co.* Section II.A argues that the plain meaning of the statute's language indicates that courts should define "property of the estate" narrowly. Although § 541 makes room in "property of the estate" for fraudulently transferred property, such property is allowed only upon recovery. Section II.B demonstrates that the Fifth Circuit's broad reading of § 541 violates the rule against surplusage by obviating two key portions of the Bankruptcy Code, § 548 and § 550. Because the structure and language of the statute indicate Congress's likely intention to define "property of the estate" narrowly, the Fifth Circuit's attempt to draw not-yet-recovered property into the "property of the estate" through the general language of § 541(a)(1) is ultimately inappropriate.

### A. The Plain Meaning Approach

A plain meaning reading of the statute's language counsels against the Fifth Circuit's interpretation of § 541. Indeed, the "golden rule" of statutory interpretation is that interpreters should "adhere to the ordinary meaning of the words used, and to the grammatical construction, unless that . . . leads to any manifest absurdity or repugnance."<sup>77</sup> The Fifth Circuit's expansive approach holds that "[t]he transferee may have colorable title to the property, but the equitable interest . . . is considered to remain in the debtor so that

---

74. *Id.* at 304–05.

75. *Id.* at 305. In *In re Saunders*, the court stated that

[u]ntil a judicial determination has been made that the property was, in fact, fraudulently transferred, it is not property of the estate. If it were, the trustee could simply use a turnover action under 11 U.S.C. § 542, and the two (2) year statute of limitations of § 546(a) for actions under §§ 544 and 548 could be avoided.

*Id.*

76. *Id.*; *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125, 131 (2d Cir. 1992) (citing *In re Saunders*, 101 B.R. at 305).

77. WILLIAM N. ESKRIDGE, JR. ET AL., *CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY* 829 (3d ed. 2001) (quoting *Becke v. Smith*, (1836) 150 Eng. Rep. 724, 726 (Exch. Div.)).

creditors may attach or execute judgment upon it as though the debtor had never transferred it.”<sup>78</sup> However, this approach runs afoul of the golden rule because it strains the plain meaning of two key terms: “equitable interest” and “recovers.”

A plain reading of § 541(a)(1) demonstrates that purportedly fraudulently transferred property does not constitute an “equitable interest” that belongs to the estate. An equitable interest is one either “held by virtue of an equitable title or claimed on equitable grounds, such as the interest held by a trust beneficiary.”<sup>79</sup> An equitable title is one “that indicates a beneficial interest in property and that gives the holder the right to acquire formal legal title.”<sup>80</sup> However, the trustee cannot satisfy the requirements of equitable title with respect to purportedly fraudulently transferred property without an adjudication that the property has been fraudulently transferred in the first place. Title is the “union of all elements (as ownership, possession, and custody) constituting the legal right to control and dispose of property; the legal link between a person who owns property and the property itself.”<sup>81</sup> These elements of title are precisely those that are in dispute when a trustee alleges that the debtor fraudulently transferred property. Therefore, the debtor cannot have an equitable interest in purportedly fraudulently transferred property on the grounds that the debtor has equitable title unless the court makes a judicial determination that the property was fraudulently transferred.

No equitable grounds exist for considering the debtor as retaining an equitable interest in purportedly fraudulently transferred property because there is an adequate remedy at law. Equity involves “recourse to principles of justice to correct or supplement the law as applied to particular circumstances.”<sup>82</sup> Although equitable interests themselves are property of the estate under § 541(a)(1), there is no reason for the courts to consider the debtor as having an equitable interest<sup>83</sup> in the purportedly fraudulently transferred property for reasons of fairness or justice because the combination of §§ 548, 550, and 541(a)(3) provides a sufficient remedy.<sup>84</sup> That is, courts

---

78. *Am. Nat’l Bank of Austin v. MortgageAmerica Corp.* (*In re MortgageAmerica Corp.*), 714 F.2d 1266, 1275 (5th Cir. 1983).

79. BLACK’S LAW DICTIONARY 829 (8th ed. 2004).

80. *Id.* at 1523.

81. *Id.* at 1522.

82. *Id.* at 579.

83. *See In re MortgageAmerica Corp.*, 714 F.2d at 1275 (“The transferee may have colorable title to the property, but the equitable interest . . . is considered to remain in the debtor so that creditors may attach or execute judgment upon it as though the debtor had never transferred it.” (emphasis added)).

84. *See* DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES (3d ed. 2002). Laycock notes that “[i]t is hornbook law that equity will not act if there is an adequate remedy at law,” *id.* at 370, and that, while the rule may “no longer ha[ve] much bite,” *id.* at 8, practitioners must “argue within the terms of traditional doctrine” because no court has explicitly repudiated it and even a “successful argument within the terms of the rule does not necessarily mean that plaintiff will get the remedy she prefers,” *id.* at 382.

need not apply equitable principles to purportedly fraudulently transferred property because the law has already provided an adequate remedy to address title of such property under §§ 548, 550, and 541(a)(3).<sup>85</sup>

Likewise, Congress's use of verb tense in § 541(a)(3) undermines the Fifth Circuit's broad interpretation of § 541(a)(1). Verb tense is generally significant in construing statutes,<sup>86</sup> and the Bankruptcy Code is no exception.<sup>87</sup> While courts have dealt with the issue of verb tense and its impact on statutory analysis principally in non-bankruptcy cases,<sup>88</sup> the Bankruptcy Code uses various tenses to draw important distinctions.<sup>89</sup> For example, the Bankruptcy Code's definitional section "defines a 'disinterested person' as a person that, among other things, 'is not and was not an investment banker for any outstanding security of the debtor.'"<sup>90</sup> Other subsections of § 101 also make temporal distinctions.<sup>91</sup>

Section 541(a)(3)'s reference to property that the trustee "recovers"<sup>92</sup> denotes Congress's intent to include as property of the estate any property that has been or will be fully recovered, but not property that the trustee merely "might recover." Unless the context indicates otherwise, words used in the present tense in any Act of Congress include the future as well as the present tense.<sup>93</sup> But the present and future tenses here—"recover" and "will

---

85. See *Terrace v. Thompson*, 263 U.S. 197, 214 (1923) ("That a suit in equity does not lie where there is a plain, adequate and complete remedy at law is so well understood as not to require the citation of authorities."); *Lacassagne v. Chapuis*, 144 U.S. 119, 124 (1892) ("The question here involved is a dispute about title. The plaintiff has a full, adequate and complete remedy at law, and the case is not one for the jurisdiction of a court of equity.").

86. *United States v. Wilson*, 503 U.S. 329, 333 (1992) (holding that sentencing credit may not be applied in the case at bar because "[b]y using these verbs in the past and present perfect tenses [in the statute at issue], Congress has indicated that computation of the credit must occur after the defendant begins his sentence"); *United States v. Valentine*, 63 F.3d 459, 463 (6th Cir. 1995) ("Congress' use of a verb tense is significant in construing statutes." (quoting *Wilson*, 503 U.S. at 333)).

87. *Bank Brussels Lambert v. Coan (In re AroChem Corp.)*, 176 F.3d 610, 623 (2d Cir. 1999).

88. See, e.g., *Wilson*, 503 U.S. at 333 (criminal sentencing guidelines); *Valentine*, 63 F.3d at 463 (misappropriation of city property); *Hughes v. Bd. of Architectural Exam'rs*, 952 P.2d 641, 649 (Cal. 1998) (architectural licensing); *Martin v. City of Albany*, 880 P.2d 926, 930 (Or. 1994) (workers' compensation benefits); *State v. Root*, 123 P.3d 281, 284 (Or. Ct. App. 2005) (drug possession).

89. See *In re AroChem Corp.*, 176 F.3d at 623 (citing *Wilson*, 503 U.S. at 333).

90. *In re AroChem Corp.*, 176 F.3d at 623 (quoting 11 U.S.C. § 101(14)(B) (2000)).

91. See, e.g., 11 U.S.C. § 101(21A) (defining "farmout agreement" as one in which an owner "agrees or has agreed"); *id.* § 101(26) (defining "forward contract merchant" partially based upon a "right, or interest which is presently or in the future becomes"); *id.* § 101(53B)(A)(ii)(I) (defining "swap agreement" to include a temporal agreement that "has been, is presently, or in the future becomes").

92. *Id.* § 541(a)(3).

93. 11 U.S.C. § 1 (2000) ("In determining the meaning of any Act of Congress, unless the context indicates otherwise . . . words used in the present tense include the future as well as the present . . .").

recover,” respectively—do not encompass the concept of “might recover.”<sup>94</sup> That is, the fact that a bankruptcy court may ultimately render a decision in favor of the trustee is not the same as the court actually deciding; a trustee’s filing suit to recover property under § 548 on Monday is not the same as the court’s adjudication on Friday that the property was fraudulently transferred and is property of the estate.<sup>95</sup> Thus, the Fifth Circuit’s failure to adhere to the statute’s plain meaning by imputing unsaid language runs afoul of the golden rule.

### B. *The Rule Against Surplusage*

The Fifth Circuit’s reading of § 541 violates the rule against surplusage because it obviates § 548. While the canons of statutory interpretation are not binding on a court,<sup>96</sup> courts should give statutory provisions meaning, rather than “emasculat[ing]” them.<sup>97</sup> Therefore, a court must read a statute’s words in their context and with a view to their place in the general statutory construct.<sup>98</sup> Whenever possible, courts must construe statutes to give effect to every word, clause, and sentence<sup>99</sup> because “no provision should be construed to be entirely redundant.”<sup>100</sup>

The language of § 541 distinguishes the debtor’s legal and equitable interests from fraudulently transferred property. Section 541(a)(3) specifically includes as property of the estate “[a]ny interest in property that the trustee recovers” under various sections of the Code.<sup>101</sup> Section 541(a)(1) separately provides that property of the estate shall include “all legal or equitable interests of the debtor in property as of the commencement of the case.”<sup>102</sup> The Fifth Circuit’s approach includes property the trustee “might recover” as

94. Equating “might recover” with “recover” or “will recover” would render § 548 surplusage, allowing the trustee to avoid § 548’s two-year statute of limitations and creating uncertainty in the bankruptcy process. *See infra* notes 101–107 and accompanying text.

95. Transfers not meeting § 548’s criteria are not subject to avoidance and therefore the trustee cannot recover them. *See, e.g.,* *Morris v. Midway S. Baptist Church (In re Newman)*, 183 B.R. 239, 246 (Bankr. D. Kan. 1995) (noting that § 548(a) allows the trustee to recover any transfer that meets its criteria).

96. *Chickasaw Nation v. United States*, 534 U.S. 84, 85 (2001) (“[T]he canons of [statutory] interpretation . . . do not determine how to read this statute. First, the canons are guides that need not be conclusive.”).

97. *United States v. Menasche*, 348 U.S. 528, 538–39 (1955) (“The cardinal principle of statutory construction is to save and not to destroy. It is our duty to give effect, if possible, to every clause and word of a statute, rather than to emasculate an entire section . . .” (citations omitted) (internal quotation marks omitted)).

98. *Davis v. Mich. Dep’t of Treasury*, 489 U.S. 803, 809 (1989); *see also* *Owasso Indep. Sch. Dist. No. I-011 v. Falvo*, 534 U.S. 426, 434 (2002) (citing *Davis*, 489 U.S. 803).

99. *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (citing *Duncan v. Walker*, 533 U.S. 167, 174 (2001)); *see also Menasche*, 348 U.S. at 538–39 (“It is our duty ‘to give effect, if possible, to every clause and word of a statute’ . . .” (quoting *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883))).

100. *ESKRIDGE, supra* note 77, at 833 (quoting *Kungys v. United States*, 485 U.S. 759, 778 (1988)).

101. 11 U.S.C. § 541(a)(3) (2000).

102. *Id.* § 541(a)(1).

“legal or equitable interests” under subsection (a)(1). But legal and equitable interests under subsection (a)(1) do not require an adjudication of recoverability; they are already part of the estate “as of the commencement of the case.”<sup>103</sup> The trustee cannot recover an equitable interest because it never left the debtor’s possession in the first place.<sup>104</sup> Under the Fifth Circuit analysis, then, the trustee would not need to attempt a recovery of fraudulently transferred property at all, let alone complete one.<sup>105</sup>

Thus, following the Fifth Circuit’s approach would relegate § 548 to mere surplusage. If fraudulently transferred property automatically qualifies as property of the estate under § 541(a)(1), the trustee has no need for either § 548<sup>106</sup> or § 550<sup>107</sup> even though Congress specifically provided such guidelines and made room in the estate for such recovered property under § 541(a)(3). As noted previously, property recovered under §§ 548 and 550 falls under § 541(a)(3).<sup>108</sup> Section 548 allows the trustee to avoid fraudulent transfers that meet certain criteria on or within two years of the debtor’s filing for bankruptcy protection.<sup>109</sup> Once a trustee has avoided a transfer under § 548, the trustee may recover the property under § 550, which has its own one-year statute of limitations.<sup>110</sup> Property recovered under § 550 within that time period is property of the estate under § 541(a)(3).<sup>111</sup> However, the Fifth Circuit’s expansive reading of § 541(a)(1), which includes purportedly fraudulently transferred property as property of the estate under subsection (a)(1) without the need for an adjudication in favor of the trustee under § 548, renders both §§ 548 and 550 surplusage by obviating the need to use them to bring the property into property of the estate under subsection (a)(3).

103. *Id.*

104. *Am. Nat’l Bank of Austin v. MortgageAmerica Corp. (In re MortgageAmerica Corp.)*, 714 F.2d 1266, 1275 (5th Cir. 1983) (“The transferee may have colorable title to the property, but the equitable interest . . . is considered to remain in the debtor so that creditors may attach or execute judgment upon it *as though the debtor had never transferred it.*” (emphasis added)).

105. *See, e.g., In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989). In *In re Saunders*, the court noted that

[u]ntil a judicial determination has been made that the property was, in fact, fraudulently transferred, it is not property of the estate. If it were, the trustee could simply use a turnover action under 11 U.S.C. § 542, and the two (2) year statute of limitations of § 546(a) for actions under §§ 544 and 548 could be avoided.

*Id.*

106. *See* 11 U.S.C. § 548(a)(1) (allowing the trustee to avoid transfers made within two years before the date of the filing of the bankruptcy petition). In certain situations, the statute of limitations can be extended to ten years. *Id.* § 548(e).

107. *See id.* § 550(f)(1) (“An action or proceeding under this section may not be commenced after the earlier of—(1) one year after the avoidance of the transfer on account of which recovery under this section is sought; or (2) the time the case is closed or dismissed.”).

108. *See supra* notes 16–29 and accompanying text.

109. 11 U.S.C. § 548(a)(1).

110. *See id.* § 550(f).

111. *Id.* § 541(a)(3) (including as property of the estate “[a]ny interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title”).

Moreover, even if § 541(a)(1) were to include fraudulently transferred property prior to its recovery, purportedly fraudulently transferred property cannot become property of the estate as an equitable interest under § 541(a)(1) until a judge makes a formal finding that the property still belongs to the debtor.<sup>112</sup> But for it to “make sense” for the debtor to retain an equitable interest in the purportedly fraudulently transferred property, the court must assume that the debtor actually fraudulently transferred the property.<sup>113</sup> Given that Congress has provided § 548 and prescribed methods for its use, and given that the bankruptcy judge determining whether the debtor fraudulently transferred the property essentially makes the same determination as under § 548 even under the Fifth Circuit’s approach,<sup>114</sup> courts should use the method for recovering fraudulently transferred property that Congress provided. Otherwise, § 548 is rendered surplusage.

Congress’s use of a separate subparagraph for the inclusion of trustee-recovered property—§ 541(a)(3)—demonstrates its intent that courts not consider such property to be property of the estate until the trustee has fully recovered it.<sup>115</sup> To hold otherwise makes § 548 and § 550 meaningless because the trustee could simply declare the property to be property of the estate under § 541(a)(1) instead of using § 548 and § 550 to bring the property within § 541(a)(3). That is, if § 541(a)(1) includes purportedly fraudulently transferred property even without an adjudication in favor of the trustee under § 548 followed by recovery under § 550, §§ 548 and 550 are surplusage because the trustee gets to include property that falls under those sections without actually having to use them. Because the Fifth Circuit’s approach violates the rule against surplusage, that court’s attempt to draw not-yet-recovered property into “property of the estate” through the general language of § 541(a)(1) is inappropriate.

---

112. See S. REP. NO. 95-989, at 82 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5868 (conditioning the inclusion of equitable interests under § 541(a)(1) on whether “the property recovered was merely out of the possession of the debtor, yet remained ‘property of the debtor’”). Although the Bankruptcy Code does not define “property of the debtor,” the Supreme Court has held that § 541 is property of the debtor’s “postpetition analog.” *Begier v. IRS*, 496 U.S. 53, 58-59 (1990); see also *supra* notes 47-52 and accompanying text.

113. See *Am. Nat’l Bank of Austin v. MortgageAmerica Corp.* (*In re MortgageAmerica Corp.*), 714 F.2d 1266, 1275 (5th Cir. 1983) (holding that “it makes the most sense to consider the debtor as continuing to have a ‘legal or equitable interest[.]’ in the property fraudulently transferred” even though the court made no formal adjudication that the property was actually fraudulently transferred (alteration in original)).

114. See *id.* at 1277 (“Property fraudulently conveyed and recoverable . . . remains, despite the purported transfer, property of the estate [as an equitable interest] within . . . section 541(a)(1) . . .”). By this reasoning, in order for the court to consider the debtor as continuing to have an equitable interest in the property, it must also consider whether the property was fraudulently transferred. The difficulty with the Fifth Circuit’s position in *In re MortgageAmerica Corp.* is that the court never actually holds that the property was fraudulently transferred before attributing to the debtor an equitable interest in it and including it as property of the estate.

115. See *In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989) (“[T]he inclusion of property recovered by the trustee pursuant to his avoidance powers in a separate definitional subparagraph clearly reflects the congressional intent that such property is not to be considered property of the estate until it is recovered.”); see also *FDIC v. Hirsch* (*In re Colonial Realty Co.*), 980 F.2d 125, 131 (2d Cir. 1992) (citing *In re Saunders*, 101 B.R. at 305).

## III. AVOIDING PRACTICAL AND LEGAL PROBLEMS UNDER § 541

Although the Fifth Circuit's approach to "property of the estate" seeks to equitably protect creditors, this Part argues that the courts should reject it because including fraudulently transferred property as "property of the estate" prior to its recovery potentially clouds title to that property. Such a result is problematic in terms of bankruptcy administration. By encouraging certainty regarding title to the property of the estate, the Second Circuit's approach better serves the main goals of bankruptcy: to efficiently and equitably distribute the debtor's property and to provide the debtor with a fresh start.

The Fifth Circuit's decision to impute an equitable interest to the debtor in a situation involving a purportedly fraudulent transfer is well intentioned insofar as it prevents debtors from skirting the law and protects creditors' interests. The court approached the problem of fraudulent transfer from the creditors' point of view, finding that the transferee "may have colorable title to the property, but the equitable interest—at least as far as the creditors (but not the debtor) are concerned—is considered to remain in the debtor so that creditors may attach or execute judgment upon it as though the debtor had never transferred it."<sup>116</sup> In light of its chosen perspective, the Fifth Circuit decided that it "makes the most sense" to consider the debtor as having a legal or equitable interest in the purportedly fraudulently transferred property and to include it as property of the estate under § 541(a)(1) even though the trustee has not yet recovered the property.<sup>117</sup>

Allowing a trustee to exercise authority over property that has not been recovered, however, conflicts with the main purposes of the Bankruptcy Act and creates administrative problems for both the trustee and the creditors. The Bankruptcy Code serves two main purposes: one equitable and the other rehabilitative.<sup>118</sup> First, the Code attempts to distribute the debtor's remaining assets to its creditors both efficiently and equitably.<sup>119</sup> Since the Bankruptcy Act's landmark enactment in 1898, the aim of the Act and its subsequent incarnations has been to provide for the conservation of the debtor's estate and for an equitable distribution of assets.<sup>120</sup> Second, the

---

116. *In re MortgageAmerica Corp.*, 714 F.2d at 1275.

117. *Id.*

118. *Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 251 (3d Cir. 2001) (citing *Andrews v. Riggs Nat'l Bank of Wash.*, D.C. (*In re Andrews*), 80 F.3d 906, 909 (4th Cir. 1996)).

119. *Westmoreland*, 246 F.3d at 251 (citing *City of New York v. Quanta Res. Corp.*, 739 F.2d 912, 915 (3d Cir. 1984)). This concept is not new, however, as cases as far back as 1849 recognize pro rata distribution of the debtor's property to be the main purpose of the Bankruptcy Act. *See, e.g.*, *Shawhan v. Wheritt*, 48 U.S. (7 How.) 627, 630 (1849).

120. *Simonson v. Granquist*, 369 U.S. 38, 40 (1962). Although the United States has had many Bankruptcy Acts on the books, the Act of 1898 lasted the longest, enduring eighty years, until it was replaced by the Bankruptcy Reform Act of 1978. *See, e.g.*, 1 COLLIER ON BANKRUPTCY ¶ 1.01 (15th ed., rev. 2007) ("Until the enactment of the [1978] Code, the bankruptcy law was contained in the Bankruptcy Act of 1898. Prior to 1898, there was no bankruptcy law that had been continuously in effect during the life of the United States." (citation omitted)); David A. Skeel, Jr., *The Genius of*

Code endeavors to relieve debtors of their outstanding debts and permit them to reorganize their affairs on the way to a fresh start.<sup>121</sup>

Including fraudulently transferred property within § 541 prior to its recovery would appear to advance the Bankruptcy Code's distributional purpose by facilitating equitable distribution of the debtor's assets.<sup>122</sup> However, such a determination fails to do so efficiently. Allowing the debtor to retain any interest in purportedly fraudulently transferred property prior to its recovery creates uncertainty in the bankruptcy process. For example, if courts were to consider allegedly fraudulently transferred property as property of the estate prior to its recovery, the trustee could use a turnover action under § 542—which requires holders of the debtor's property to “deliver to the trustee, and account for, such property or the value of such property”<sup>123</sup>—and thereby avoid the two-year statute of limitations for actions to recover fraudulently transferred property under § 548<sup>124</sup> or the one-year statute of limitations under § 550.<sup>125</sup> If a mere allegation of fraudulent transfer is sufficient to include the property as property of the estate,<sup>126</sup> the statute of limitations under either § 548 or § 550 that limits the trustee's ability to act has no force. Moreover, under the Fifth Circuit's approach, a trustee could pull transferred property into the estate with a mere allegation of fraudulent transfer, instead of having to prove the allegation first. Such a result would potentially cloud the title of *all* property that the debtor has transferred within the relevant period—and make the results of the bankruptcy petition uncertain—until a court determined that each transfer was *not* fraudulent.<sup>127</sup>

Creating clouds on title in this manner also thwarts the second goal of bankruptcy: it denies debtors fresh starts. Despite the Fifth Circuit's intentions to help creditors, the uncertainty that cloudy titles can cause regarding the final results of a bankruptcy petition can render the process unnecessar-

---

*the 1898 Bankruptcy Act*, 15 BANKR. DEV. J. 321, 321–22 (1999) (“For the first century of the nation's existence, there had never been a stable bankruptcy law. . . . Congress passed the 1898 Act, and the rest is history. The 1898 Act endured, and bankruptcy law has expanded—rather than contracted or been repealed—ever since.”).

121. See, e.g., *Westmoreland*, 246 F.3d at 251 (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983), and *Ins. Co. of N. Am. v. Cohn (In re Cohn)*, 54 F.3d 1108, 1113 (3d Cir. 1995)).

122. See *Am. Nat'l Bank of Austin v. MortgageAmerica Corp. (In re MortgageAmerica Corp.)*, 714 F.2d 1266, 1275 (5th Cir. 1983) (holding that when a “debtor has fraudulently transferred [property] in an effort to put it out of the reach of creditors . . . it makes the most sense to consider the debtor as continuing to have a ‘legal or equitable interest[.]’ in the property” under § 541(a)(1)).

123. 11 U.S.C. § 542(a) (2000).

124. *In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989); see also 11 U.S.C. §§ 542, 544, 546(a), 548; *supra* notes 104–106 and accompanying text. This interpretation also violates the rule against surplusage by obviating § 548. For more on the rule against surplusage, see *supra* Section II.B.

125. See *supra* notes 104–106 and accompanying text.

126. See *supra* note 112 and accompanying text.

127. *In re Saunders*, 101 B.R. at 305.

ily long for the debtors seeking a clean slate.<sup>128</sup> This uncertainty can also leave creditors in a more precarious position than they otherwise would have been.<sup>129</sup> Creditors will likely react to this increased uncertainty with increased litigation over the bankruptcy matter, dragging out the process and denying the debtors their fresh start.

*In re BFP*<sup>130</sup> is a prime example of a bankruptcy case that would have benefited from certainty of title. This case reached the U.S. Supreme Court because a quiet title action was not resolved prior to the property's disposition.<sup>131</sup> In *In re BFP*, a pair of homeowners conveyed a single piece of property to two entities: investment partnership BFP and Off-Road Vehicles—Recreation & Family Campground, Inc. ("Off-Road").<sup>132</sup> As a result, BFP and its partners brought suit against Off-Road in state court to quiet title.<sup>133</sup> Meanwhile, the mortgage holder on the property, Imperial, moved to foreclose, prompting Off-Road to file an involuntary bankruptcy petition against BFP.<sup>134</sup> The bankruptcy stayed the foreclosure, but the court subsequently granted both BFP's motion to dismiss the involuntary petition and Imperial's motion to lift the stay.<sup>135</sup> The property was sold in foreclosure proceedings.<sup>136</sup> Three months *after* the foreclosure sale, the quiet title action was settled in Imperial's favor.<sup>137</sup> BFP then filed a voluntary Chapter 11 bankruptcy petition and sought to nullify the foreclosure sale as a transfer for less than reasonably equivalent value under § 548(a)(2).<sup>138</sup>

While the Ninth Circuit's Bankruptcy Appellate Panel upheld Imperial's foreclosure sale because BFP "failed to show that the bankruptcy court erred in concluding that reasonably equivalent value was given for the subject property,"<sup>139</sup> the difficulties that took *In re BFP* from a California bankruptcy court to the U.S. Supreme Court<sup>140</sup> stemmed from the fact that the court did

---

128. See, e.g., *BFP v. Imperial Sav. & Loan Ass'n (In re BFP)*, 132 B.R. 748 (B.A.P. 9th Cir. 1991), *aff'd*, 974 F.2d 1144 (9th Cir. 1992), *aff'd sub nom. BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994). BFP's fresh start took at least five years to obtain, with BFP stuck in involuntary bankruptcy from at least June 1989 to June 1994, when the Supreme Court denied the petitioner's request for rehearing. *Id.*

129. See *id.* (subjecting a lender to a five-year lawsuit regarding whether a foreclosure sale was valid).

130. *Id.*

131. *Id.* at 749.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.* at 751. The court's holding meant the sale did not qualify for avoidance as a fraudulent transfer under § 548 because the absence of "reasonably equivalent value" is required in order to maintain the action.

140. *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994).

not resolve the quiet title action prior to the disposition of the collateral. If the court had settled title in the lender prior to the property's sale in foreclosure, there would have been little to no question whether the lender in *BFP* had the right to dispose of the collateral. This certainty would have allowed the bankruptcy proceeding to be resolved much faster, equitably distributing the property and providing the debtors with their fresh start much more efficiently.

Considering purportedly fraudulently transferred property as property of the estate prior to its recovery would give rise to further instances of *BFP*-like uncertainty because not all attempts to avoid fraudulent transfers will succeed.<sup>141</sup> In fact, *In re BFP* is a prime example of a case where a fraudulent conveyance action failed.<sup>142</sup> The fact that the quiet title action in this case was later resolved in the lender's favor<sup>143</sup>—thereby affirming the preliminary determination of the lower court—does not ameliorate the uncertainty prior to such resolution. Because a court may later adjudge purportedly fraudulently transferred property as having been validly transferred, the Fifth Circuit's approach creates only temporary certainty regarding the disposition of the property. Until the court finally resolves the issue of ownership and allegations of fraudulent transfer, its initial determination remains speculative.

By considering purportedly fraudulently transferred property as property of the estate prior to adjudication, the court skips a necessary step and leaves bankruptcy proceedings open to potentially lengthy appeals. Such lengthy litigation and appeals would overburden courts, a result not likely contemplated by Congress.<sup>144</sup> For example, although *BFP* was only a small, three-partner company, it still took over five years to reach final adjudication on this matter.<sup>145</sup> Bankruptcies involving larger companies with greater as-

---

141. See, e.g., *id.* at 545 (denying avoidance under § 548); see also *Granfinanciera, S. A. v. Nordberg*, 492 U.S. 33, 49 (1989) (holding that the Seventh Amendment guarantees a jury upon request in fraudulent conveyance actions where the petitioner "plainly seeks relief traditionally provided by law courts or on the law side of courts having both legal and equitable dockets"). The right to a jury trial established in *Granfinanciera* demonstrates a potential for uncertainty in this arena.

142. *BFP*, 511 U.S. at 545 (deeming that "a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with" and that, therefore, the foreclosure sale in question does not fall under § 548).

143. *In re BFP*, 132 B.R. at 749.

144. See, e.g., *In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989). The *In re Saunders* court reasoned that Congress did not intend to include fraudulently transferred property as property of the estate prior to adjudication:

We think that the inclusion of property recovered by the trustee pursuant to his avoidance powers in a separate definitional subparagraph clearly reflects the congressional intent that such property is not to be considered property of the estate until it is recovered. . . . If it were, the trustee could simply use a turnover action under 11 U.S.C. § 542, and the two (2) year statute of limitations of § 546(a) for actions under §§ 544 and 548 could be avoided. . . . This result was clearly not contemplated by Congress.

*Id.*

145. *In re BFP*, 132 B.R. at 748. While the original filing date of the involuntary bankruptcy petition does not appear in any of the reported cases, the Ninth Circuit's Bankruptcy Appeals Panel

sets would likely take even longer to resolve. As the Supreme Court has noted, “[b]ankruptcy courts would understandably be reluctant to encourage a policy that would contribute to the overburdening of the bankruptcy court system.”<sup>146</sup> While some appeals are inevitable, the overburdening caused by overstimulating the appellate process would hamper the bankruptcy courts’ efforts to efficiently and equitably distribute the debtors’ property and to provide debtors with a fresh start.<sup>147</sup>

#### CONCLUSION

Courts should adopt the Second Circuit’s approach to “property of the estate” and hold that § 541 does not include fraudulently transferred property that the trustee has yet to recover from a third party. Canons of construction indicate that fraudulently transferred property is property of the estate only once the trustee has recovered it. Moreover, although the Fifth Circuit’s approach to “property of the estate” attempts to equitably protect creditors, including fraudulently transferred property as “property of the estate” prior to its recovery potentially clouds title to property of the estate. Such a result is problematic in terms of administration of bankruptcy proceedings and contravenes bankruptcy’s twin goals of giving the debtor a fresh start and efficiently and equitably distributing the debtor’s property to its creditors.

---

noted that the original bankruptcy stay was lifted on June 14, 1989 and that the foreclosure sale took place July 12, 1989. *Id.* at 749.

146. *Taylor v. Freeland and Kronz*, 503 U.S. 638, 649 n.4 (1992) (Stevens, J., dissenting).

147. To reduce the bankruptcy courts’ burden, Congress recently implemented the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which requires that consumers first go through credit counseling before being eligible for bankruptcy and reduces the scope of bankruptcy relief. American Bankruptcy Institute, *Bankruptcy Filings Increase 66 Percent over First Quarter 2006*, June 27, 2007, <http://www.abiworld.org/AM/Template.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=47794> (last visited Feb. 16, 2008). The American Bankruptcy Institute noted the following:

While representing an increase over the first quarter 2006 totals, the 2007 first quarter filings are still below the 341,662 first quarter filing average recorded since 1997. This filing shortfall reflects the changes brought about by the implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).

*Id.*

