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A CONTRADICTION IN INTERPRETATIONS: A LOOK AT THE CIRCUIT SPLIT REGARDING CREDITOR DERIVATIVE STANDING IN BANKRUPTCY

Lisa J. Pappas[1]

I. INTRODUCTION

Within the past few years the issue of a plaintiff's standing to commence adversary litigation in bankruptcy has grown exponentially. Particularly, the issue concerning whether or not creditors' committees can initiate suit on behalf of the bankruptcy estate to avoid fraudulent transfers by the debtor in possession has received increased attention. Although there is no express provision in the Bankruptcy Code granting creditors' committees the right to commence adversary proceedings, some courts have found an implied right to bring suit on behalf of the estate. However, not all courts are in agreement on the issue of creditor derivative standing. Some circuits allow creditors to bring suit derivatively, some allow derivative suits in limited situations, and other courts deny creditors' committees the right bring derivative suits altogether. This Comment will explore the doctrine of the split among the circuits by analyzing the policies for and against creditor derivative standing in bankruptcy. Furthermore, this Comment will explore two significant cases that have added *more fuel to the fire*[2] of the split among the circuits.[3]

II. BACKGROUND

A. *The Split Amongst the Circuits*

While some circuits have allowed creditors to bring derivative suits on behalf of the bankruptcy estate, these circuits recognize that such a right is the exception and not the rule.[4] The Bankruptcy Code does not provide explicit authority for creditors to initiate adversary proceedings, but most bankruptcy courts that have considered the issue "have found an implied,

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2. Emphasis added.

3. This Comment will look at the Supreme Court decision in Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1 (1942) as well as the Third Circuit case of Official Comm. of Unsecured Creditors of Cybergenics *ex rel.* v. Chinery, 330 F.3d 548, 552 (3d Cir. 2003).

4. *See, e.g.*, *In re* SPM Mfg. Corp. v. Stern, 984 F.2d 1305 (1st Cir. 1993).

but qualified, right for creditors to initiate adversary proceedings in the name of the debtor-in-possession under 11 U.S.C. §§ 1103(c)(5) and 1109(b)."[5] Derivative standing is thus an implied exception to the general rule that the trustee or the debtor in possession has the right and the power to bring suit on behalf of the estate and in fact has the legal responsibility to do so.[6]

Most of the circuits that have allowed a creditors' committee to bring a derivative suit on behalf of the estate have placed limitations on such a right. The Second Circuit noted that although there was no explicit authority for creditors' committees to initiate suits, courts that have considered the issue have allowed a creditors' committee to bring suit on behalf of the estate "only when the trustee or debtor in possession unjustifiably failed to bring suit or abused its discretion in not suing to avoid a preferential transfer."[7] The Second Circuit agreed with the other bankruptcy courts and held that 11 U.S.C. §§ 1103(c)(5) and 1109(b) "imply a qualified right for creditors' committees to initiate suit with the approval of the bankruptcy court."[8] Other circuits have followed suit and allowed creditors' committees to bring an action only when a debtor in possession has refused to do so. The Seventh Circuit has suggested that derivative standing would be available only where "the debtor was shirking his statutory responsibilities."[9] Furthermore the Seventh Circuit has held that if a "trustee unjustifiably refuses a demand to bring an action to enforce a colorable claim of a creditor, the creditor may obtain permission of the bankruptcy court to bring the action in place of, and in the name of, the trustee."[10]

Other circuits that allow creditor derivative standing have placed even stricter requirements on a creditor's ability to gain standing. The Sixth Circuit, in 1995, held that:

> [A] creditor or creditors' committee may have derivative standing to initiate an avoidance action where: 1) a demand has been made upon the statutorily authorized party to take action; 2) the demand is declined; 3) a colorable claim that would benefit the estate if successful exists, based on a cost –benefit analysis performed by the court; and 4) the inaction is an abuse of discretion ("unjustified") in light of the debtor-in-possession's duties in a Chapter 11 case.[11]

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5. *In re* STN Enters. Inc., 779 F.2d 901, 904 (2d Cir. 1985).

6. *See* 11 U.S.C. §§ 1107, 323 (1978).

7. *In re STN Enters.*, 779 F.2d. at 904. The Second Circuit quoted *In re STN Enters*, where it noted that it has previously held that derivative standing "'to initiate a suit with the approval of the bankruptcy courts" exists when the "debtor in possession [has] unjustifiably failed to bring suit."' *In re* Smart World Techs., LLC., 423 F.3d 166, 176 (2d Cir. 2005) (quoting *In re STN Enters.*, 779 F.2d. at 904).

8. *Id.*

9. *In re* Xonics Photochemical Inc., 841 F.2d 198, 203 (7th Cir. 1988).

10. Fogel v. Zell, 221 F.3d 955, 965 (7th Cir. 2000).

11. *In re* The Gibson Group, Inc., 66 F.3d 1436, 1446 (6th Cir. 1995).

Furthermore, the court concluded that a creditor has met its burden if it has satisfied the first three prongs and the debtor-in-possession has failed to take action without stating a reason.[12] Then, the burden will shift to the "debtor-in-possession to establish, by a preponderance of the evidence, that its reason for not acting is justified."[13]

Some courts have granted creditors' committees derivative standing under the auspices of the equitable power of bankruptcy courts. Recently, in a 2009 decision, the Sixth Circuit held that in spite of the Supreme Court's decision in *Hartford Underwriters Ins. Co.* "other provisions of the Bankruptcy Code, as well as pre-Code practice, clearly contemplate the equitable power of bankruptcy courts to authorize creditors, in appropriate instances, to bring claims on behalf of the bankruptcy estate."[14] The court agreed with the decision in *Cybergenics Corp.*, that "the ability to confer derivative standing . . . is a straightforward application of bankruptcy courts' equitable powers."[15] "When the trustee is delinquent, the bankruptcy court . . . should be able to exercise its equitable powers to authorize a creditor to pursue recovery of fraudulently transferred property for the benefit of the estate."[16] Furthermore, the court held that by allowing creditor derivative suits the "equitable remedy effectuates Congress's intent that fraudulently transferred property be recovered for the bankruptcy estate."[17]

Other circuits have considered whether creditor derivative is standing available when the debtor in possession consents.[18] In 2001, the Second Circuit approached the questions of whether a creditors' committee may gain standing with the consent of the trustee, debtor in possession, or court-approved representative as a matter of first impression.[19] The Second Circuit adopted an approach similar to the one followed by the Ninth Circuit in *Spaulding Composites Co.* and held that a creditors committee may gain standing to pursue the debtor's claim if: "(1) the committee has the consent of the debtor in possession or trustee, and (2) the court finds that suit by the committee is (a) in the best interest of the bankruptcy estate, and (b) is 'necessary and beneficial' to the fair and efficient resolution of the bankruptcy proceedings."[20] The approach adopted by the court, known as the Commodore test, allows the debtor in possession and the

12. *Id.*

13. *Id.*

14. *In re* Trailer Source, Inc., 555 F.3d 231, 240 (6th Cir. 2009).

15. *Id.* at 242. (quoting *Cybergenics Corp.*, 330 F.3d at 568).

16. *Id.* at 243.

17. *Id.*

18. *See In re Smart World Techs.*, 423 F.3d. at 176 n.15 (stating "We have also recognized that derivative standing may be appropriate where the debtor-in-possession consents.").

19. *In re* Commodore Int'l, Ltd., 262 F.3d 96, 99 (2d Cir. 2001).

20. *Id.* at 100 (citing *In re* Spaulding Composites Co., 207 B.R. 899, 904 (B.A.P. 9th Cir. 1997)). The court in *Spaulding Composites Co.* held that a debtor in possession could stipulate to the representation by an unsecured creditors' committee "[s]o long as the bankruptcy court exercises its judicial oversight and verifies that the litigation is indeed necessary and beneficial." *Spaulding Composites Co.*, 207 B.R. at 904.

creditors' committee to divide the labor between them, while still allowing the bankruptcy court the authority to manage the litigation and check for possible abuses by the parties.[21] Therefore, the court held that a creditors' committee may sue on behalf of the debtors, with the approval of the bankruptcy court, "not only where the debtor in possession unreasonably fails to bring suit on its claims, but also where the trustee or debtor in possession consents."[22]

On the other hand, some circuits have foreclosed on the idea of creditor derivative standing in bankruptcy due to the fact that there is no explicit authority in the Bankruptcy Code to allow for such a practice. In 1999, the District Court for the Middle District of Florida held that the bankruptcy court erred as a matter of law by granting an individual creditor standing to pursue a fraudulent transfer action on behalf of the bankruptcy estate.[23] After analyzing the provisions of the bankruptcy code the court held that the "Code does not vest bankruptcy courts with the power to grant standing to individual creditors to prosecute such actions."[24] Furthermore, the court held that the bankruptcy courts cannot unilaterally confer standing upon the creditor to pursue the claim itself and that "[i]f such authority is to be granted it must come from Congress and not the courts."[25] The Tenth Circuit has also considered the issue of creditor derivative standing and has held that "the Bankruptcy Code does not allow such suits."[26]

The Fourth Circuit refused to decide the issue of whether creditors' committees could gain standing to sue in bankruptcy cases when faced with the issue in 2005.[27] The court noted that "[w]e have never decided whether creditor derivative suits are permitted in the bankruptcy courts of this circuit" and that "[i]t is far from self-evident that the Bankruptcy Code permits creditor derivative standing."[28] The court went on to note that it would be "ill advised to decide this important and difficult issue here."[29] In the end, the court held very narrowly stating that even assuming creditor derivative standing was available it would not be permitted in this case since the plaintiff failed to prove any prong of the Commodore test, including the fact that there was no evidence that the debtor consented to the suit.[30]

21. *Id.*
22. *Id.*
23. Surf N Sun Apartments, Inc., v. Dempsey, 253 B.R. 490, 491 (M.D. Fla. 1999).
24. *Id.*
25. *Id.* at 495.
26. *In re* Fox, 305 B.R. 912, 914 (B.A.P. 10th Cir. 2004).
27. *In re* Balt. Emergency Servs. II Corp., 432 F. 3d 557 (4th Cir. 2005).
28. *In re* Balt. Emergency Servs. II, Corp., 432 F.3d 557, 560-61 (4th Cir. 2005).
29. *Id.* at 561.
30. *Id.* at 562.

B. *Bankruptcy Code and Pre-Code Based Arguments*

Proponents of the doctrine of creditor derivative standing in bankruptcy argue that the Code itself gives bankruptcy courts permission to approve such derivative suits, although that permission is implied. There is no express provision in the Bankruptcy Code that confers derivative standing on creditors' committees. In fact, Section 544 of the Bankruptcy Code "confers standing to bring avoidance claims only on the trustee."[31] Other provisions of the Code specify that the "debtor in possession my assert the rights of the trustee in Chapter 11 cases where a trustee had not been appointed, [b]ut nowhere does the Code say that creditors may assert claims derivatively on behalf of the trustee or the estate."[32] However, while there is no express provision in the Code granting derivative standing, there is also no provision that "expressly forbids it either."[33] Therefore, the courts that allow derivative standing have found an implicit right in the Code to bring such suits.

The Sixth Circuit looked to the language 11 U.S.C. §§ 547 and 548 and concluded that neither section precluded the "judicially created doctrine of derivative standing" and that "the express statutory language does not prohibit creditor standing, and that such standing furthers Congress's purposes in balancing the interests between the debtor and its creditors in a Chapter 11 reorganization."[34] The court noted that Section 547(b) provides that "'[t]he trustee may avoid any [preferential] transfer . . . .,'" and that Section 548(a) provides that "[t]he trustee may avoid any [fraudulent] transfer . . . .'"[35] Therefore, the court must determine whether or not Congress intended "to confer exclusive authority on the trustee or debtor-in-possession to bring avoidance actions."[36] The court concluded that since a debtor may use "Sections 547 and 548 as a sword to favor certain creditors over others, rather than a tool . . . for the benefit of all creditors" that Congress did not intend to exclude creditors from seeking to avoid fraudulent transfers when the debtor-in-possession abuses its discretion in not bringing suit.[37]

Other courts have looked to the language of 11 U.S.C. § 1109 to argue that the Code implicitly provides for creditor derivative suits. Section 1109 of the Bankruptcy Code provides "[a] party in interest, including . . . a creditors' committee . . . may raise and may appear and be heard on any issue in a case under this chapter."[38] Courts have held that this section gives the creditor a qualified right to initiate suit with the bankruptcy

31. Keith Sharfman, *Derivative Suits in Bankruptcy*, 10 STAN. J.L. BUS. & FIN. 1, 6 (2004) [hereinafter Sharfman].

32. *Id.*

33. *Id.*

34. *In re The Gibson Group*, 66 F.3d at 1440.

35. *Id.* at 1440-41 (quoting 11 U.S.C. §§ 547(b), 548(a)).

36. *Id.*

37. *Id.*

38. 11 U.S.C. § 1109(b) (1978).

court's approval.[39] However, the Supreme Court in *Hartford Underwriters Ins. Co.* stated "we do not read § 1109(b)'s general provision of a right to be heard as broadly allowing a creditor to pursue substantive remedies that other Code provisions make available only to other specific parties."[40] Therefore, courts that oppose creditor derivative standing hold that § 1109(b) does not entitle parties in interest to usurp the role of the debtor-in-possession as the legal representative of the estate.[41]

Courts have also looked to 11 U.S.C. § 503(b)(3)(B) to provide a basis for allowing creditor derivative standing. Section 503(b)(3)(B) of the Bankruptcy Code allows creditors to recover administrative expenses including "the actual, necessary expenses . . . incurred by . . . a creditor that recovers, after the court's approval, for the benefit of the estate any property transferred or concealed by the debtor."[42] The creditors' committee in *Cybergenics Corp.,* argued, and the majority of the court agreed, "that this language would be superfluous if it were not possible for creditors to bring derivative avoidance actions in bankruptcy."[43] The court in *Cybergenics Corp.* focused on the word recover and held that "a creditor cannot directly recover any property beyond that necessary to satisfy its own claim; it cannot recover property for the benefit of the estate unless it sues derivatively."[44] Those courts that rely on 11 U.S.C. § 503(b)(3)(B) conclude that when the Code speaks of a creditor's right to recover it is referring to a derivative suit.[45]

However, those who oppose creditor derivative standing argue that Section 503(b)(3)(B) "could easily refer to a creditor who recovers property for the benefit of the estate in a *direct* action rather than a derivative action."[46] Furthermore, Professor Keith Sharfman in his article *Derivative Suits in Bankruptcy* explains that the language "for the benefit of the estate' does not have to mean 'on behalf of the estate."[47] He further argues that the section is not superfluous (even if the court does not recognize derivative standing) since without such a section a creditor who brings a "direct, state law fraudulent transfer claim" would not be able to recover the expenses incurred in prosecuting such a direct claim that benefits the estate.[48]

39. *See In re STN Enters.*, 779 F.2d. at 904 (stating "We agree with these bankruptcy courts that . . . [§]1109(b) imply a qualified right for creditors' committees to initiate suit with the approval of the bankruptcy court.").

40. *Hartford Underwriters Ins. Co.* 530 U.S. at 8.

41. *In re Smart World Techs.*, 423 F.3d at 182.

42. Sharfman, *supra* note 31, at 1-2 (internal quotations omitted).

43. *Id.* at 7 (citing *Cybergenics Corp.*, 330 F.3d at 565).

44. *Id.* at 8 (internal quotations omitted).

45. *Id.* at 7.

46. *Id.*

47. *Id.* (internal quotations omitted).

48. *Id.*

C. *Bankruptcy Policies for and Against Creditor Derivative Standing*

There is also disagreement among courts about whether or not granting a creditors' committee derivative standing enhances the policies behind bankruptcy. Proponents of the doctrine argue that allowing creditor derivative standing promotes the bankruptcy policy of value maximization. For instance, in *Cybergenics Corp.*, the creditors' committee argued that since their lawyers were working on a contingency basis and the estate would not be liable for fees in excess of the recovery, the estate could only benefit from the litigation and would not be harmed by it.[49] After all, maximizing the recovery of creditors would maximize the value of the estate as a whole.

On the other hand, opponents of the doctrine argue that although value maximization is a policy behind bankruptcy, one cannot look to promote one policy at the exclusion of all the other policy objectives and values reflected in the Bankruptcy Code and legislative history.[50] Furthermore, creditor derivative suits may add value in some cases but they could also reduce the value in others.[51] Sharfman argues that although no empirical studies have been done to determine the value maximization effect of creditor derivative suits, they could be analogized to the shareholder derivative suits in the corporate context.[52] In those cases, "scholars have long doubted whether shareholder derivative suits, on balance, add value for shareholders" and in those cases where shareholders succeed the amount is frequently only enough to benefit the shareholders lawyers and not the shareholders themselves[53]

Sharfman also argues that creditor derivative suits are more likely to subtract value than to add value given that "the prospect of creditors suing derivatively would exacerbate the problems of firms and individuals in financial distress by increasing transaction risks for potential lenders, assets purchasers, suppliers, customers, . . . and employees, who might insist on harsher terms or refrain from transacting altogether rather than risk future derivative litigation with creditors."[54] The Supreme Court took this view in *Hartford Underwriters Ins. Co.,* when it noted that "'[t]he possibility of being targeted [by creditor-instituted litigation] . . . could make secured creditors less willing to provide postpetition financing.'"[55] Furthermore, to the extent that creditor derivative suits produce a reluctance of the part of third parties to transact with the firm or individual in financial distress, the aggregate debtor values and creditor recovery is reduced.[56]

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49. *Id.* at 15.
50. *Id.*
51. *Id.* at 16.
52. *Id.*
53. *Id* at 16-17.
54. *Id.* at 17.
55. *Id.* (quoting *Hartford Underwriters Ins. Co.*, 503 U.S. at 13).
56. *Id.* at 18.

Sharfman believes that creditor derivative standing is contrary to the protection on nonbankruptcy entitlements, which is one of the central policies intended and reflected in the Bankruptcy Code.[57] First of all "creditor derivative standing enhances the rights of creditors by displacing the nonbankruptcy norm that creditors may not bring lawsuits on a bankruptcy estate's behalf."[58] Secondly, "creditor derivative standing narrows the nonbankruptcy entitlements of a bankruptcy estate's potential defendants by expanding the universe of those who may assert claims against them on the estate's behalf."[59]

However proponents of the doctrine argue that creditor derivative standing does not alter nonbankruptcy substantive entitlements.[60] Daniel Bussel argues that "[s]tanding is a procedural device for enforcing a substantive entitlement" and "[t]he substantive entitlement of the estate is not altered by conferring standing on the creditors' committee."[61] Bussel notes that "[t]he elements of the causes of action, the available remedies, and the defenses all remain the same" and that "no novel derivative action has been created."[62] In essence, the bankruptcy court has merely substituted one estate fiduciary for another as the proper representative of the estate.[63]

Opponents of the doctrine also note that creditor derivative standing is contrary to the policy of administrative efficiency and judicial economy. A foreseeable consequence of creditor derivative standing is that "bankruptcy cases will become more complex and hence more difficult and costly to administer."[64] In *Hartford Underwriters Ins. Co.,* the Supreme Court took note of this when it stated, "'the possibility of multiple . . . claimants' created by '[a]llowing recovery to be sought at the behest of parties other than the trustee could . . . impair the ability of the bankruptcy court to coordinate the proceedings, as well as the ability of the trustee to manage the estate.'"[65]

Another consequence of granting creditors' committees derivative standing is that bankruptcy cases will take longer to wind up which in turn will work to the detriment of creditors who will suffer from the delay.[66] After all, one of Congress's stated goals in the Bankruptcy Code was to provide a speedy resolution to the bankruptcy process, but allowing creditor derivative suits is at odds with this policy since it would increase the amount of litigation.[67]

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57. *Id.* at 19.
58. *Id.* at 19-20.
59. *Id.* at 20.
60. Daniel J., Brussel, *Creditors' Committees as Estate Representatives in Bankruptcy Litigation,* 10 STAN. J.L. BUS. & FIN. 28, 35 (2004).
61. *Id.* at 35-36.
62. *Id.* at 36.
63. *Id.*
64. Sharfman, *supra* note 31, at 20.
65. *Id.* (quoting *Hartford Underwriters Ins. Co.*, 503 U.S. at 12-13).
66. *Id.* at 21.
67. *Id.* at 22-23.

Another policy behind Chapter 11 bankruptcy is rehabilitation of the business debtor, but it is hard to see how creditor derivative standing promotes that policy.[68] While creditor derivative litigation "might net a financial recovery for the bankruptcy estate," it is difficult to see how more cash will improve its chances of rehabilitation since that depends on the firm's long-term viability.[69] The firm's long-term viability depends on its ability to produce positive cash flows and recovery for a past wrong and "has little if anything to do with the viability of the firm's operation going forward."[70] In fact, the costs of creditor derivative litigation are incurred at the outset "when the firm's financial distress is like to be the most acute, while the benefits (if any) are realized only later once there has been a judgment or settlement."[71] Therefore, creditor derivative standing is likely to exacerbate short-term financial distress and thus undermine the goal of rehabilitation.[72]

III. ANALYSIS

Although the issue of creditor derivative standing has not yet reached a consensus among the circuits, two cases in particular have created more debate and added to the controversy. The next section discusses, in detail, the Supreme Court's decision in *Harford Underwriters Ins. Co.*, and the Third Circuit's decision in *Cybergenics Corp.* While the Supreme Court appeared to have definitively closed the debate by ruling that creditor derivative standing was not available, a case decided by the Third Circuit after the Supreme Court's decision argued that the doctrine was still available.

A. Adding Fuel to the Fire: The Third Circuit's Disloyalty to the Supreme Court: A Detailed Look at the Intersection of Hartford Underwriters Ins. Co. *and* Cybergenics Corp.

Some argue that a creditor cannot gain standing because the Supreme Court in *Hartford Underwriters Ins. Co.*, a Chapter 7 case that interpreted the text of 11 U.S.C. § 506(c), held that such a provision excluded anyone other than the trustee from seeking to recover administrative costs on its own behalf, thereby preventing a bankruptcy court from authorizing a creditor committee's suit.[73] However, faced with the issue of whether a creditors' committee can obtain permission from the bankruptcy court to sue on behalf of the estate to avoid a fraudulent transfer in a Chapter 11 proceeding, the Third Circuit in *Cybergenics Corp.*, authorized a creditors'

68. *Id.*
69. *Id.* at 23.
70. *Id.*
71. *Id.*
72. *Id.*
73. *See Cybergenics Corp.*, 330 F.3d at 552.

committee to bring suit derivatively.[74] The Third Circuit stated that: "Sections 1109(b), 1103(c)(5), and 503(b)(3)(B) of the Bankruptcy Code evince Congress' approval of derivative avoidance actions by creditors' committees, and that bankruptcy courts' equitable powers enable them to authorize such suits as a remedy in cases where a debtor-in-possession unreasonably refuses to pursue an avoidance claim."[75] The holding is consistent with the understanding that "'[n]early all courts considering the issue have permitted creditors' committees to bring actions in the name of the debtor in possession if the committee is able to establish' that a debtor is neglecting his fiduciary duty."[76]

The Third Circuit in *Cybergenics Corp.*, was faced with the issue concerning the bankruptcy court's equitable power to craft a remedy, including authorizing a suit brought by a creditors' committee, when the Code does not authorize such an action.[77] The facts surrounding this case are as follows: Scott Chinery, who founded L&S Research Corporation in 1985 and was its sole shareholder, marketed nutritional food supplements for weight loss and body building under the brand name "Cybergenics."[78] In 1994, Lincolnshire Management, Inc., (Lincolnshire) approached Chinery and initiated negotiations to buy L&S, and the two reached an agreement for a cumulative consideration of $110.5 million.[79] Lincolnshire then established Cybergenics Corporation, an equity investment affiliate, to obtain nearly all of L&S's assets.[80] Cybergenics Corporation became the majority shareholder in Cybergenics and provided the largest equity stake, although several other lenders (the Lenders) helped to fund the asset acquisition.[81] The Lenders also agreed to provide working capital funds for Cybergenics after the purchase.[82] The buyout was memorialized in a writing dated October 13, 1994.[83] Despite increased investments by Lincolnshire and the Lenders, Cybergenics' financial position worsened.[84] In August 1996, Cybergenics filed for voluntary relief under Chapter 11 of the Bankruptcy Code.[85] At which time Cybergenics remained in control of its' assets as debtor-in-possession, therefore no trustee was appointed but a creditors' committee was appointed to represent the interests of the unsecured creditors.[86] Cybergenics soon realized that reorganization would not be possible and decided to liquidate through a court-supervised auction.[87]

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74. *Id.* at 552-53.
75. *Id.* at 553.
76. *Id.* (quoting 7 COLLIER ON BANKRUPTCY ¶ 1103.05[6][a] (Lawrence P. King, ed., 15th rev. ed. 1996)).
77. *Id.* at 552.
78. *Id.* at 553.
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.* at 553-54.

The bankruptcy court approved the sale in October 1996 and Cybergenics moved to dismiss the bankruptcy claim.[88] However, the creditors' committee objected on the grounds that certain transactions in the buyout could lead to fraudulent transfer actions and that the debtor-in-possession has a fiduciary duty to maximize the value of the estate.[89] In June of 1997, Cybergenics advised the court that it would not pursue any fraudulent transfer claims because it believed that the cost of litigation would outweigh any benefits.[90] At this time the committee volunteered to bear all the costs, but Cybergenics still refused to bring an avoidance action.[91] The Committee then sought leave from the bankruptcy court to bring a derivative action on behalf of the estate to avoid any fraudulent transfers.[92]

After a hearing, the bankruptcy court decided that the avoidance claims were colorable and that Cybergenics' refusal to prosecute them was unreasonable.[93] Accordingly, the bankruptcy court granted the Committee permission to proceed derivatively.[94] The defendants moved to dismiss the suit claiming that § 544(b) of the Bankruptcy Code states that only "the trustee may" avoid fraudulent transfers and the Supreme Court's interpretation in *Hartford Underwriters Ins. Co.* of the same language in § 506(c) gave the trustee exclusive standing that does not extend to creditors' committees.[95] The district court granted the defendants' motion to dismiss and concluded that the Supreme Court's interpretation of "the trustee may" in *Hartford Underwriters Ins. Co.* applied to the same language in § 544(b).[96] The creditors' committee appealed, but a panel of the Third Circuit Court of Appeals affirmed the district court's holding that "§ 544(b) did not authorize derivative standing for creditors' committees to sue to avoid allegedly fraudulent transfers."[97] In November, the Third Circuit Court of Appeals granted the committee's motion for a rehearing *en banc* vacating the panel's decision upon finding that the bankruptcy court acted within its power in granting the Committee derivative standing.[98]

B. Plain Language and the Supreme Court's Ruling in Hartford Underwriters Ins. Co.

The district court's decision in *Cybergenics Corp.* relied heavily on the Supreme Court's holding in *Hartford Underwriters Ins. Co.*, so it is important to examine the latter decision in length. In *Hartford Underwriters Ins.*

88. *Id.* at 554.
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.* (citing *Hartford Underwriters Ins. Co.*,530 U.S. at 1)).
96. *Id.* at 554.
97. *Id.* at 555 (citing *Cybergenics Corp.*, 304 F.3d 316 (3d Cir. 2002)).
98. *Id.* at 555, 569.

Co., the Supreme Court was faced with the issue of whether an administrative claimant could seek recovery under § 506(c) of the Bankruptcy Code.[99] In this case, Hen House International Inc. filed a voluntary petition under Chapter 11 of the Bankruptcy Code becoming a debtor-in-possession.[100] Therefore, Hen House retained possession of its assets and continued to operate its business.[101] During the reorganization the debtor continued to receive workers compensation insurance from the petitioner, Hartford Underwriters Ins., Co., although Hen House had repeatedly failed to pay the insurance premium.[102] Once it was clear that reorganization would not be possible the court converted the action into a Chapter 7 liquidation proceeding and appointed a trustee.[103] Hartford heard this news and realized the estate lacked enough unencumbered funds to satisfy the past due premiums, and attempted to the charge the premiums to the respondent bank.[104] Hartford filed an "Application for Allowance of Administrative Expense, Pursuant to 11 U.S.C. § 503 and Charge Against Collateral, Pursuant to 11 U.S.C. § 506(c)."[105] The bankruptcy court ruled in favor of Hartford and the District Court affirmed, but the Eight Circuit Court of Appeals reversed, *en banc*, concluding that § 506(c) could not be used by an administrative claimant.[106]

Petitioners in *Hartford Underwriters Ins. Co.* argued that an effort to recover unpaid premiums involved two provisions of the Bankruptcy Code, namely §§ 503(b) and 506(c).[107] Section 503(b) provides that "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case" are treated as administrative expenses that are given priority over unsecured claims.[108] While the respondent did not dispute the fact that the insurance premiums were an administrative expense within the meaning of the statute, such expenses do not have priority over secured claims.[109] Furthermore, because the respondent held a security interest in essentially all of the available assets, there were inadequate encumbered funds to pay the administrative claims.[110]

Petitioners then relied on 11 U.S.C. § 506(c) which constitutes an important exception to the rule that administrative claims are inferior to secured claims by providing that: "[t]he trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expense of preserving, or disposing of, such property to the extent of any

99. *Hartford Underwriters Ins. Co.*, 530 U.S. at 3.
100. *Id.*
101. *Id.*
102. *Id.* at 4.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.* (citing *In re* Hen House Interstate, Inc., 177 F.3d 719 (8th Cir. 1999)).
107. *Id.*
108. *Id.* at 5 (quoting 11 U.S.C. § 503(b) (1994)) (internal quotations omitted).
109. *Id.*
110. *Id.*

benefit to the holder of such claims."[111] The petitioner argued that this provision gave them a right to bring a claim to recover the past due insurance premiums as administrative expenses, since its furnishing of worker's compensation payments benefitted the respondent by allowing the continued operation of Hen House, thus preserving the value of respondent's collateral.[112] Alternatively, the petitioner argued that "such benefit could be presumed from the respondents consent to the postpetition financing order."[113]

The Supreme Court did not reach the issue of whether the workers' compensation met the requirements of a "'benefit to the holder'" under § 506(c), but instead assumed throughout this decision that it did.[114] Instead, the Supreme Court focused on the issue of whether an administrative claimant, like the petitioner, is a proper party to seek recovery under § 506(c).[115] In making its decision, the Court opened with an overview of statutory construction stating that Congress "says in a statute what it means and means in a statute what it says there."[116] The Court also noted that, in construing a provision of § 506, the function of the courts is to enforce the provision according to its terms.[117] The statute's plain language specifies that "[t]he trustee" may bring an action under § 506(c).[118] Although the statute is silent as to its accessibility by persons not trustees, the Supreme Court held that the trustee was the only party entitled to invoke the provision.[119]

In supporting its decision, the Court noted that many contextual features supported the conclusion that exclusivity in the statute was intended.[120] First, where a statute authorizes specific action and designates a specific party entitled to take such action, "it is surely among the least appropriate in which to presume nonexclusivity."[121] Second, the fact that the trustee, who has an exceptional role in bankruptcy proceedings, is named as the sole party in §506(c) makes it conceivable that Congress would grant a power to him and not to others.[122] Even if no party was named in

111. *Id.* (quoting 11 U.S.C. § 506(c) (1984)) (emphasis added) (internal quotations omitted).

112. *Id.*

113. *Id.* The respondent after the initiation of the Chapter 11 proceeding agreed to lend Hen House an additional $300,000 to help finance the reorganization and the Bankruptcy Court entered a financing order approving the loan and authorized Hen House to use such funds to pay expenses, including workers' compensation expenses. *Id.* at 3-4.

114. *Id.* at 5 (quoting § 506(c)) (internal quotation marks omitted).

115. *Id.* at 5-6.

116. *Id.* at 6. (quoting Conn. Nat. Bank v. Germain, 503 U.S. 249, 254, (1992)) (internal quotation marks omitted).

117. *Id.* (quoting 11 U.S.C. § 506(c)) (internal quotations omitted).

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.* at 7.

§ 506(c), the trustee is the most obvious party empowered to this provision.[123] Furthermore, if Congress intended the provision to merely establish that certain costs could be recovered from collateral, it could have drafted it that way.[124] Had Congress intended the provision to be widely available, it could have inserted such language to make that intention clear.[125] The Court noted that Congress, in other sections of the Bankruptcy Code, used broad language to describe the party who could act under that section including terms like "a party in interest" in § 502(a) or "an entity" in § 503(b)(4).[126] Accordingly, the Court concluded that the broad language in other sections, contrasted with the phrase "the trustee" in § 506(c), supports a conclusion that persons other than the trustee are not entitled to use § 506(c).[127]

Petitioner further argued that "what matters is that § 506(c) does not say that *'only'* a trustee may enforce its provisions."[128] Petitioner cited other sections of the Bankruptcy Code that do use the word "only" or other explicitly restrictive language in identifying the parties at issue and argued that the absence of restrictive language meant that no party in interest was excluded.[129] The Court stated that Petitioner's "theory-that the expression of one thing indicates the inclusion of others unless exclusion is made explicit-is contrary to common sense and common usage."[130] The Court then went on to cite multiple provisions of the Bankruptcy Code that do not contain the restrictive language but "cannot sensibly be read to extend to all parties in issue."[131]

Petitioner then argued that § 1109 evidenced a right for a nontrustee to recover under § 506(c) because § 1109 provides that "a party in interest . . . may raise and may appear and be heard on any issue in a case under [Chapter 7]."[132] However, the Court concluded that Chapter 11 provisions were inapplicable in this case because the Petitioner attempted to use the provision after the case was converted from Chapter 11 reorganization to a Chapter 7 liquidation case.[133] The Court refused to read "§ 1109(b)'s general provision of a right to be heard as broadly allowing a creditor to pursue substantive remedies that other Code provisions make available only to

123. *Id.*

124. *Id.*

125. *Id.* (quoting 11 U.S.C. § 502(a) (1994)) (internal quotations omitted).

126. *Id.* (quoting 11 U.S.C. §§ 502(a), 503(b)(4)) (internal quotations omitted).

127. *Hartford Underwriters Ins. Co.*, 503 U.S. at 7 (quoting 11 U.S.C. § 506(c)) (internal quotations omitted).

128. *Id.* at 7-8 (emphasis added).

129. *Id.* at 8.

130. *Id.*

131. *Id.* The Court noted provisions of the Bankruptcy Code that do not expressly use the term "only" but that still denote exclusive rights in the trustee, quoting 11 U.S.C. § 363(b)(1), providing that "[t]he trustee, after notice and a hearing, may use, sell, or lease . . . property of the estate;" 11 U.S.C. § 364(a) providing that "the trustee" may incur debt on behalf of the bankruptcy estate; and 11 U.S.C. § 554(a) giving "the trustee" power to abandon property of the bankruptcy estate. *Id.*

132. *Id.* (quoting 11 U.S.C. § 506(c)).

133. *Hartford Underwriters Ins. Co.*, 503 U.S. 1 at 8.

other specific parties."[134] The Court went on to note that "[i]n general, section 1109 does not bestow any right to usurp the trustee's role as representative of the estate with respect to the initiation of certain types of litigation that belong exclusively to the estate."[135] The Court then held that the "most natural" reading of § 506(c) evidences that the rights only extends to the trustee and the petitioner has an "exceptionally heavy" burden to persuade the court that the section should be read to allow other parties to use it.[136]

1. Pre-Code Practice and *Hartford Underwriters Ins., Co.*

Petitioner in *Harford Underwriters Ins., Co.* also argued that pre-Code practices and policy consideration supported derivative standing for creditors' committees.[137] Petitioner argued that § 506(c)'s provision allowing administrative expenses to be charged against lienholders continued a practice that existed under the Bankruptcy Act of 1898.[138] Although such a policy was not within the text of the Act, its origin was traced back to early cases that established an equitable principle providing that "where a court has custody of property, costs of administering and preserving the property are a dominant charge."[139] Recognizing that it was the norm for the trustee to seek recovery costs from the secured creditor, the Petitioner also cited a number of lower court decisions in which parties other than the trustee were allowed to pursue such charges under the Act, sometimes simultaneously with the trustee's pursuit of his own costs,[140] but sometimes[141] independently.[142] Petitioner also relied on earlier decisions of the United States Supreme Court allowing individual claimants to request recovery from secured assets.[143]

However, the Court stated that it was "questionable" whether such precedents established a "bankruptcy practice sufficiently widespread and well organized to justify the conclusion of implicit adoption by the Code."[144] Further, The Court concluded that they had no confidence that Congress was aware of such a rule when enacting the Code and that while

134. *Id.*

135. *Id.* at 7-8 (quoting 7 COLLIER ON BANKRUPTCY ¶ 1103.05[6][1] (Lawrence P. King, ed. 15th rev. ed. 1996) (internal quotations omitted)).

136. *Id.* at 9 (internal quotations omitted).

137. *Id.*

138. *Id.*

139. *Id.*; *see, e.g.*, Atlantic Trust Co. v. Chapman, 208 U.S. 360, 376 (1908); Bronson v. La Crosse & Milwaukee R.R Co., 1 Wall. 405, 410 (1863).

140. *See, e.g.*, First Western Savings and Loan Ass'n. v Anderson, 252 F.2d. 544, 547-48 (9th Cir. 1958); *In re* Louisville Slugger Storage Co., 21 F. Supp. 897, 898 (W.D. Ky. 1936), *aff'd*, 93 F.2d 1008 (9th Cir. 1938).

141. *See, e.g.*, In re Chapman Coal Co., 2 F.2d. 779, 780 (7th Cir. 1952); *In re* Rotary Tire & Rubber Co., 2 F.2d. 364 (6th Cir. 1924).

142. *Hartford Underwriters Ins. Co.*, 503 U.S. at 9-10.

143. *Id.* at 10; *see, e.g.*, Louisville, Evansville & St. Louis Ry. Co. v. Wilson, 138 U.S. 501, 506 (1891); Burnham v. Bowen, 111 U.S. 776, 779 (1884); New York Dock Co. v. Poznan, 274 U.S. 117, 121 (1927).

144. *Id.* (quoting Kelly v. Robinson, 479 U.S. 36, 44 (1986)) (internal quotations omitted).

"pre-Code practice 'informs our understanding of the language of the Code,' it cannot overcome that language," but it is a tool on construction and not an extra-textual supplement."[145] Furthermore, "where the meaning of the Bankruptcy Code's text is itself clear . . . its operation is unimpeded by contrary . . . prior practice."[146] The Court thought the language of the Code, specifically § 506(c), left "no room for clarification by pre-Code practices," and pre-Code practices cannot change § 506(c)'s language of "the trustee" to "the trustee and other parties in interest."[147]

Lastly, the Petitioner argued that the reading of § 506(c) to allow other parties in interest to bring suit was necessary for policy reasons, contending that in some cases the trustee would lack the incentive to pursue payment.[148] Without allowing parties other than the trustee to bring suit, the Petitioner argued that secured creditors would enjoy services without having to pay for them.[149] Furthermore, the Petitioner argued that allowing nontrustees to bring suit under § 506(c) may in fact further bankruptcy's goals to the extent that a trustee may not use the section while another individual creditor would.[150] Therefore, allowing such suits could "encourage the provision of postpetition services to debtors on more favorable terms."[151] While the Court agreed that such concerns were valid, it did not agree that policy implications favored allowing nontrustee to pursue claims under § 506(c).[152]

Although some cases may lie dormant without nontrustee use, such cases are limited by the trustee fiduciary duty obligations to seek recovery under the section.[153] Furthermore, those that provide services to secured creditors have other means to protect themselves: they may insist on cash payment; they may be able to obtain superpriority under § 364(c)(1); they can also avoid unnecessary losses by paying attention to the status of their account.[154] The Petitioners argument may also lead to undesirable results as a matter of public policy, increasing the number of parties that can seek recovery under § 506(c) would create the likelihood of multiple administrative claimants seeking recovery under that section.[155] Each claim would require an inquiry into "the necessity of the services at issue and the degree of benefit to the secured creditor"; therefore, such suits could impair the bankruptcy court's ability to organize proceedings, as well as the capability of the trustee to administer the estate.[156] Lastly, secured creditors may be less willing to provide postpetition funding for the fear that creditors might

145. *Id.* (quoting Kelly v. Robinson, 479 U.S. 36, 44 (1986)).
146. *Id.* (quoting BRP v. Resolution Trust Corp., 511 U.S. 531, 546 (1994)).
147. *Id.* at 11 (quoting 11 U.S.C. § 506(c)) (internal quotations omitted).
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.* at 11-12.
152. *Id.* at 12.
153. *Id.*
154. *Id.* (citing 11 U.S.C. § 364(c)(1)).
155. *Hartford Underwriters Ins. Co.*, 503 U.S. at 12.
156. *Id.* at 13.

use § 506(c) to recover funds, "even though their claim to have benefitted the secured creditor was quite weak."[157] The Court then concluded that the plain language of § 506(c) of the Bankruptcy Code "does not provide an administrative claimant an independent right to use the section to seek payment of its claim," and that it is a task for Congress and not the courts to achieve a better policy outcome.[158]

2. How *Hartford Underwriters Ins. Co.* Affects *Cybergenics Corp.*

The court in *Cybergenics Corp.* agreed that *Hartford Underwriters Ins. Co.* is useful "for interpretive methodology," but the context in which that decision arose was critical, because it is materially unlike the situation in *Cybergenics Corp.*[159] While the same language, "the trustee may," is used in §§ 506(c) and 544(b) of the Bankruptcy Code, the Third Circuit held that § 544(b) does not preclude the bankruptcy court from providing an equitable remedy of authorizing a creditors' committee to sue derivatively when the trustee unreasonably fails to do so.[160] How then did the Third Circuit circumvent the finding of exclusivity found in the language "the trustee may?"

The Third Circuit distinguished *Cybergenics Corp.* from *Hartford Underwriters Ins. Co.*, noting that, in the latter case, Hartford did not seek the trustee or the court's permission to proceed with its claims but rather did so unilaterally.[161] In contrast, the Committee in *Cybergenics Corp.* first petitioned the debtor in possession to file an avoidance action, and only when management refused (even after the Committee volunteered to bear the costs), did the Committee seek action on its own.[162] The court in *Cybergenics Corp.* noted that this difference was of critical importance because the question in *Hartford Underwriters Ins. Co.* was whether a non-trustee has the right to unilaterally circumvent the Code's remedial scheme, but the issue in *Cybergenics Corp.* "concern[ed] a bankruptcy court's equitable power to craft a remedy when the Code's envisioned scheme breaks down."[163] After making this critical distinction, how did the Third Circuit determine that derivative suits survived *Hartford Underwriters Ins. Co.*? The Third Circuit reclassified the issue as the bankruptcy court's equitable power to authorize creditor derivative standing, but the substantive issue remains the same; whether or not a party other than the debtor in possession or the trustee can sue derivatively on the estate's behalf.

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157. *Id.*

158. *Id.*

159. *Cybergenics*, 330 F.3d at 558 (citing *Hartford Underwriters Ins. Co.*, 503 U.S. at 1).

160. *Id.* at 558.

161. *Id.*

162. *Id.*

163. *Id.* at 558-59.

3. Surviving after *Hartford Underwriters Ins. Co.*

The Third Circuit took great pains to distinguish *Cybergenics Corp.* from *Hartford Underwriters Ins. Co.*, in order to allow the derivative suit brought by the creditors' committee.[164] Initially, the Third Circuit Court of Appeals concluded that an interpretation of the language in § 506(c) supported exclusivity since that code section "is effectively self contained."[165] In support of its determination, the Third Circuit looked to the Supreme Court's interpretation in *Hartford Underwriters Ins. Co.*, which noted that there is no other provision in Chapter 7 of the Bankruptcy Code that "even arguably authorizes a party to 'recover [administrative expenses] from property securing an allowed secured claim'"; therefore, there is no reason to look beyond that section to understand its meaning.[166] Second, the Court concluded that the trustee unique role in bankruptcy also evidenced intent to give him powers not available to others.[167]

The court in *Cybergenics Corp.* noted that 11 U.S.C. § 544(b), unlike § 506(c), cannot be read in isolation, but it must be viewed as only a part of the Chapter 11 framework.[168] For instance, if one reads § 544(b) in isolation, it would lead to immediate confusion because it seems to vest a cause of action exclusively in a party, the trustee, that usually does not exist in a Chapter 11 case.[169] Therefore, in order to understand § 544(b), one must also look to § 1107(a), which gives the debtor in possession the rights and powers of a trustee in the case where no trustee is appointed.[170] The Third Circuit also noted that three other sections of the Bankruptcy Code must be read in conjunction with § 544(b) to determine whether or not derivative standing is an acceptable equitable remedy in cases where the court determines that the trustee or debtor in possession has unjustly declined to bring an avoidance claim, specifically § 1109(b), § 1103(c)(5), and § 503(b)(3)(B).[171]

C. Creditor Derivative Standing and Statutory Authorization

1. Section 1109(b)

Section 1109(b) of the Bankruptcy Code states: "[A] party in interest, including the debtor, the trustee, a creditor's committee . . . may raise and may appear and be heard on any issue in a case under this chapter."[172] The Committee in *Cybergenics Corp.* contended that § 1109 does not provide independent rights for creditors' committees to initiate suit; however, that section does allow the bankruptcy court to permit and approve a creditors'

164. *Id.* at 559-60.
165. *Id.* at 560.
166. *Id.* (quoting 11 U.S.C. § 506(c)).
167. *Id.* at 560.
168. *Id.*
169. *Id.* The appointment of a trustee in a Chapter 11 bankruptcy case is the exception rather than the rule. *In re* Sharon Steel Corp., 871 F.2d 1217, 1226 (3d Cir. 1989).
170. *Id.*
171. *Id.* (citing 11 U.S.C. §§ 1109(b); 1103(c)(5); 503(b)(3)(B)).
172. 11 U.S.C. § 1109(b).

committee from bringing suit on behalf of the debtor in possession for the benefit of the estate.[173] There is precedent for such a view.[174] While quoting Collier, the Third Circuit Court of Appeals stated, "consistent with the broad right of participation conferred by § 1109(b), the court may authorize a party in interest to commence litigation on behalf of the estate if certain conditions are satisfied."[175] Although the Court in *Hartford Underwriters Ins. Co.* held that § 1109 was inapplicable since that section is only available in Chapter 11 proceedings and the debtor converted his case to a Chapter 7 case, the Court stated in dictum that "'we do not read § 1109(b)'s general provision of a right to be heard as broadly allowing a creditor to pursue substantive remedies that other Code provisions make available only to other specific parties.'"[176] The Committee responded that § 1109(b) must stand for something more than a right to interfere since "'a general right to be heard would be an empty grant unless those who had such right were allowed to act when those who should act did not.'"[177] The Committee then submitted that such dicta should not be given great weight since the Court noted that it was inapplicable and that the Committee is not asserting an independent right to bring a claim like the one asserted in *Hartford Underwriters Ins. Co.*[178]

While the Third Circuit admitted that the Supreme Court's dictum is not binding, such dictum is not viewed lightly.[179] The court stated,

> [W]e should not idly ignore considered statements that the Supreme Court makes in dicta. The Supreme Court uses dicta to help control and influence the many issues it cannot decide because of its limited docket. "Appellate courts that dismiss these expressions [in dicta] and strike off on their own increase the disparity among tribunals (for other judges are likely to follow the Supreme Court's marching orders) and frustrate the evenhanded administration of justice by giving litigants an outcome other than the one the Supreme Court would be likely to reach were the case heard there."[180]

Regardless of the dicta in *Hartford Underwriters Ins. Co.*, the Third Circuit did not conclude that the case presented in *Cybergenics Corp.* was the type anticipated by the Supreme Court.[181] The Third Circuit concluded that the Supreme Court was concerned that a party might use § 1109(b) to

173. *Cybergenics Corp.*, 330 F.3d at 560-61.
174. *Id.* at 561.
175. *Id.* (quoting 7 COLLIER ON BANKRUPTCY, *supra* note 135, at ¶ 1109.05).
176. *Id.* (quoting *Hartford Underwriters Ins. Co.*, 503 U.S. at 8).
177. *Id.* (quoting Brief of Appellant at 26, *Cybergenics Corp.*, 330 F.3d 548 (No. 01-3895)).
178. *Id.*
179. *Id.*
180. *Id.* (quoting McDonald v. Master Fin., Inc., 205 F.3d 606, 612-13 (3d Cir. 2000) (internal quotations omitted).
181. *Id.* at 562.

assume the trustee's role as representative of the estate,[182] but that no such risk of usurpation existed in *Cybergenics Corp.* since the Committee did not take any unsanctioned action.[183] Instead, the Committee sought permission from the bankruptcy court to sue in the estate's name, which the court granted "only after it determined that the debtor was neglecting its statutory duty to act in the estate's interest."[184] However, the Third Circuit went on to conclude that § 1109(b) alone could not provide judicial power to grant a creditors' committee the authority to bring a suit on its own since that provision only addresses a committee's direct rights and not whether a court has power to grant derivative standing.[185]

The Third Circuit found that although § 1109(b) did not address judicial power to grant derivative standing that it is helpful in the fact that it "evinces Congress's intent for creditors' committees to play a vibrant and central role in Chapter 11 adversarial proceedings."[186] In support of this proposition, the Third Circuit looked to historical authority, including § 206 of the former Bankruptcy Act, 11 U.S.C. § 606, and former Chapter X Rule 10-210(a), which it claimed were "designed to broaden creditor participation in reorganization proceedings in order to remedy the deficiencies of prior procedures."[187] Most notably, however, is that § 1109(b) is "broader than either of those provisions" since neither of them allowed a creditor to raise an issue but rather allowed a creditor to merely be heard on an issue.[188] Therefore, the Third Circuit noted that since derivative standing was available "in the pre-Code days of Section 206 and Chapter X 10-210(a), it would be odd to conclude that Congress abolished derivative standing at the same time as it broadened committees' adversarial role through § 1109(b)."[189]

After agreeing with the Committee, the Third Circuit held that § 1103(c)(5) of the Bankruptcy Code, which specifically states that "a committee appointed under section 1102 of this title may perform such other services as are in the interest of those represented," also evinces Congress's intent for creditors' committees to perform some functions on behalf of the estate.[190] The court recognized that a certain amount of flexibility was written into the statute to allow the bankruptcy court to authorize the committee to bring suit when the usual representative is delinquent.[191]

182. *Id.* (citing *Hartford Underwriters Ins. Co.*, 530 U.S. at 8).
183. *Id.*
184. *Id.*
185. *Id.*
186. *Id.*
187. *Id.*; *see also In re* Amatex Corp., 755 F.2d 1034, 1042 (3d Cir. 1985).
188. *Id.* at 562.
189. *Id.*
190. *Id.*
191. *Id.* at 563 (quoting 11 U.S.C. § 1103(c)(5)).

2. Section 503(b)(3)(B) and the Role of Creditors' Committees

While §§ 1109(b) and 1103(c)(5) only provide indirect evidence of Congress's intent and its envisioned role for creditors' committees, § 503(b)(3)(B) provides direct insight into the power of a bankruptcy court. Section 503(b)(3)(B) "allows for the priority payment of the expenses of 'a creditor that recovers, after the court's approval, for the benefit of the estate any property transferred or concealed by the debtor.'"[192] Brunstad argued that this provision monetarily rewards creditors' committees that, with court authorization, pursue suits on behalf of debtors in possession because it makes little sense to provide reimbursement to a "creditor that recovers" if standing to recover is vested solely in the trustee – such an interpretation would render § 503(b)(3)(B) unnecessary.[193] However, Lincolnshire argued that such a provision only allows a creditor to recover expenses from suits that the creditor may bring directly and that it does not authorize derivative standing.[194] Furthermore, Lincolnshire argued that the text of the provision itself evidence that it only considers the rights of creditors, not creditors' committees.[195] Lincolnshire pointed out that Congress knew the difference between the two parties as evidenced by § 1109(b) where Congress grants the right to appear and be heard to a "'party in interest, including the debtor, the trustee, *a creditors' committee*, an equity security holders' committee, [or] *a creditor*.'"[196] Thus, Congress's inclusion of the word "creditor" in § 503(b)(3)(B) and not the term "creditors' committee" evidences Congressional intent for only creditors to recover expenses.[197]

While the Third Circuit noted that there is a presumption "that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another,"[198] it decided that the "most natural reading of § 503(b)(3)(B) is that it recognizes and rewards monetarily the practice of permitting creditors' committees, with court authorization, to pursue derivative actions."[199] In addition, the court concluded that § 503(b)(3)(B) is not limited to direct causes of action since "property recovered in a direct action is not recovered 'for the benefit of the estate.'"[200]

In regards to Lincolnshire's argument that the omission of the term "creditors' committee" from § 503(b)(3)(B) is dispositive of Congress's intent that the provision can only be used by creditors, the Third Circuit

192. *Id.* (quoting 11 U.S.C. 503(b)(3)(B) (1982)).

193. *Id.*

194. *Id.* at 564.

195. *Id.* (citing Br. of Appellees in Response to Br. of Amici Curiae at 16, *Cybergenics Corp.*, 330 F.3d 548 (No. 01-3805)).

196. *Id.* (quoting 11 U.S.C. § 1109(b)) (emphasis added).

197. *Id.*

198. *Id.* (quoting BFP v. Resolution Trust Corp., 511 U.S. 531, 537 (1994)).

199. *Id.*

200. *Id.* (quoting 11 U.S.C. § 503 (b)(3)(B)).

noted, "we are realists, and we recognize that if we disallow the Committee's derivative suit but sanction derivative suits by individual creditors, the individual creditors could simply substitute themselves as plaintiffs under Fed. R. Civ. Proc. 17(a) and move forward with litigation."[201] Moreover, the court pointed out that the Code generally presumes that the singular includes the plural, holding that it was satisfied that the purpose of § 503(b)(3)(B) is to allow the Committee to recover the expenses it incurred in the derivative suit.[202] The court believed that any other interpretation would render § 503(b)(3)(B) "superfluous, for absent judicial power to authorize derivative suits by creditors, it makes no sense to speak of rewarding a creditor who sues, with court permission, to recover property for the benefit of the estate."[203]

In the end, the Third Circuit concluded that the text of the Bankruptcy Code, specifically reading §§ 1109(b) and 1103(c)(5) together, evidences Congress's intent for committees to play a strong and flexible role in bankruptcy proceedings, and that the "most natural reading of the Code is that Congress recognized and approved of derivative standing for creditors' committees."[204] However, the court did note that an important "piece of the puzzle is missing."[205] While the Code plainly demonstrates Congress's approval of creditor derivative standing, none of the sections discussed directly authorize such standing.[206] To fill in this piece, the Third Circuit turned to the bankruptcy court's equitable powers to determine if such powers enabled it to craft a remedy in situations where the provisions of the Code seem to fall short of achieving their purpose.[207]

D. Equity and Bankruptcy Courts

"[C]ourts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity."[208] Although the enactment of the Bankruptcy Code in 1978 increased the amount of regulation Congress imposed on bankruptcy courts, it did not change the bankruptcy courts' elementary nature.[209] In fact, the Supreme Court after the enactment of the Code, stated, "[t]he bankruptcy court will remain a court of equity."[210] Several other post-enactment Supreme Court decisions have dispelled any lingering doubt, stating that bankruptcy courts will continue to be courts of

201. *Id.* at 565-66.
202. *Id.* at 566.
203. *Id.*
204. *Id.*
205. *Id.* at 567.
206. *Id.*
207. *Id.*
208. Local Loan Co. v. Hunt, 292 U.S. 234, 240 (1934) (citations omitted).
209. *Cybergenics Corp.*, 330 F.3d at 567.
210. *Id.* (quoting H.R. REP. NO. 95-595, at 359 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315).

equity.[211] The bankruptcy court's equitable powers are also noted in the Code itself:

> [t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.[212]

Congress clearly intended for the estate to recover property that had been "fraudulently transferred by the debtor" and created a mechanism to achieve their intent.[213] Congress vested the power and duty in the trustee or the debtor-in-possession to avoid such fraudulent transfers and to seek action if the estate would benefit.[214] After all, "[a] paramount duty of a trustee or debtor in possession in a bankruptcy case is to act on behalf of the bankruptcy estate, that is, for the benefit of the creditors."[215] Therefore, Congress undoubtedly intended for the trustee or debtor-in-possession to maximize the value of the estate and allow creditors to recover their claims from the estate by avoiding fraudulent transfers.[216]

However, a problem arises when the trustee or debtor-in-possession refuses to bring an action that would benefit the estate, thus violating its fiduciary duties.[217] In the opinion of the Third Circuit, this situation, in the opinion of the Third Circuit, is exactly the type of circumstance where a "bankruptcy court['s] equitable powers are most valuable" since it allows courts to craft a remedy that is not directly authorized in the Code, but is the type of "result the Code was designed to obtain."[218] "'There is inherent in the Courts of Equity a jurisdiction to . . . give effect to the policy of the legislature.'"[219] The apparent policy concern in § 544(b) is "the need to channel avoidance actions through the trustee, who acts as a gatekeeper and prevents independent avoidance actions by creditors that might prejudice the estate and rival creditors."[220]

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211. *Id.*; *see also* Young v. United States, 535 U.S. 43, 50 (2002) ("[B]ankruptcy courts [ ] are courts of equity and 'apply the principles and rules of equity jurisprudence.'") (quoting Pepper v. Litton, 308 U.S. 295, 304(1939)); United States v. Energy Resources Co., 495 U.S. 545, 549 (1990) ("[B]ankruptcy courts as courts of equity, have broad authority to modify creditor-debtor relationships.").

212. *Cybergenics Corp.*, 330 F.3d at 567 (quoting 11 U.S.C. § 105(a) (2000)).

213. *Id.* at 568.

214. *Id.*

215. *Id.* (quoting *In re Cybergenics Corp.*, 226 F.3d. at 237, 243).

216. *Id.*

217. *Id.*

218. *Id.*

219. *Id.* (quoting Mitchell v. Robert DeMario Jewelry, Inc., 361 U.S. 288, 292 (1960) (quoting Clark v. Smith, 38 U.S. 195, 203 (1839)).

220. *Id.* at 568.

While the text of § 544(b) allows a trustee as representative of the estate to bring avoidance actions, "that provision does not foreclose a bankruptcy court's equitable power to substitute *itself* as gatekeeper when the trustee is delinquent, and to allow a creditors' committee to pursue an avoidance action *for the estate's direct benefit* rather than its own."[221] The Third Circuit noted "that the estate's recovery of fraudulently transferred property" is the end result of the equitable remedy, which is exactly what Congress envisioned and that 11 U.S.C. §§ 1109(b), 1103(c)(5), and 503(b)(3)(B) "anticipate the court's means of achieving that result."[222] Therefore, the Third Circuit in *Cybergenics Corp.* held that the bankruptcy court acted within its power when it granted the Committee derivative standing.[223]

E. Cybergenics Corp. *Dissent*

A panel of four judges disagreed with the majority in *Cybergenics Corp.* The dissent concluded that the majority's interpretation of the language "the trustee may" is "inconsistent with the plain and natural reading of § 544(b), is not supported by the Code provisions it cites, is not adequately grounded in prior practice and . . . is inconsistent with the Supreme Court's plain meaning analysis" in *Hartford Underwriters Ins. Co.* of the identical phrase in § 506(c).[224] The dissent agreed with the Supreme Court's analysis in *Hartford Underwriters Ins. Co.* and held that Congress means what it says in a statute.[225] Furthermore, the dissent argued that there is no ambiguity in the language of § 544(b) and that the provision designates the trustee, and only the trustee, to bring suit.[226] Therefore, "[w]e should not presume [that we] have a free hand to broaden a right which Congress has made exclusive."[227] Congress specifically authorized creditors' committees to take particular action in other parts of the Code, Congress would have drafted § 544(b) in a substantially similar way had it intended for creditors' committees to be able to bring suit on behalf of the estate under that provision.[228] The dissent held that the plain meaning of the text only allows a trustee to invoke the remedy under the statute.[229]

The dissent also discussed other Sections of the Bankruptcy Code that the majority relied on to find that creditor derivative standing was authorized. The dissent looked to § 1109(b), and found that the provision only allowed a creditors' committee to be heard by way of intervention but does

221. *Id.* at 568-69.
222. *Id.* at 569.
223. *Id.*
224. *Id.* at 580 (Fuentes, J., dissenting).
225. *Id.* (citing *Harford Underwriters Ins. Co.*, 530 U.S. at 6).
226. *Id.*
227. *Id.* at 580-81 (Fuentes, J., dissenting).
228. *Id.* at 581.
229. *Id.* at 582.

not allow a committee to initiate a suit.[230] Some courts interpret this section as a broad right to be heard.[231] Such a broad right cannot be used to "expand the intent evidenced by the plain, specific language used by Congress in § 544(b)."[232] Furthermore, any doubt as to the meaning of the provisions was eliminated through the Supreme Court's reasoning in *Hartford Underwriters Ins. Co.*, when the Court stated, "'[i]n any event, we do not read § 1109(b)'s general provision of a right to be heard as broadly allowing a creditor to pursue substantive remedies that other Code provisions make available only to specific parties.'"[233]

The dissent also analyzed § 1103(c)(5) of the Bankruptcy Code, focusing on the fact that § 1103(c)(1)-(4) grant very specific powers to the creditors' committee and none of which support the authority to initiate a suit.[234] Since Congress only granted "limited, discrete rights" in § 1103(c)(1)-(4) the court should not read § 1103(c)(5) as granting a "broad, implied power to initiate suit."[235] Additionally, the dissent discussed § 503(b)(3)(B), deciding that this section only allows an individual creditor to recover expenses to compensate the creditor when they "object to discharge and then successfully locate and [bring] into the estate assets [any asset] that had been transferred or concealed by the debtor."[236]

In regard to the majority's argument that the bankruptcy court's equitable power enables it to authorize creditors' committees to sue derivatively, the dissent stated, "[t]he Code is the law here and equity cannot be used to change the clear and plain language of a Code provision."[237] Additionally, the Supreme Court possesses "whatever equitable powers bankruptcy courts have, they 'must and can only be exercised within the confines of the Bankruptcy Code.'"[238]

In the end, the dissent concluded that the Bankruptcy Code does not authorize courts to grant creditors' committees derivative standing and "the Supreme Court has rejected the notion that the federal courts have any policy-making role in construing clear statutory language."[239] Furthermore, it is a task for Congress, and not the courts, to decide "if it is a good idea for creditors' committees to have standing."[240]

F. Possible Substitutes for Creditor Derivative Standing

Granting creditors' committees derivative standing is not the only solution to the problem arising when a debtor-in-possession from failing to

230. *Id.*
231. *See* Coral Petroleum, Inc. v. Banque Paribas-London, 797 F.2d 1351, 1363 (5th Cir. 1986).
232. *Cybergenics Corp.*, 330 F.3d at 582 (Fuentes, J., dissenting).
233. *Id.* (quoting *Hartford Underwriters Ins. Co.*, 503 U.S. at 8-9).
234. *Id.* at 583.
235. *Id.*
236. *Id.* at 583-84.
237. *Id.* at 585.
238. *Id.* (quoting Northwest Bank Worthington v. Alhers, 485 U.S. 197, 206 (1988)).
239. *Id.* at 587.
240. *Id.* (citing Hartford Underwriters Ins. Co., 530 U.S. 13-14).

bring suit on behalf of the estate. Both proponents and opponents of the doctrine have discussed possible alternatives. Such alternatives include appointing a trustee, appointing an examiner, moving the court to order the debtor-in-possession to sue, converting the bankruptcy case to a Chapter 7 case, or moving the bankruptcy court to authorize a committee to bring a post-confirmation avoidance action.[241]

A creditors' committee can move to appoint a trustee pursuant to 11 U.S.C. § 1104(a), which "allows for 'any party in interest' including a creditors' committee to request appointment of a trustee 'for cause' or if the appointment would be in the interest of creditors'"[242] "Cause to appoint a trustee includes 'fraud, dishonesty, incompetence, or gross mismanagement' of the debtor's affairs by current management, either before or after commencement of the case."[243] "To the extent that they enable to remain in place incompetent or untrustworthy debtors-in-possession who would otherwise be replaced, creditor derivative suits undermine the Code's objective of appointing trustees when there is cause for doing so."[244] Furthermore, the appointment of a trustee would enable the trustee to pursue claims while avoiding conflicts of interests that can influence debtors-in-possession.[245]

However, proponents of the derivative doctrine argue that "forcing creditors['] committees to move to appoint trustees would amount to 'replac[ing] the scalpel of derivative suit with a chainsaw.'"[246] Furthermore, appointing a trustee is an extraordinary remedy.[247] Basically, a trustee amounts to replacing the debtor's high-level management, which increases costs in two ways.[248] First, trustees are entitled to a substantial statutory fee, and second, there is a cost "implicit in replacing current management with a team that is less familiar with the debtor specifically and its market generally."[249] After all, a trustee is rarely appointed in Chapter 11 cases due to the belief that existing management is in the best position to rescue the debtor.[250] The court in *Cybergenics Corp.* stated, "we believe that appointing a trustee is too drastic a step to constitute a serious alternative to allowing derivative suits by creditors' committees."[251] Consequently, since much of Chapter 11 is based on the idea of allowing current management to retain control of the debtor, it is doubtful that Congress

241. *See id.* at 576-79.

242. *Id.* at 576 (quoting 11 U.S.C. § 1104(a) (1982)).

243. *Id.* (quoting 11 U.S.C. § 1104(a)(1)).

244. Sharfman, *supra* note 31, at 25.

245. *Cybergenics Corp.*, 330 F.3d at 576-77.

246. *Id.* at 577 (quoting Brief of Law Professor as Amici Curiae Supporting Appellant at 13, *Cybergenics Corp.*, 330 F.3d 548 (No. 01-3805)).

247. *Id.* (quoting 7 COLLIER ON BANKRUPTCY ¶ 1104.02[1] (Lawrence P. King, ed., 15th rev. ed. 1996)).

248. *Id.*

249. *Id.*

250. *Id.*

251. *Id.*

intended to replace that management when a debtor makes "a questionable decision not to prosecute a fraudulent avoidance claim."[252]

Another possible alternative is to appoint an examiner who lacks the authority to sue. Appointing an examiner is not as radical as appointing a trustee since the examiner's duties are simply to investigate a debtor while the debtor's management remains in place.[253] An examiner's duties are listed in 11 U.S.C. § 1106(b), which states that the examiner has all "of the duties of a trustee that the court orders the debtor in possession not to perform."[254] Courts have interpreted that this language means that an examiner may "initiate and pursue" claims on behalf of the debtor.[255] Nonetheless, concerns with appointing an examiner include the direct cost that the estate will incur and also the possibility that § 1106(b) does not permit examiners to pursue causes of action of behalf of the estate.[256]

Another alternative is moving the court to order the debtor-in -possession to sue, which could cause some problems.[257] This option is not realistic considering the fact that the management of a debtor-in-possession often faces "severe conflicts of interest," including "a court order to file an avoidance action would frequently amount to instructing management to sue itself."[258] This situation would cause the debtor- in-possession concerning his duty to not vigorously prosecute a claim.[259] There is also the possibility of converting the Chapter 11 bankruptcy case to Chapter 7 liquidation.[260] This option is the most drastic since it essentially tells the debtor-in-possession to "[p]ursue this action or we will dissolve your company."[261] One last option focuses on a creditor's committees to bring a post-confirmation avoidance action under 11 U.S.C. § 1123(b)(3)(B) which gives the committee a variety of ways to protect its interest.[262] This option, like the other possibilities, is "far more disruptive to the reorganization process than the simple step of allowing a creditors' committee to sue derivatively."[263]

IV. CONCLUSION

While courts have granted derivative standing to creditors' committees after the Supreme Court's decision in *Hartford Underwriters Ins. Co.*, it is still unclear whether or not such a policy is authorized under the Bankruptcy Code. Courts that have authorized creditors' committees to bring

252. *Id.*
253. *Id.*
254. *Id.* (quoting 11 U.S.C. § 1106(b) (1982)).
255. *Id.* at 577-78; *see also In re* Carnegie Int'l Corp., 51 B.R. 252, 256 (Bankr. S.D. Ind. 1984).
256. *Cybergenics Corp.*, 330 F.3d at 578.
257. *Id.*
258. *Id.*
259. *Id.*
260. *Id.* at 579.
261. *Id.*
262. *Cybergenics Corp.*, 330 F.3d at 579.
263. *Id.*

suit on behalf of the estate have chosen not to follow Supreme Court precedent. Those courts have interpreted the language of 11 U.S.C. § 544(b) to have a different meaning than the identical language in 11 U.S.C. § 506(c). While § 506(c)'s language of "the trustee may" has been interpreted to give trustees the exclusive right to recover property, the same language in § 544(b) has been interpreted not to grant the trustee an exclusive right. How can identical language be interpreted so inapposite? Had Congress intended that creditors' committees be able to bring suit, it could have written the Code to incorporate such a right. After all, there are many other possibilities rather than jumping to the radical remedy of granting derivative standing to creditors' committees. While a debtor-in-possession may fail to fulfill his duties under the Code, Congress anticipated this situation and drafted provisions to deal with such a problem. Congress has allowed for a trustee or an examiner to be appointed in such cases, thus relieving the necessity for derivative suits by creditors' committees. Derivative standing for creditors' committees may have been available in the past, but, after the Supreme Court's decision in *Hartford Underwriters Ins. Co.*, it appears that the practice is not long sanctioned or available. However, despite clear precedent, some circuits continue to skillfully craft their way around the Supreme Court's decision and continue to allow creditors' committees to sue derivatively.