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*IN RE COLONIAL REALTY CO.:** THE SECOND
CIRCUIT HARMONIZES BANKRUPTCY AND BANK
INSOLVENCY LAW (REJECTING ESTABLISHED
BANKRUPTCY CASE LAW IN THE PROCESS)

*John R. Ashmead***

In *FDIC v. Hirsch (In re Colonial Realty Co.)*,¹ the Second Circuit addressed issues of first impression concerning the interaction of the Federal Deposit Insurance Act² ("FDIA" or "Act") and the Bankruptcy Code.³ The interaction of these laws generally occurs when the constituencies they aim to protect must look to the same assets to satisfy their claims. In a well-reasoned opinion, the Second Circuit harmonized ostensibly conflicting provisions of the Act and the Bankruptcy Code. Specifically, the court determined that the automatic stay,⁴ a fundamental aspect of our bankruptcy system, applied to the Federal Deposit Insurance Corporation ("FDIC")⁵ and

* 980 F.2d 125 (2d Cir. 1992).

** Associate, Paul, Weiss, Rifkind, Wharton & Garrison. The author expresses his gratitude to Alan Kornberg and Deborah Prutzman of Paul, Weiss for reviewing drafts of this Article.

¹ 980 F.2d 125 (2d Cir. 1992) [hereinafter *Colonial Realty*].

² 12 U.S.C. §§ 1811-1834 (1988 & Supp. V 1993).

³ 11 U.S.C. §§ 101-1330 (1988 & Supp. V 1993).

⁴ The automatic stay, codified at 11 U.S.C. § 362 (1988 & Supp. V 1993), provides generally that the filing of a bankruptcy petition by operation of law automatically "stays," i.e., restrains, creditors from taking further action against the debtor, property of the debtor, or property of the estate to collect their claims or enforce their liens.

⁵ Established to protect the public's faith in depository institutions, the Federal Deposit Insurance Corporation ("FDIC") is granted powers under and charged with administering the Federal Deposit Insurance Act ("FDIA" or "Act"). 12 U.S.C. § 1811 (1988 & Supp. I 1989). The FDIC discharges its statutory duties by assuming various roles. In its "corporate" capacity, the FDIC administers the FDIC insurance fund, discussed *infra* at text accompanying notes 27-31, and regulates financial institutions. In its "conservator" role, the FDIC operates troubled institutions and arranges for the disposition of the institutions' assets and liabilities. As a "receiver," the FDIC marshals a failed institution's assets and makes distributions to creditors. See generally BARRY S. ZISMAN, BANKS AND THRIFTS: GOVERNMENT ENFORCEMENT AND RECEIVERSHIP § 11.01 (1993 & Supp. July 1993). For simplicity, unless otherwise indicated, references to "FDIC" in this

barred it from exercising its powers to avoid asset transfers previously made by the debtor. In the course of its determination, the Second Circuit repudiated the long-accepted view that a debtor retains some legal or equitable interest in fraudulently transferred property.

The Second Circuit's decision was supported by fundamental statutory construction and policy considerations.⁶ First, the court addressed the applicability of the automatic stay to actions to recover property fraudulently transferred by the debtor before bankruptcy.⁷ The court determined that the debtor retained no interest in such property, but that suits to recover the property were barred by the stay because the suits would be predicated on a claim against the debtor.⁸ Because of that determination, the Second Circuit had to consider the FDIC's argument that the laws were in conflict and the Act should prevail over conflicting provisions of the Bankruptcy Code.⁹ The Second Circuit examined the alleged "conflict" and concluded that the goals of each law could be achieved under the circumstances.¹⁰

Colonial Realty is the most recent federal court of appeals decision to address the "conflicting" provisions and policies of laws applying to failed banks and bankruptcy cases. It is not likely to be the last. The Second Circuit's ruling in *Colonial Realty* responds to a number of cases brought over the last few years that have pitted long-standing precepts of bankruptcy law against the FDIC's nascent powers.¹¹ The court's decision sends a message that the FDIC's many and varied powers do not exist in a vacuum; they exist within a framework of many federal laws—including some with competing objectives.

Article mean the FDIC in all of its capacities.

⁶ The decision primarily rested upon two related canons of statutory construction: (1) a later statute will not repeal an earlier statute by implication unless the statutes are irreconcilable; and (2) when addressing the ostensibly inconsistent requirements of two statutes, courts must strive to give effect to both where at all possible. See *Colonial Realty*, 980 F.2d at 132-35.

⁷ *Id.* at 131-32.

⁸ *Id.*

⁹ *Id.* at 132-35.

¹⁰ *Id.*

¹¹ While the FDIC was created 61 years ago, the focus of this Article is on the powers recently granted to the FDIC to help it resolve the bank failure crisis of the 1980s.

Colonial Realty demonstrates, however, that the FDIC's powers can be harmonized with the most basic bankruptcy policy objectives.

Part I of this Article considers the primary objectives and certain fundamental aspects of the Federal Deposit Insurance Act and the Bankruptcy Code. In Part II, *Colonial Realty*—its facts, the parties' arguments and the court's decision—is summarized. Part III analyzes the Second Circuit's decision. The Article concludes with a discussion of other decisions that have addressed similar conflicts between the Act and the Bankruptcy Code.

I. OVERVIEW OF BANK INSOLVENCY LAW AND BANKRUPTCY LAW

A. Objectives

Bank insolvency and bankruptcy law have distinct objectives. The paramount objective of bank insolvency law is the maintenance of public confidence in the nation's banking system.¹² FDIC insurance is the most visible symbol of this objective.¹³ Public confidence in the banking system results in deposits, which provide banks with capital for lending purposes. Loans in turn support local economies and, in the aggregate, the national economy. Bank insolvency law seeks to avoid bank "runs" caused by a sudden collapse in confidence, common during the Great Depression, but also witnessed in recent years.¹⁴

Bankruptcy law, by contrast, is not concerned with maintaining confidence in a particular system, but in promoting two fundamental goals. First, bankruptcy law gives debtors the opportunity to make a "fresh start," by granting them a second chance at becoming economically viable.¹⁵ Second, bankruptcy

¹² FEDERAL DEPOSIT INS. CORP., 1992 ANNUAL REPORT (1993) [hereinafter ANNUAL REPORT]; ZISMAN, *supra* note 5, §§ 11.01, 11.02.

¹³ The FDIC provides \$100,000 insurance for each depositor account relationship with an FDIC-insured bank. 12 U.S.C. § 1821(a)(1) (1988 & Supp. V 1993).

¹⁴ See generally Peter P. Swire, *Bank Insolvency Laws Now That It Matters Again*, 42 DUKE L.J. 469 (1992). In the last several years, the Bank of New England, in 1990, and First Republicbank, in 1988, suffered such "runs." See Thomas C. Hayes, *RepublicBank in Settlement with FDIC*, N.Y. TIMES, Feb. 13, 1991, at D5; Stephen Labaton, *U.S. is Taking Over a Group of Banks to Head Off a Run*, N.Y. TIMES, Jan. 7, 1991, at A1.

¹⁵ See Report of the Commission on the Bankruptcy Laws of the United States,

law stops the "race to the courthouse" by placing all similarly situated creditors on an equal footing such that all such creditors receive ratable recoveries.¹⁶ Bankruptcy theory suggests that on the whole, both debtors and creditors benefit from this approach.¹⁷

While their goals are dissimilar, the mechanics of bank insolvency and bankruptcy law are quite similar.¹⁸ Each is predicated on a federal statutory scheme; one deals with the failure of federally insured financial institutions,¹⁹ the other with the insolvency of natural and most artificial persons.²⁰ Bank insolvency law attempts to make depositors whole by marshaling the assets of the failed bank through avoidance powers and other causes of action, and deposit insurance.²¹ The Bankruptcy Code strives to treat equitably the debtor's creditors by marshaling the debtor's assets through avoidance powers and other causes of action, and by reducing the assets to cash and distributing the proceeds to creditors. In either case, claimants submit their claims for determination to a disinterested arbiter: under the FDIA, the FDIC receiver;²² in bankruptcy, bankruptcy courts.²³

H.R. DOC. NO. 93-137, 93d Cong., 1st Sess. 74, 75 (1973), *reprinted in* WILLIAM M. COLLIER, 2 COLLIER ON BANKRUPTCY app. (Lawrence P. King ed., 15th ed. 1993) [hereinafter Commission Report]; THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 4-5 (1986).

¹⁶ See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, *reprinted in* 1978 U.S.C.A.N. 5787, 6138.

¹⁷ See generally Commission Report, *supra* note 15, at 61-74 (discussing the bankruptcy philosophy and its impact on credit markets and commerce).

¹⁸ First City Asset Servicing Co. v. FDIC (*In re* First City Asset Servicing Co.), 158 B.R. 78, 80 (Bankr. N.D. Tex. 1993).

¹⁹ See 12 U.S.C. §§ 1811-1834. Between 1984 and 1992, 1339 banks insured by the FDIC failed. ANNUAL REPORT, *supra* note 12, at 168.

²⁰ The United States Bankruptcy Code is codified at 11 U.S.C. §§ 101-1330. Notably, the Bankruptcy Code provides in pertinent part that:

(b) A person may be a debtor under chapter 7 . . . only if such person is not—

. . .

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association . . . or similar institution which is an insured bank as defined in . . . (12 U.S.C. [§] 1813(h))

11 U.S.C. § 109(b)(2) (1988).

²¹ See, e.g., 12 U.S.C. § 1821(a), (d), (f), (g).

²² 12 U.S.C. § 1821(d), (i).

²³ 11 U.S.C. § 502 (1988).

Both the Bankruptcy Code and the FDIA establish distribution priority. The Bankruptcy Code's distribution scheme treats unsecured creditors in a substantially identical manner, with few exceptions.²⁴ Under the Act, however, unsecured creditors are not treated as equals; they are subdivided into three distinct priority groups: the bank depositors, the FDIC and general unsecured creditors.²⁵ The bank's depositors (creditors by virtue of their deposits) receive the best treatment, including deposit insurance coverage of up to \$100,000 per depositor. Through the payment of insurance to depositors, FDIC "corporate" becomes subrogated to the depositors' claims against the failed institution and, in the process, often becomes the largest creditor of the FDIC "receiver."²⁶ Generally, not until depositors and the FDIC are made whole do other general unsecured creditors participate in distributions. Furthermore, if the recovery from the institution is less than the amount of FDIC insurance paid, the FDIC (and, indirectly, taxpayers) bears that loss, while general unsecured creditors receive nothing.

B. *Bank Insolvency Law*

Congress created the FDIC in 1933 in response to the widespread bank failures during the Great Depression.²⁷ The FDIA established an insurance fund financed by bank premiums and put the FDIC in charge of administering that fund.²⁸ To help the FDIC in its task, Congress empowered the FDIC to supervise and regulate FDIC-insured banks.²⁹ The FDIC also was given the responsibility of managing troubled and failed

²⁴ The Bankruptcy Code does establish priority among unsecured creditors. See 11 U.S.C. § 503 (1988) and 11 U.S.C. § 507 (1988 & Supp. V 1993). In most bankruptcy cases, however, high-priority, unsecured creditors are not as large and ubiquitous as is the FDIC in a bank insolvency.

²⁵ See *Resolution Trust Corp. v. Elman*, 949 F.2d 624 (2d Cir. 1991).

²⁶ 12 U.S.C. § 1821(a), (g). See *supra* note 5.

²⁷ See S. 1821, 86th Cong., 2d Sess. §§ 2-5 (1960), reprinted in 1960 U.S.C.A.N. 3234, 3234-37. The FDIC provisions originally were codified as an amendment to the Federal Reserve Act, but were withdrawn in 1950 and recodified and renamed as the Federal Deposit Insurance Act at 12 U.S.C. §§ 1811-1833.

²⁸ ZISMAN, *supra* note 5, at § 19.02[2].

²⁹ ZISMAN, *supra* note 5, at § 19.02[2].

insured institutions.³⁰ The original version of the Act remained in effect until Congress passed several important laws updating the Act in response to the bank failure crisis that began in the mid-1980s.³¹ These new laws endowed the FDIC with what have been commonly referred to as "superpowers."³² Two of these "superpowers" were implicated in *Colonial Realty*: fraudulent conveyance avoidance power and anti-injunction power.³³

³⁰ ZISMAN, *supra* note 5, at § 19.02[3]. The FDIC manages failed banks, and the Resolution Trust Corporation ("RTC") manages failed thrifts (including savings and loan associations, building and loan associations, and savings banks). In this Article, the phrase "failed bank" is used for both FDIC-managed banks and RTC-managed thrifts.

³¹ The laws that give the FDIC its charter include the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 (codified in scattered sections of Titles 2, 12, 15 and 31 U.S.C.); the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA") of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of Titles 2, 5, 12, 15, 18, 26, 28, 31, 40, 42 and 44 U.S.C.); the Crime Control Act of 1990, Pub. L. No. 101-647, 104 Stat. 4789 (codified in scattered sections of Titles 11, 12, 18 and 28 U.S.C.) (also known as the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990); and the Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified in scattered sections of 5, 12, 15 U.S.C.). See Swire, *supra* note 14, at 473-74.

³² Congress and the courts have provided the agencies with "superpowers" in their handling of an institution's estate. That is, the FDIC and RTC gain powers in insolvency that would not have been available to the institution pre-insolvency, or to a non-bank in insolvency—to the disadvantage of third parties. Swire, *supra* note 14, at 474.

³³ See generally ZISMAN, *supra* note 5, §§ 19, 24. The other superpowers are:

FDIC Stay—upon request by the FDIC, a court shall stay any judicial action in which the failed bank is or becomes a party through intervention or impleader. 12 U.S.C. § 1821(d)(12).

Cross-Guarantees—any loss incurred by the FDIC due to the failure of one bank is automatically assessed against its affiliate banks, irrespective of whether the affiliate banks contributed to the failure. 12 U.S.C. § 1815(e) (1988 & Supp. V 1993). Under the cross-guarantees provision, stockholders are not guarantors; their claims against or interests in the failed bank, however, are subordinated to the FDIC's claims, even when the shareholders also are creditors, and the affiliate's liability is to commonly controlled entities (including other insured depository institutions). See Swire, *supra* note 14, at 482 (the affiliate's obligation to the FDIC under the cross-guarantees provision has priority over the affiliate's liability to its shareholders (including a bank holding company)).

Injunctive Relief—the FDIC may request any court of competent jurisdiction to freeze the assets of debtors of the failed bank. 12 U.S.C. § 1821(d)(18); see also, *FDIC v. Cafritz*, 762 F. Supp. 1503, 1505 (D.D.C. 1991).

Extension of Limitations Periods—the FDIC is granted the longer of the state law statute of limitations period or three years for tort claims, six years for contract claims and five years for fraudulent transfer claims. These periods do not

First, under its fraudulent conveyance avoidance powers, the FDIC can avoid certain transfers of property, interests in property, or obligations incurred by, among others, a person who is a debtor of an FDIC-insured institution, as long as two conditions are met: (1) the transfer was made or the obligation incurred within five years of the FDIC's appointment as receiver and (2) the transfer was made or the obligation was incurred with the intent to hinder, delay or defraud the insured depository institution, receiver or federal banking agency.³⁴ Furthermore, the FDIC has the right to recover fraudulently transferred property or its value for the benefit of the insured depository institution, and that right is "superior to any rights of a trustee or any other party (other than a party that is a

begin to run until either the FDIC's appointment or accrual of the cause of action, whichever is later. 12 U.S.C. § 1821(d)(14)(A).

Removal Power—the FDIC may remove to federal district court any action in which it is a party in any capacity. 12 U.S.C. § 1819(b)(2)(B) (1988 & Supp. V 1993).

Discretionary Claim Treatment—although the FDIC's maximum liability to any single creditor is the liquidation value of the creditor's claim, the FDIC has discretion to make discriminatory payments to creditors in excess of the statutory limits. 12 U.S.C. § 1821(i)(2), (i)(3)(A).

Special Defenses—the FDIC takes a failed bank's negotiable instruments under a federal common-law, holder-in-due-course doctrine that defeats an obligor's personal defenses. *Campbell Leasing, Inc. v. FDIC*, 901 F.2d 1244, 1248-49 (5th Cir. 1990). In addition, FIRREA essentially codified the *D'Oench, Duhme* doctrine, which precludes an obligor from asserting that a side agreement, which is not otherwise contained in the records of the failed bank, relieves the obligor of his obligations to the bank, which may be founded upon a written loan agreement, a promissory note, or both. See 12 U.S.C. § 1823(e) (1988 & Supp. V 1993); *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 460-61 (1942); *Bell & Murphy & Assocs. v. Interfirst Bank Gateway*, 894 F.2d 750, 755-54 (5th Cir.), *cert. denied*, 498 U.S. 895 (1990). Finally, assets in the possession of the FDIC in its receivership capacity are not subject to attachment. 12 U.S.C. § 1821(d)(13)(C).

Contract Rejection—the FDIC, within a "reasonable period" after its appointment, may reject any contract or lease that it deems burdensome, if rejection would promote the failed bank's orderly administration. 12 U.S.C. § 1821(e)(1)-(2). Contract damages are limited to actual, direct compensatory damages incurred immediately before the FDIC's appointment. 12 U.S.C. § 1821(e)(3). Certain "qualified financial contracts," including securities contracts, commodities contracts, repurchase agreements and swap agreements may not be repudiated unless the FDIC can demonstrate an actual intent to hinder, delay or defraud the insured depository institution, the receiver or a federal banking agency. 12 U.S.C. § 1821(e)(8)(C).

Contract Enforcement—the FDIC may enforce any contract, other than an officer's or director's liability insurance contract or a depository institution bond, notwithstanding an ipso facto termination clause. 12 U.S.C. § 1821(e)(12)(A).

³⁴ 12 U.S.C. § 1821(d)(17) (Supp. V 1993).

Federal agency) under Title 11."³⁵ Second, under the FDIC's anti-injunction aegis, no court may take any action by regulation or order to restrain or affect the powers or functions of the FDIC, except at the request of the FDIC.³⁶

In addition to these "superpowers," the Federal Reserve Board and other bank regulators have asserted the so-called "source-of-strength" doctrine against bank holding companies.³⁷ Under this doctrine, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks.³⁸ Failure to do so is regarded as an "unsafe and unsound practice," and can lead to an agency enforcement action.³⁹ Under this doctrine, regulators attempt to force a bank holding company to fund a subsidiary bank's losses to prevent the subsidiary from failing.⁴⁰

Finally, the FDIC is not subject to the direction or supervision of any federal or state agency or department.⁴¹ Doubtless, Congress has endowed the FDIC with extensive tools to deal with bank failure.⁴² Problems arise, however, when these powers collide with bankruptcy law and policy.

C. Bankruptcy Law

Like conservatorship and receivership under the FDIA, the Bankruptcy Code provides for reorganization and liquidation proceedings. Liquidation generally is carried out under Chap-

³⁵ *Id.* § 1821(d)(17)(D). The FDIC thus stands ahead of all other claimants, except federal agencies, in collecting from the bankruptcy estate of the transferee. Swire, *supra* note 14, at 486.

³⁶ 12 U.S.C. § 1821(j).

³⁷ 1 Fed. Reserve Reg. Serv. ¶ 4-878 (Apr. 24, 1987).

³⁸ 12 C.F.R. § 225.4(a) (1993). See generally Howell E. Jackson, *The Expanding Obligations of Financial Holding Companies*, 107 HARV. L. REV. 507, 528-32 (1994).

³⁹ 1 Fed. Reserve Reg. Serv. ¶ 4-878; see also Jackson, *supra* note 38, at 529, 530 n.72.

⁴⁰ Jackson, *supra* note 38, at 528-29. The "source-of-strength" doctrine is not unlike the cross-guarantees provision. See *supra* note 33. A primary difference, however, is that the "source-of-strength" doctrine is invoked before the bank fails to help prevent its failure, whereas the cross-guarantees provision is applicable only after a bank failure, thereby diminishing the FDIC's loss.

⁴¹ 12 U.S.C. § 1821(c)(2)(C), (c)(3)(C).

⁴² Brief for Appellant at 6-7, *Federal Deposit Ins. Corp. v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125 (2d Cir. 1992) (No. 92-5023); see also *FDIC v. Cafritz*, 762 F. Supp. 1503, 1509 (D.D.C. 1991).

ter 7 of the Bankruptcy Code and reorganization is carried out under Chapter 11.⁴³ Whereas the FDIC takes charge of a failed bank, maintaining or dismissing management as it sees fit, under a Chapter 7 liquidation case, debtors automatically are ousted from control of their property.⁴⁴ In a Chapter 7 case, the trustee (the individual who takes charge of the debtor's property) collects the nonexempt property of the debtor, converts that property to cash, and distributes the proceeds to creditors. Chapter 7 involves a significant trade-off for a debtor: the debtor gives up all nonexempt property in the hope of obtaining a discharge—a release from all liability on pre-bankruptcy debts.

Unlike a liquidation case under Chapter 7, in a Chapter 11 reorganization case creditors generally look to future earnings of the debtor for their recovery, not just to the property of the debtor existing at the time of the bankruptcy filing. The debtor typically retains its assets and makes payments over time to creditors pursuant to a court-approved reorganization plan.

The bankruptcy court oversees most aspects of the cases before it, approving or rejecting numerous proposed actions by the debtor or its trustee, and ruling on issues raised by creditors. In contrast, once the FDIC takes control of a failed bank, it makes all of the decisions concerning the bank, subject to review only upon challenge by suit filed in a federal district court.⁴⁵

⁴³ Liquidation may occur under Chapter 11 when the assets of the debtor are better liquidated in a more orderly fashion to maximize values. The more customary liquidation under Chapter 7 contemplates expeditious liquidation of assets, generally without regard to the value potential of such assets over time.

⁴⁴ In Chapter 11, the presumption is that the debtor will remain in possession of its property as a debtor in possession throughout the case. A Chapter 11 trustee may be appointed, however, for cause. 11 U.S.C. § 1104 (1988).

⁴⁵ Under the Act, creditors with claims against the failed depository institution or its receiver

must first present their claims to the receiver, who decides the disputes according to the procedures contained in the statute. [12 U.S.C.] § 1821(d)(3)-(10). The receiver has 180 days in which to make a determination on the claim, . . . then the claimant has 60 days after the notice of disallowance either to request an administrative review or to commence a *de novo* action in the appropriate federal district court. § 1821(d)(6)(A). If the receiver fails to give notice of disallowance within the claim determination period, then the claimant has 60 days from the end of that period to request an administrative review or file suit in the

The Bankruptcy Code provides certain powers to debtors and trustees that are analogous to the FDIC superpowers implicated in *Colonial Realty*.⁴⁶ First, the Bankruptcy Code provides an anti-injunction power in the form of an automatic stay. The filing of a petition in bankruptcy, without any further action, results in a stay by operation of law. This prevents the commencement or continuation of any action or proceeding against the debtor or the property of the estate; any act to create, perfect or enforce a security interest in the debtor's property; and, any act to collect, assess or recover a claim against the debtor or the property of the estate.⁴⁷ The automatic stay prevents the issuance of an injunction, except in furtherance of a governmental unit's police or regulatory powers.⁴⁸ Second, like the FDIA, the Bankruptcy Code provides for fraudulent conveyance avoidance. A debtor or its trustee in bankruptcy can avoid transfers that were actually or constructively fraudulent.⁴⁹

appropriate federal court.

Lloyd v. FDIC, 812 F. Supp. 293, 297 (D.R.I. 1993), *vacated on other grounds*, 22 F.3d 335 (1st Cir. 1994).

⁴⁶ The Bankruptcy Code analogues to the other superpowers mentioned above are the following:

Limitations Periods—the Bankruptcy Code establishes certain limitations periods, tolls certain limitation periods, and allows the debtor or its trustee to abide nonbankruptcy law limitation periods. *See, e.g.*, 11 U.S.C. §§ 108, 544, 548, 550 (1988 & Supp. V 1993).

Removal Power—the Bankruptcy Code permits removal to federal district court of any state court claims related to bankruptcy cases. 28 U.S.C. § 1452 (1988 & Supp. IV 1992).

Claim Treatment—unlike the FDIC, a debtor in bankruptcy may not exercise discretion in paying claims; claims are paid strictly according to the statutory distribution scheme. 11 U.S.C. §§ 507, 1129 (1988).

Special Defenses—a debtor or its trustee in bankruptcy, unlike the FDIC, does not gain any holder-in-due-course or *D'Oench, Duhme* defenses by filing for bankruptcy protection unless the debtor had such defenses available to it before bankruptcy. A debtor or its trustee does, however, gain the ability to void unperfected or improperly perfected security interests. 11 U.S.C. § 544 (1988 & Supp. V 1993).

Injunctive Relief—the debtor's or trustee's ability to obtain an injunction rests on proof of the standard injunction elements. *See* FED. R. BANKR. P. 7065.

Contract Rejection—like the Act, the Bankruptcy Code permits the rejection of burdensome leases and contracts; unlike the Act, however, the rejection claim is not limited to the out-of-pocket damages incurred prior to the bankruptcy filing. 11 U.S.C. § 365 (1988 & Supp. V 1993).

⁴⁷ 11 U.S.C. § 362 (1988 & Supp. V 1993).

⁴⁸ 11 U.S.C. § 362(b).

⁴⁹ The statute of limitations period is one year or the relevant applicable state

Unlike the FDIC, however, bankruptcy creditors do not have an analogue to the source-of-strength power. There is no similar power for creditors to reach the assets of shareholders or affiliates, absent a successful veil-piercing action.⁵⁰

The Crime Control Act of 1990 added several amendments to the Bankruptcy Code that give greater rights to the FDIC and other bank regulators involved with debtors in bankruptcy proceedings. Many of the amendments clearly prohibit a debtor from using bankruptcy as a shield against liability for fraud or mismanagement of a bank.⁵¹

Other significant amendments concern "capital maintenance commitments," agreements entered into between an insured depository institution's purchaser and a regulatory agency, which provide that the purchaser will commit its own assets to maintain capital at certain levels if necessary.⁵² Three amendments to the Bankruptcy Code implement this objective. The first makes the malicious or reckless failure to fulfill such a commitment a nondischargeable debt.⁵³ Second,

law period. 11 U.S.C. §§ 544, 548, 550. The FDIC's five-year period or state-law period is an enhancement over the powers of its bankruptcy counterpart.

⁵⁰ Substantive consolidation is a consensual veil-piercing bankruptcy concept that, for purposes of repayment, treats several debtors or parties affiliated with a debtor as one entity. See *infra* note 65 and accompanying text.

⁵¹ For instance, debts arising out of fraud or defalcation while acting as a fiduciary (under the definitional amendments—a director, officer, employee, controlling stockholder, agent or other control person) of an insured bank are not dischargeable. See 11 U.S.C. § 523(a)(11) (1988 & Supp. V 1993) (fraud or defalcation while in fiduciary capacity nondischargeable); 11 U.S.C. §§ 101(33), 523(e) ("fiduciary" includes "institution-affiliated party," which is defined with a reference to 12 U.S.C. § 1813(u) (1988 & Supp. V 1993)). Before the amendments, § 523(a)(4), which prevented discharge of a debt arising from fraud or defalcation while acting in a fiduciary capacity, was not applicable to directors, officers or controlling persons of a bank.

Additionally, the FDIC/RTC is excused from the strict deadlines to challenge the dischargeability of certain debts if the FDIC/RTC was not appointed in time to reasonably comply. 11 U.S.C. § 523(c)(2); FED. R. BANKR. P. 4007(c). In a related amendment, an exception to the debtor's right to exempt property was added to the Bankruptcy Code so that otherwise exempt assets may be used to satisfy debts to the FDIC/RTC for fraud, embezzlement, larceny, or willful or malicious injury of an insured depository institution. 11 U.S.C. § 522(c)(3) (1988 & Supp. V 1993).

⁵² Put another way, a "capital maintenance commitment" is a bank purchaser's agreement to become another source of capital to bolster the bank so that the risk of failure is minimized and the need to tap the FDIC's deposit insurance fund becomes unlikely.

⁵³ 11 U.S.C. § 523(a)(12).

in a Chapter 7 case, a bank receiver's capital maintenance commitment claim is given priority over the claims of other general unsecured creditors.⁵⁴ The most controversial amendment in furtherance of this objective, however, is new section 365(o), which requires a Chapter 11 debtor to assume and perform a capital maintenance commitment according to its terms.⁵⁵

II. *IN RE COLONIAL REALTY CO.*⁵⁶

A. *Facts*

Colonial Realty Company, a Connecticut general partnership and its partners, Jonathan Googel and Benjamin Sisti, promoted numerous real estate limited partnerships throughout the United States during the 1980s.⁵⁷ Googel and Sisti acted as general and/or managing partners of the limited partnerships.⁵⁸ The limited partnerships were financed by direct borrowings from financial institutions and from funds invested by third parties.⁵⁹ In turn, Colonial, Googel and Sisti guaranteed many of the loans to these ventures, becoming subject to contingent guarantor liability of tens of millions of dollars.⁶⁰

Between March and August 1990, Sisti transferred approximately \$10 million in cash under his control to third parties.⁶¹ Several million dollars allegedly went to Sisti's wife,

⁵⁴ *Id.* § 507(a)(8).

⁵⁵ Section 365(o) states in part: "In a case under chapter 11 of this title, the trustee [or debtor in possession] shall be deemed to have assumed . . . and shall immediately cure any deficit under, any commitment by the debtor to the Federal Deposit Insurance Corporation . . . to maintain the capital of an insured depository institution" The Bankruptcy Code contains no other "deemed assumption" clauses.

⁵⁶ 980 F.2d 125 (2d Cir. 1992).

⁵⁷ *Colonial Realty*, 980 F.2d at 127.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*; see also Brief for Appellant, *supra* note 42, at 11.

⁶¹ *Colonial Realty*, 980 F.2d at 128 n.3; see also Brief for Appellant, *supra* note 42, at 12. The complaint in the Florida action describes the following transfers:

1. On or about March 26, 1990, when a certificate of deposit in the amount of \$1.7 million in the name of and owned by Sisti matured at a bank in Connecticut, \$1 million was transferred to Barnett Bank in Florida with instructions to open an account for it in Helene's name.
2. On or about April 4, 1990, when a certificate of deposit in the amount of

who in turn transferred a large portion of those funds to their son and to two Florida corporations that the wife owned and controlled—Panda Angel and Martin Marina.⁶² Sisti also transferred funds to a Florida corporation, Southern Ties, which in turn transferred the funds to a Florida law firm, the “Cohen Firm.”⁶³

In September 1990, midway through the real estate recession, involuntary bankruptcy petitions were filed against Colonial, Googel and Sisti (together, the “Debtors”) in the United States Bankruptcy Court for the District of Connecticut.⁶⁴ A Chapter 7 trustee was appointed for the Debtors, who, after a trial on the issue, were substantively consolidated.⁶⁵

\$3.8 million in the name of and owned by Sisti matured at the same bank in Connecticut, such amount was transferred to Barnett Bank in Florida with instructions to open a certificate of deposit in the same amount in Helene's name.

3. On or about April 5, 1990, when a certificate of deposit in the amount of \$228,000 in the name of and owned by Sisti matured at the same bank in Connecticut, such amount was transferred to a certificate of deposit in the same amount in Helene's name at the same bank.

4. On or about April 9, 1990, when a certificate of deposit in the amount of \$365,000 in the name of and owned by Sisti matured at the same bank in Connecticut, such amount was transferred to a certificate of deposit in the same amount in Helene's name at the same bank. Upon maturity, these funds were placed in Helene's money market account.

5. On or about May 4, 1990, Sisti transferred \$560,000 from his demand account at a Connecticut bank to an account in the name of Southern Ties at Barnett Bank in Florida.

6. On or about May 16, 1990, Sisti transferred \$4 million from his account at an Illinois bank to an account in the name of Helene at the Connecticut bank. Later, \$3 million was transferred to an account in Helene's name at Barnett Bank in Florida, and the other \$1 million was transferred to another account in Helene's name at the Connecticut bank.

Complaint, FDIC v. Sisti (S.D. Fla. Dec. 2, 1991) (No. 91-7866).

All of these transfers were followed by further transfers of the same funds to the Cohen Firm, Southern Ties, Panda Angel and Martin Marina, and also used to purchase certain real property in Florida.

⁶² Brief for Appellant, *supra* note 42, at 12. Panda Angel and Martin Marina each purchased trailer parks with the funds (totaling over \$6 million). *Id.* at 13.

⁶³ Brief for Appellant, *supra* note 42, at 13.

⁶⁴ *Colonial Realty*, 980 F.2d at 127.

⁶⁵ See *FDIC v. Colonial Realty Co.*, 966 F.2d 57 (2d Cir. 1992). The trial decision on substantive consolidation was appealed by the FDIC to the district court and to the court of appeals, where it was affirmed.

Substantive consolidation results in the pooling of the assets and liabilities of the substantively consolidated debtors, who are treated as if they were a single entity. It is an equitable doctrine based on a number of factors pertaining to the ultimate fairness of requiring a creditor to satisfy her claim against only one debt-

1. Enter the FDIC

Within one year of Colonial's collapse and the commencement of the Debtors' bankruptcy cases, the FDIC was appointed as receiver for five failed banks that were owed nearly \$70 million from the Debtors.⁶⁶ The FDIC actively participated in the bankruptcy cases.⁶⁷

The trustee, attempting to carry out his duties to locate and marshal property of the estate, had sought discovery through the FDIC of certain suspicious transfers from the Debtors to the banks. The FDIC blocked the trustee's efforts, claiming that the banks' records were in disarray and that the FDIC did not have the time nor the manpower to facilitate the discovery.⁶⁸ As described below, the FDIC had reason to stonewall the trustee's discovery efforts.

2. The Florida Action

On December 2, 1991, the FDIC, in its role as receiver for the banks, commenced an action in the United States District Court for the Southern District of Florida to contest the transfer of and, if successful, to recover approximately \$10 million that Sisti had transferred to third parties, including his wife.⁶⁹ The action was brought under 12 U.S.C. § 1821(d)(17), which permits the avoidance and recovery of any transfer "that was intended to hinder, delay, or defraud an insured depository institution or the FDIC as receiver . . . if the transfer was made within five years from the date that the FDIC was appointed receiver [of] the institution."⁷⁰

or when that creditor dealt with several debtors as a single economic entity without separate identity when extending credit.

⁶⁶ *Colonial Realty*, 980 F.2d at 127.

⁶⁷ *Id.*

⁶⁸ See Trustee's Application in Support of Motion Upon Short Notice Pursuant to Bankruptcy Rule 9006(c) Enforcing the Automatic Stay as Against the Federal Deposit Insurance Corporation at 5-6, *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125 (2d Cir. 1992) (No. 92-5023).

⁶⁹ *Colonial Realty*, 980 F.2d at 127-28.

⁷⁰ *Id.* Section 1821(d)(17) provides, in relevant part:

(A) *In general*

The [FDIC], as conservator or receiver for any insured depository institution, . . . may avoid a transfer of any interest of . . . any person who the [FDIC] determines is a debtor of the institution, in proper-

Named as defendants in the action were Sisti's wife and son, Southern Ties and the Cohen Firm. Sisti and the trustee, however, were not named as defendants in or served with the complaint, and neither they nor the bankruptcy court were notified of the commencement of the action.⁷¹ On December 12, 1991, the district court entered an ex parte temporary restraining order freezing the transferred assets and appointed a trustee under 12 U.S.C. § 1821(d)(18).⁷² The trustee received notice via telephone of the action on December 13, 1991.⁷³

3. The Lower Court Hearings

On December 16, 1991, at a hearing commenced by the trustee, the bankruptcy court ruled that the FDIC's actions were subject to the automatic stay.⁷⁴ Because the bankruptcy court was left with the impression that the FDIC would not abide the court's ruling on the automatic stay's applicability, the court issued an injunction under its section 105 powers enjoining the action.⁷⁵ The bankruptcy court issued a written order one day later, and a written decision on December 24, 1991.⁷⁶ The bankruptcy court's view may be summarized by two quotes from its decision:

ty, . . . that was made within 5 years of the date on which the [FDIC] was appointed conservator or receiver if such . . . person voluntarily or involuntarily made such transfer . . . with the intent to hinder, delay, or defraud the insured depository institution, [or] the [FDIC].

. . . .
(D) *Rights under this paragraph*

The rights under this paragraph of the [FDIC] . . . shall be superior to any, rights of a trustee or any other party (other than a party which is a Federal agency) under Title 11.

12 U.S.C. § 1821(d)(17).

⁷¹ *Colonial Realty*, 980 F.2d at 127-28; see also Brief for Appellee at 4, *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125 (2d Cir. 1992) (No. 92-5023).

⁷² *Colonial Realty*, 980 F.2d at 128. The FDIC-receiver is empowered to obtain attachment of assets and other injunctive relief pursuant to the relaxed standards set forth in 12 U.S.C. § 1821(d)(19). See 12 U.S.C. § 1821(d)(18).

⁷³ A facsimile was sent by Florida counsel to the Sistis. Brief for Appellee, *supra* note 71, at 3.

⁷⁴ *In re Colonial Realty Co.*, 134 B.R. 1017, 1020-23 (Bankr. D. Conn. 1991) [hereinafter *Colonial I*].

⁷⁵ *Id.* at 1023 n.9. Bankruptcy courts have a broad grant of authority to issue any order, process or judgment that is necessary or appropriate to carry out the provisions and purposes of Title 11. See 11 U.S.C. § 105(a).

⁷⁶ *Colonial I*, 134 B.R. at 1024.

It is well settled that fraudulent conveyance actions based upon prepetition transfers by a debtor are property of the estate; that the estate trustee has exclusive authority to maintain such actions, and that the automatic stay bars all other parties from pursuing such actions unless relief from the stay is sought in and granted by the bankruptcy court.⁷⁷

....
The overarching point is that the forum that Congress provided for the trustee and all parties, without exception, making a claim to estate property is the bankruptcy court.⁷⁸

On December 30, 1991, the United States District Court for the Southern District of New York entered an oral order, followed by a written order dated December 31, 1991, that affirmed the bankruptcy court.⁷⁹ The FDIC then appealed to the Second Circuit.

B. *Issues Presented to the Second Circuit*

The FDIC's appeal to the Second Circuit requested a determination on three separate issues. First, the FDIC asserted that its section 1821(d)(17) action was not property of the bankruptcy estate nor subject to the automatic stay.⁸⁰ Alternatively, the FDIC claimed that section 1821(d)(17)(D) precluded application of the automatic stay by designating the FDIC's rights to transferred assets as superior to those of the trustee⁸¹ and, therefore, the transferred property did not belong to the bankruptcy estate to the extent of the FDIC's claim.

Finally, the FDIC asked the court to find that the operation of the section 362 stay and the section 105 injunction was ineffective against the FDIC in the light of the anti-injunction

⁷⁷ *Id.* at 1020.

⁷⁸ *Id.* at 1022.

⁷⁹ *Colonial Realty*, 980 F.2d at 130; see also Brief for Appellee, *supra* note 71, at 5.

⁸⁰ On appeal to the Second Circuit, there was general agreement that the FDIC's fraudulent transfer claim, itself, was not property of the estate. *Colonial Realty*, 980 F.2d at 131. Because that action was exclusive to the FDIC and the assets to be recovered by such action would inure to the benefit of the FDIC only, the bankruptcy trustee could not step into the FDIC's shoes under § 544(b) of the Bankruptcy Code. Section 544(b) permits a trustee to exercise the rights of an unsecured creditor and to avoid any transfer voidable under applicable law by such unsecured creditor. 11 U.S.C. § 544(b).

⁸¹ See *supra* text accompanying notes 34-35.

provision found at 12 U.S.C. § 1821(j). This provision precludes any court from restraining or affecting the exercise of powers or functions of the FDIC as receiver.⁸²

The trustee's arguments were straightforward. In response to the first two issues, the trustee relied on the broad definition of "property of the estate" contained in section 541 of the Bankruptcy Code and case law. Arguing that fraudulently conveyed property belongs to the estate, the trustee characterized the FDIC's Florida action as an act to obtain possession of property of the estate, which was prohibited by the automatic stay.⁸³ The trustee addressed the third issue by arguing that the section 362 stay is not a judicial act but a congressionally mandated stay applicable by operation of law and, furthermore, that section 1821(j) is applicable only when the FDIC is acting within the proper scope of its authority. Because the FDIC was acting outside the scope of its authority—i.e., in violation of the automatic stay—the lower courts' issuance and affirmation of the section 105 injunction were proper.⁸⁴

1. Applicability of the Automatic Stay to the Florida Action

On appeal, the FDIC argued that the rights granted under section 1821(d)(17) are exclusive to the FDIC and expressly "superior" to the rights of a bankruptcy trustee; therefore, the automatic stay was inapplicable to the Florida action.⁸⁵ Under section 1821(d)(17)(A) the FDIC alone has the right to avoid certain transfers of interests in property, and obligations incurred by, among others, debtors of an FDIC-insured institution.⁸⁶ Section 1821(d)(17)(A) imposes only two limitations on

⁸² *Colonial Realty*, 980 F.2d at 130; see also *supra* note 36 and accompanying text.

⁸³ 980 F.2d at 129; see 11 U.S.C. § 362(a)(3).

⁸⁴ *Colonial Realty*, 980 F.2d at 129.

⁸⁵ *Id.*

⁸⁶ Brief for Appellant, *supra* note 42, at 18. These powers also are granted to the RTC, which exists under the auspices of the FDIC. 12 U.S.C. § 1441a(b)(4) (1988 & Supp. V 1993). The exclusivity of these fraudulent transfer avoidance powers differs from traditional state law fraudulent transfer (or conveyance) laws, which generally give the debtor or any of its creditors the right to bring such actions. In bankruptcy, a trustee (or the debtor in possession) succeeds to these state law rights by virtue of § 544 of the Bankruptcy Code. 11 U.S.C. § 544(b).

the FDIC's avoidance power. First, the transfer must have been made or the obligation incurred within five years of the FDIC's appointment as receiver. Second, the transfer must have been made or the obligation incurred with the intent to hinder, delay or defraud either the insured depository institution, the receiver or a federal banking agency.⁸⁷

The FDIC also argued that section 1821(d)(17)(D) makes the FDIC's rights to avoid and recover fraudulently transferred property or its value "superior to any rights of a trustee or any other party (other than a party that is a Federal agency) under Title 11."⁸⁸

The FDIC relied on statutory construction. First, it asserted that the plain language of the statute should be given effect.⁸⁹ Here, the statute was unambiguous, expressly stating the FDIC's rights without reference to or a caveat concerning an intervening bankruptcy.⁹⁰ The FDIC also argued that because its avoidance rights flowed from a "specific" statute, the "general" law of the automatic stay and bankruptcy estate property must give way.⁹¹

In response, the trustee argued that the automatic stay applied because the transferred property belonged to the bankruptcy estate.⁹² The trustee relied on the Bankruptcy Code's broad definition of property of the estate, which includes "all legal or equitable interests of the debtor in property as of the commencement of the case."⁹³ The trustee also relied on

⁸⁷ Brief for Appellant, *supra* note 42, at 18; see also *Colonial Realty*, 980 F.2d at 128.

⁸⁸ 12 U.S.C. § 1821(d)(17)(D).

⁸⁹ Brief for Appellant, *supra* note 42, at 15-16; see also *Colonial Realty*, 980 F.2d at 134.

⁹⁰ Brief for Appellant, *supra* note 42, at 16; see also *Colonial Realty*, 980 F.2d at 134. According to the FDIC, because the automatic stay and bankruptcy-estate property concepts are very old, Congress was well aware of them and would have carved them out from the FDIC's avoidance powers if that was what it had intended. The more commonly recognized statutory construction would argue that an older law is never altered by a newer law unless they are completely incompatible or there is an express indication that Congress intended the latter law to control. Brief for Appellant, *supra* note 42, at 20-23; see also *Colonial Realty*, 980 F.2d at 132-33.

⁹¹ Brief for Appellant, *supra* note 42, at 28; see also *Colonial Realty*, 980 F.2d at 129.

⁹² Brief for Appellant, *supra* note 42, at 25; see also *Colonial Realty*, 980 F.2d at 131.

⁹³ 11 U.S.C. § 541(a)(1).

American National Bank v. MortgageAmerica Corp., a Fifth Circuit decision holding that a debtor retains some legal or equitable interest in fraudulently transferred property that precludes the debtor/fraudulent transferor's creditors from pursuing claims against that property outside the bankruptcy case.⁹⁴ Finally, the trustee argued that the FDIC's "superior rights" merely established the FDIC's priority in the assets once the trustee recovered them through use of his avoiding powers under sections 544 and 548 of the Bankruptcy Code, much like the priority positions of an administrative or secured creditor.⁹⁵

The Second Circuit first addressed the "straight bankruptcy" issue presented by the case. It began by discussing the *MortgageAmerica* case, which expressed the "traditional" view that the debtor retains some interest in fraudulently transferred property. The Second Circuit stated that the *MortgageAmerica* analysis was seriously flawed, notwithstanding several earlier Second Circuit cases that had affirmed its reasoning.⁹⁶ Specifically, the Second Circuit determined that application of *MortgageAmerica's* section 541(a)(1) analysis would render meaningless section 541(a)(3) of the Bankruptcy Code.⁹⁷ Section 541(a)(3) includes *recovered* property as part of the bankruptcy estate. Therefore, the Second Circuit determined that unrecovered, fraudulently transferred property must not be property of the estate under section 541(a)(1).⁹⁸

⁹⁴ *American Nat'l Bank v. MortgageAmerica Corp.* (*In re MortgageAmerica Corp.*), 714 F.2d 1266 (5th Cir. 1983).

⁹⁵ *Colonial Realty*, 980 F.2d at 129, 134.

⁹⁶ See *id.* at 131. The Second Circuit relied upon the bankruptcy court's decision in *In re Saunders*, 101 B.R. 303 (Bankr. N.D. Fla. 1989), in reaching its conclusion about *MortgageAmerica*. *Id.*

⁹⁷ *Colonial Realty*, 980 F.2d at 131. As noted earlier, § 541(a)(1), entitled "Property of the Estate," includes "equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1) (emphasis added). The *MortgageAmerica* court had stated that even where fraudulent transfer causes of action can only be brought by the creditors of the debtor/fraudulent transferor and the transferee holds colorable title to the assets, "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 the creditors may attach or execute judgment upon it." *MortgageAmerica*, 714 F.2d at 1275 (emphasis added).

⁹⁸ 11 U.S.C. § 541(a)(3) (1988 & Supp. V 1993). Section 541(a)(3) provides that property recovered through §§ 544 and 548 avoidance powers becomes part of the bankruptcy estate. See also § 550, which provides the mechanism for the recovery of avoided transfers.

This ruling, the first by a court of appeals, establishes that fraudulently transferred property is not property of the estate until it is recovered.⁹⁹ Accordingly, the trustee's argument, that the Florida action violated the automatic stay as an attempt to possess property of the estate, failed.

Not all was lost for the trustee, however, because the Second Circuit determined the FDIC was trying "to recover a claim against the debtor," in violation of the automatic stay.¹⁰⁰ Subsection one of section 362(a) provides in part that actions "to recover a claim against the debtor that arose prior to the commencement" of the bankruptcy case are stayed.¹⁰¹ Because subsection one in its first part stays actions "against the debtor," the Second Circuit concluded that the second part of the subsection—"to recover a claim against the debtor"—must encompass cases in which the debtor is not a defendant; for instance, in a fraudulent transfer action against a third party.¹⁰² In its conclusion, the Second Circuit quoted the "issuance of process" hypothetical from *In re Saunders*, a Florida bankruptcy court decision:

While a fraudulent transfer action may be an action against a third party, it is also an action "to recover a claim against the debtor." Absent a claim against the debtor, there is no independent basis for the action against the transferee. Moreover, the creditor can only recover property or value thereof received from the debtor sufficient to satisfy the creditor's claim against the debtor. This interpretation is consistent with the legislative history of section 362(a)(1) which states:

The provision in this first paragraph prohibiting the issuance of process is designed to prevent the issuance of a writ of execution by a judgment creditor of the debtor to obtain property that was property of the debtor before the case *but that was transferred*, subject to the judgment lien, before the case. Because the other paragraphs of this subsection refer only to property of the estate or property of the debtor, *neither of which apply to this kind of transferred property*, they would not prohibit pursuit of the transferred property by issuance of process.¹⁰³

⁹⁹ *Colonial Realty*, 980 F.2d at 131.

¹⁰⁰ *Id.* at 131-32.

¹⁰¹ 11 U.S.C. § 362(a)(1).

¹⁰² *Colonial Realty*, 980 F.2d at 131.

¹⁰³ *Id.* at 132 (quoting *In re Saunders*, 101 B.R. 303, 305-06 (Bankr. N.D. Fla. 1989) (citations omitted)).

The Second Circuit applied this analysis to the FDIC's Florida action. The FDIC's complaint against the fraudulent transferees stated that the FDIC was seeking to recover a claim against a debtor, Sisti, because Sisti was liable to the FDIC as the result of loans made by the failed banks. The defendants in the action were liable only as fraudulent transferees.¹⁰⁴ Accordingly, if Sisti were not liable to the FDIC, the FDIC would have no cause of action against the fraudulent transferees.¹⁰⁵ Thus, the Second Circuit held that the automatic stay was applicable to the Florida action unless it was trumped by the provisions of section 1821 of the FDIA.¹⁰⁶

The Second Circuit next addressed the FDIC's statutory construction arguments.¹⁰⁷ The FDIC had argued that the absence of any bankruptcy carve-out to section 1821(d)(17) enacted in 1990 meant that the FDIC's fraudulent transfer rights were not subject to the automatic stay.¹⁰⁸ The Second Circuit stated two reasons for rejecting this "partial-repeal-by-implication" argument.¹⁰⁹ First, repeal requires either some affirmative showing of an intent to repeal, or proof that the two statutes are completely irreconcilable.¹¹⁰ Second, courts should reconcile the inconsistent requirements of two statutes wherever possible.¹¹¹

In applying the first prong of the "repeal analysis," the Second Circuit turned the FDIC's argument on its head. The court highlighted the 1990 Amendments,¹¹² concluding: "Given this careful attention to the harmonization of the new banking provisions with the existing Bankruptcy Code, it becomes *especially implausible* to conclude that a quite significant modification of the bankruptcy automatic stay was enacted by implication."¹¹³ The court ended its decision with a brief discus-

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Colonial Realty*, 980 F.2d at 132.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 132-33.

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² See *supra* notes 51-55 and accompanying text.

¹¹³ *Colonial Realty*, 980 F.2d at 133 (emphasis added).

sion of the salutary purposes of the automatic stay.¹¹⁴ The automatic stay prevents "a chaotic and uncontrolled scramble for the debtor's assets," and facilitates the centralization of the debtor's affairs in a single forum resulting in an organized proceeding.¹¹⁵

Next, the Second Circuit agreed with the trustee's view that the FDIC's "superior" rights in the recovered property merely established the FDIC's priority of recovery.¹¹⁶ The court stated that although the FDIC's rights to the property were superior, the rights and obligations of the trustee were not extinguished.¹¹⁷ If the FDIC were free to sue fraudulent transfer recipients without notice to bankruptcy trustees, trustees would be placed in the intolerable position of expending time and money to uncover FDIC actions throughout the country, in order to intervene in each forum to protect the rights of bankruptcy estates.¹¹⁸ The ramifications of such a scenario run afoul of fundamental bankruptcy policy; namely, that any matters affecting the debtor's affairs "be centralized, [at least] initially, in a single forum in order to prevent conflicting judgments from different courts and in order to harmonize all of the creditors' interests with one another."¹¹⁹

Ultimately, the Second Circuit determined that both of the statutory provisions, section 362 of the Bankruptcy Code and section 1821(d)(17) of the Act, could be given effect.¹²⁰ The FDIC could request relief from the automatic stay to commence any action, and also could request equitable (injunctive) relief on an expedited basis.¹²¹ The automatic stay could serve its centralization function and the bankruptcy trustee (and estate) would receive appropriate due process.

¹¹⁴ *Id.*

¹¹⁵ *Id.* (quoting *In re Fidelity Mortgage Investors*, 550 F.2d 47, 55 (2d Cir. 1976), *cert. denied*, 429 U.S. 1093 (1977)).

¹¹⁶ *Id.* at 134.

¹¹⁷ *Id.*

¹¹⁸ *Colonial Realty*, 980 F.2d at 134.

¹¹⁹ *Id.* at 133 (quoting *In re Fidelity Mortgage Investors*, 550 F.2d at 55).

¹²⁰ *Id.* at 135.

¹²¹ *Id.* at 134.

2. Applicability of the Anti-Injunction Act

Because the FDIC had suggested that it did not agree with the bankruptcy court's application of the automatic stay, the bankruptcy court issued an injunction under its section 105 powers.¹²² The FDIC appealed the injunction as a contravention of the anti-injunction provision of Act section 1821(j).¹²³ The FDIC exhorted that the plain, unambiguous language and meaning of the statute was controlling, and cited several cases showing that similar anti-injunction statutes were applicable in bankruptcy proceedings.¹²⁴

According to the FDIC, the Supreme Court's decision in *Board of Governors v. MCorp Financial, Inc.*,¹²⁵ provided the most recent guidance in this area. In *MCorp*, a bank holding company, which had filed for Chapter 11 protection, sought to enjoin two proceedings brought against it by the Board of Governors of the Federal Reserve System.¹²⁶ The district court issued the injunction despite the Board's argument that it was void in light of the anti-injunction provision applicable to such proceedings.¹²⁷ The Fifth Circuit partially reversed the district court, grounding its holding on the anti-injunction provision.¹²⁸ On appeal, the Supreme Court affirmed in part and

¹²² See *supra* text accompanying notes 75-76.

¹²³ *Colonial Realty*, 980 F.2d at 135; see *supra* note 81.

¹²⁴ See, e.g., *Petrusch v. Teamsters Local 317 (In re Petrusch)*, 667 F.2d 297, 299-300 (2d Cir. 1981) (bankruptcy court without subject matter jurisdiction to issue injunction restraining labor union from picketing debtor's place of business because the Norris-LaGuardia Act prohibited such an injunction), *cert. denied*, 456 U.S. 974 (1982); *Third Ave. Transit Corp. v. Quill (In re Third Ave. Transit Corp.)*, 192 F.2d 971 (2d Cir. 1951) (same).

¹²⁵ 112 S. Ct. 459 (1991).

¹²⁶ *Id.* at 461.

¹²⁷ *Id.* The anti-injunction provision states:

[E]xcept as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

12 U.S.C. § 1818(i)(1) (1988 & Supp. V 1993).

¹²⁸ *MCorp*, 112 S. Ct. at 461. The Fifth Circuit held that, in light of the applicable anti-injunction statute, 12 U.S.C. § 1818(i)(1), the district court was without jurisdiction to enjoin one of the Board proceedings dealing with restrictions on transactions between bank holding-company subsidiaries and nonbank affiliates. 112 S. Ct. at 461 n.2, 462. The Court of Appeals, however, remanded to the district court the second Board proceeding concerning the "source-of-strength" regulation, with instructions to enjoin that proceeding for its lack of proper statutory

reversed in part, primarily on the ground that the Board's administrative proceedings were excepted from the operation of the automatic stay by virtue of the police and regulatory powers exception.¹²⁹ The Court, however, noted in dicta that "the specific preclusive language in [the anti-injunction provision] is not qualified or superseded by the general provisions governing bankruptcy proceedings on which MCorp relies."¹³⁰ The FDIC argued that this statement by the Supreme Court expressly recognized that the anti-injunction provision was applicable in bankruptcy cases.

The FDIC cited other case law analogues, including several that discussed the "trumping" of a "general" statute by a "specific" statute.¹³¹ The FDIC's theory was that the automatic stay was a statute of broad and "general" application, without any specific reference to FDIC proceedings, whereas the anti-injunction provision of section 1821(j) was a "specific" statement by Congress that no court should act to enjoin the FDIC in the furtherance of its powers and duties.¹³²

In response, the trustee argued that the injunction was issued solely in support of the automatic stay, which is the result of congressional mandate, not judicial action.¹³³ The trustee then cited an extensive line of cases, most of which stood for the proposition that anti-injunction laws are inapplicable when the entity benefitted by the law acts beyond the scope of its power or authority.¹³⁴ Those cases also establish

authority. *Id.* at 462.

¹²⁹ 112 S. Ct. at 464. The Bankruptcy Code excepts from the operation of the automatic stay "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power." 11 U.S.C. § 362(b)(4) (1988 & Supp. 1993).

¹³⁰ *MCorp*, 112 S. Ct. at 465. Because the Court already had ruled on the applicability of § 362(b)(4), the Court's statement might have been directed solely at MCorp's alternative argument that the district (or bankruptcy) court had authority under 28 U.S.C. § 1334(b) to exercise concurrent jurisdiction over certain bankruptcy-related civil proceedings that otherwise would be subject to the exclusive jurisdiction of another court. *Id.*

¹³¹ See, e.g., *Cook County Nat'l Bank v. United States*, 107 U.S. 445, 451 (1883) ("A law embracing an entire subject, dealing with it in all its phases, may thus withdraw the subject from the operation of a general law as effectually as though, as to such subject, the general law were in terms repealed.").

¹³² Brief for Appellant, *supra* note 42, at 43.

¹³³ Brief for Appellee, *supra* note 71, at 30.

¹³⁴ See, e.g., *Cummings Prop. Mgmt. v. FDIC*, 786 F. Supp. 144 (D. Mass. 1992) (section 1821(j) does not divest court of jurisdiction to determine if FDIC is acting

that such laws do not prevent a court from determining whether the "protected" entity is acting within its proper scope.¹³⁵

On the applicability of the Anti-Injunction Act, the Second Circuit concluded that the bankruptcy court's issuance of the injunction was superfluous since the automatic stay covered the Florida action.¹³⁶ Agreeing with the trustee, the court opined that section 1821(j) was ineffective against a congressionally mandated stay.¹³⁷ The Court of Appeals next reviewed several of the cases relied upon by the parties.¹³⁸

It summarily dismissed the FDIC's *MCorp* argument because it found that the Supreme Court's holding in *MCorp* was grounded primarily in the police and regulatory exception to the automatic stay.¹³⁹ Next, the court addressed *Coit Independence Joint Venture v. Federal Savings & Loan Insurance Co.*,¹⁴⁰ in which the Supreme Court found the Federal Savings and Loan Insurance Corporation's ("FSLIC") anti-injunction provision inapplicable when the FSLIC was acting beyond the scope of its powers because it attempted to adjudicate creditors' claims.¹⁴¹ Thus, the Second Circuit found this case inapposite as well.¹⁴²

Finally, the Court turned its attention to *Gross v. Bell Savings Bank*,¹⁴³ a Third Circuit decision holding that injunctive relief imposed by statute without court action does not contravene an anti-injunction provision.¹⁴⁴ This dovetailed with the Second Circuit's determination that the *Colonial Realty* injunction was superfluous in the first place, and had been

outside the scope of its powers), *vacated and appeal dismissed*, No. 92-1504, 1992 WL 366909 (1st Cir. Sept. 1, 1992); *Gross v. RTC*, No. 92-0296, 1992 WL 55741 (E.D. Pa. Mar. 13, 1992) (section 1821(j) does not prohibit court determination of whether RTC is acting outside the scope of its powers), *rev'd sub nom.*, *Gross v. Bell Savs. Bank*, 974 F.2d 403 (3d Cir. 1992); *In re Lane*, 136 B.R. 319 (D. Mass. 1992) (appellate court can reissue automatic stay despite § 1821(j)).

¹³⁵ See Brief for Appellee, *supra* note 71, at 32-38.

¹³⁶ *Colonial Realty*, 980 F.2d at 136 n.10, 137.

¹³⁷ *Id.* at 137.

¹³⁸ See *id.* at 135-37.

¹³⁹ *Id.* at 135.

¹⁴⁰ 489 U.S. 561 (1989).

¹⁴¹ *Id.* at 575.

¹⁴² *Colonial Realty*, 980 F.2d at 135. The court reviewed other cases, finding none particularly applicable.

¹⁴³ 974 F.2d 403 (3d Cir. 1992) (RTC permitted to withhold pension and profit-sharing assets from bank insiders).

¹⁴⁴ *Id.* at 407.

imposed only because of the FDIC's aggressive response to the bankruptcy court's ruling on the applicability of the automatic stay.¹⁴⁵

III. ANALYSIS OF THE SECOND CIRCUIT'S DECISION

Colonial Realty is important because it reconciles ostensibly inconsistent provisions of bankruptcy law and bank insolvency law without adversely impacting the policies or goals of either. *Colonial Realty's* significance to bankruptcy practice in general, however, transcends that effect.

By adopting the reasoning of *In re Saunders*,¹⁴⁶ the *Colonial Realty* court rejected the commonly held view of bankruptcy case law and commentary that a bankruptcy debtor retains at least an equitable interest in fraudulently transferred property and that the automatic stay may be used to protect this interest.¹⁴⁷ Under this theory, most often credited to the Fifth Circuit's *MortgageAmerica* decision, direct creditor action against the recipients of fraudulent property transfers is precluded.¹⁴⁸ Only the debtor or its trustee may pursue avoidance of the transfer and recovery of the property or its value for the benefit of all creditors.¹⁴⁹

At first blush, the reasoning of *MortgageAmerica* and its progeny appears sound because its result is salutary and consistent with fundamental bankruptcy policies. As highlighted by the Second Circuit, however, if *MortgageAmerica* were correct, it would render meaningless the Bankruptcy Code section that expressly includes recovered property within the bankruptcy estate.¹⁵⁰ Such a result is contrary to basic principles of statutory construction.

Legislative history supports the Second Circuit's conclu-

¹⁴⁵ *Colonial Realty*, 980 F.2d at 136 n.10, 137.

¹⁴⁶ 101 B.R. 303 (Bankr. N.D. Fla. 1989); see also *supra* text accompanying notes 102-05.

¹⁴⁷ See *Colonial Realty*, 980 F.2d at 131; see also 4 COLLIER, *supra* note 15, ¶¶ 541.10[8] n.28, 541.16 n.5a; DANIEL R. COWANS ET AL., BANKRUPTCY LAW AND PRACTICE § 9.2(h) nn.24-25 (6th ed. 1994).

¹⁴⁸ American Nat'l Bank v. MortgageAmerica Corp. (*In re MortgageAmerica Corp.*), 714 F.2d 1266 (5th Cir. 1983).

¹⁴⁹ *Id.* at 1275-76.

¹⁵⁰ *Colonial Realty*, 980 F.2d at 131; see *supra* notes 97-99 and accompanying text.

sion that property of the estate does not include fraudulently transferred assets until they are recovered. The Bankruptcy Act of 1898,¹⁵¹ the foundation of modern bankruptcy law, included a provision that gave title to the trustee of "property transferred by [the debtor] in fraud of his creditors."¹⁵² The commentators viewed this section of the 1898 Act, section 70a(4), as meaning that property recovered by avoiding fraudulent transfers would be included in the estate.¹⁵³ The Bankruptcy Act of 1973 enacted the commentators' view by removing what had been section 70a(4), and adding a section providing that fraudulently transferred property becomes property of the estate after its recovery.¹⁵⁴ This section has remained unchanged since the amendment.¹⁵⁵

¹⁵¹ The Bankruptcy Act of July 1, 1898, 30 Stat. 565 [hereinafter 1898 Act].

¹⁵² *Id.* § 70a(4); see also 4A COLLIER, *supra* note 15, ¶ 70.03[1] at 28; HOWARD L. OLECK, DEBTOR AND CREDITOR LAW § 69, at 268 (1986); Vern Countryman, *The Use of State Law in Bankruptcy Cases (Part I)*, 47 N.Y.U. L. REV. 407, 434 n.172 (1972).

¹⁵³ 4A COLLIER, *supra* note 15, ¶ 170.14[1] at 127. One commentator noted: clause 4 of § 70a . . . is somewhat superfluous [because the avoidance powers of the trustee already stated that fraudulently transferred property could be recovered for the benefit of the estate] . . . except that it does clearly indicate a general intent to include all fraudulently transferred property as a part of the bankrupt estate available for distribution to all creditors, *provided there is an avoidance of such transfer*.

Id. at 131 (emphasis added). Similarly, if § 70a(4)

were taken literally, it would automatically endow the trustee with complete title to property fraudulently transferred and consequently would cut off even bona fide transferees . . . [as indicated previously, § 70a(4) does not avoid or render void any transfer, but merely indicates the trustee's right to act under the applicable provisions of the statute [avoidance powers] for the benefit of the estate.

Id. at 131; see also *In re Locks*, 104 F. 783 (W.D.N.Y. 1900) ("Property does not vest in the trustee [under § 70a(4)] until there has been an adjudication setting aside the transfer."); OLECK, *supra* note 152, at 268 ("[Section 70a(4)] seems to refer to any interest therein remaining in the bankrupt. Fraudulent transfers . . . are voidable, not void, and this section empowers the trustee to set them aside for the benefit of the estate.")

Congress made [an error] in the original Act in section 70a(4) by giving the trustee the title of the bankrupt to property which he has fraudulently conveyed although the bankrupt has no interest in property he has fraudulently conveyed. Section 70a(4) should be repealed. Given the trustee's present power to avoid fraudulent conveyances[,] . . . it serves no useful purpose.

Countryman, *supra* note 152, at 436.

¹⁵⁴ See Commission Report, *supra* note 15, at 147 n.2; 2 COLLIER, *supra* note 15, at 192, 194 (Commission notes the adoption of Professor Countryman's reasoning with respect to the § 70a(4) problem).

¹⁵⁵ See H.R. 8200, 95th Cong., 1st Sess. § 541 (1977); S. 2266, 95th Cong., 1st

The *Colonial Realty* and *Saunders* courts also relied on the language of section 541(a)(1) of the Bankruptcy Code in their "to-recover-a-claim" analysis under section 362(a)(1).¹⁵⁶ The legislative history for this clause is sparse.¹⁵⁷ The "issuance-of-process" hypothetical, is all that can be found.¹⁵⁸ The existing legislative history suggested that the phrase "to recover a claim" was included to prevent creditors from circumventing or running afoul of the stay by issuing process against the transferred property.¹⁵⁹ Both the *Colonial Realty* and *Saunders* decisions, however, omitted the last sentence of that paragraph, which helped clarify this understanding:

Thus, the prohibition in this paragraph [(issuance of process)] is included and the judgment creditor is allowed to proceed by way of foreclosure against the property, but not by a general writ of execution (in the State court, or wherever the creditor obtained the judg-

Sess. § 541; see also 11 U.S.C. § 541.

¹⁵⁶ See *Colonial Realty*, 980 F.2d at 131; *In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fla 1989).

¹⁵⁷ A review of the legislative history of the phrase "to recover a claim" is not particularly enlightening. First, H.R. 8200 did not include the "to recover a claim" language in the current section, but did include such a phrase in another subsection staying "any act to collect, assess or recover a claim against the debtor (proposed § 362(a)(6), found in current § 362(a)(6))". In addition, the proposed § 362(a)(6) has been described as preventing "creditors from attempting in any way to collect a pre-petition debt. Creditors in consumer cases occasionally telephone debtors to encourage repayment in spite of bankruptcy. . . . This provision prevents evasion of the purpose of the bankruptcy laws by sophisticated creditors." H.R. REP. No. 595, 95th Cong., 1st Sess. 342 (1977), reprinted in 1977 U.S.C.C.A.N. 5963, 6298. The "to recover a claim" language was added to § 362(a)(1), however. See S. 2266 § 541. The senate version, S. REP. No. 989, 95th Cong., 2d Sess. 50-51 (1978), reprinted in 1978 541. U.S.C.C.A.N. 5787, 5836-37, essentially adopts the House version of subsection (a)(6) and repeats the comments of the House on the necessity of the subsection. Also, when describing subsection (a)(1), the Senate report does not mention anything about recovering a claim against the debtor or its addition to the Senate version. S. REP. No. 989 at 50, 1978 U.S.C.C.A.N. 5836-37. Finally, the *Congressional Record* reports that the House

adopts the [(a)(1)] provision contained in the Senate amendment enjoining the commencement or continuation of a judicial, administrative, or other proceeding to recover a claim against the debtor that arose before the commencement of the case. The provision is beneficial and interacts with section 362(a)(6), which also covers assessment, to prevent harassment of the debtor with respect to pre-petition claims.

124 CONG. REC. H11092 (daily ed. Sept. 28, 1978).

¹⁵⁸ See *supra* text accompanying note 103.

¹⁵⁹ See *supra* note 157.

ment) against the debtor and all of the debtor's property.¹⁶⁰

Thus, taken as a whole, the legislative history explains that, in addition to barring the commencement of a judicial, administrative or other action or proceeding, the stay precludes a judgment creditor whose lien attached to property *before* transfer from using the general writ of execution procedure to recover the transferred property. The comment is also an instruction to the judgment lienor that simple foreclosure of its lien on the transferred property (remember, it was transferred "subject to") is permissible.

The drafters may have been concerned that before "issuance of process" was added, certain subsections of section 362, those which only discussed actions against the debtor or "property of the estate," were not sufficiently specific on the extent of the stay's protection. For instance, even if the creditor only had the intention of levying against the transferred property (which would not be property of the estate), a general writ of execution would automatically be issued by the court clerk against all of the debtor's property. This action potentially could lead to confusion and error by the levying sheriff, and needlessly involve the debtor in the process by naming the debtor in the writ.

This background illuminates the strength of the *Colonial Realty* and *Saunders* analyses. Section 541(a)(1) of the Bankruptcy Code does not include property fraudulently transferred by the debtor, otherwise section 541(a)(3) would be meaningless, and section 362(a)(1)'s "to-recover-a-claim" language must mean something different from the remainder of the section concerning actions "against the debtor." *MortgageAmerica* and its progeny, on the other hand, strained to determine that the debtor retained "some legal or equitable interest" in fraudulently transferred property. Those cases failed to seize upon the differences between actions directed at the debtor and those to recover a claim against the debtor. Lacking this latter analysis, it is likely that the *MortgageAmerica* court believed that the fundamental purposes of bankruptcy (i.e., "equality of distribution" and avoiding the "race to the court") would be thwarted.¹⁶¹ Creditors simply would begin a new race against

¹⁶⁰ H.R. REP. No. 595, at 341, 1978 U.S.C.C.A.N. at 6297-98.

¹⁶¹ *American Nat'l Bank v. MortgageAmerica Corp.* (*In re MortgageAmerica*), 714

the assets held by the fraudulent transferee, with recovery on a first-come-first-served basis.¹⁶² *Colonial Realty* establishes that there is no need for such a strained analysis, while clarifying the operation of the automatic stay in such circumstances.¹⁶³

Once *Colonial Realty* reached beyond these "straight bankruptcy" issues, the court's analysis of the applicability of the automatic stay to the Florida action was persuasive. As the court explained, Congress certainly was aware of the Bankruptcy Code and its processes when it enacted the bulk of the superpowers. The 1990 Amendments, which bolstered and clarified the impact of federal banking law in bankruptcy cases, prove the reverse—that Congress likewise would have amended the automatic stay if it intended to free the FDIC's fraudulent transfer avoidance rights from the stay's strictures. And, as the Second Circuit recognized, the FDIC had the ability to request relief from the automatic stay.

In its appellate briefs, the FDIC registered its fear that it would not get fair treatment from the bankruptcy court on a request for relief from the stay.¹⁶⁴ The Second Circuit did not directly address this fear, but did note that the FDIC could move to withdraw the reference from the bankruptcy court and seek relief in the district court.¹⁶⁵

F.2d 1266, 1274 (5th Cir. 1983); see *supra* text accompanying note 16.

¹⁶² *Id.*

¹⁶³ Although *Saunders* and *Colonial Realty* shed light on one of the basic flaws in the *MortgageAmerica* analysis, a further review demonstrates that it was flawed in another sense as well. Namely, if property of the estate included fraudulently transferred property, the transferees would have to turnover such property pursuant to Bankruptcy Code § 542 and an avoidance action would be unnecessary.

¹⁶⁴ See Brief for Appellant, *supra* note 42, at 36; Reply Brief of Plaintiffs-Appellants at 10, *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125 (2d Cir. 1992) (No. 92-5023). The FDIC's fear was based in part on the bankruptcy court's decision, which stated that at a stay relief hearing the trustee could make inquiries into the FDIC's claims against the alleged transferees and inquire whether any other recovery alternatives were available to the FDIC so that the estate would not be deprived needlessly of a recovery. *Colonial I*, 134 B.R. 1017, 1022 (Bankr. D. Conn. 1991). The bankruptcy court also mentioned the possible application of the marshaling doctrine, which provides that a creditor with two funds from which to satisfy its claim may not apply the funds in such a way as to defeat unnecessarily the claims of another creditor who may resort to only one of the funds for recovery. *Id.*

¹⁶⁵ *Colonial Realty*, 980 F.2d at 134. The court also noted that such a request for withdrawal of the reference should be granted since withdrawal under 28

From a "balance of the equities" approach, if the FDIC's pursuit of fraudulent transfer claims were exempt from the automatic stay, the harm that would be suffered by the bankruptcy estate would considerably outweigh any inconveniences faced by the FDIC as a result of the automatic stay. If the stay did not apply, the trustee would have the near-impossible task of monitoring the nation's courts to ascertain whether the FDIC's litigation efforts would impact the estate's ability to recover assets. This is contrary to the fundamental bankruptcy policy of centralizing the resolution of the debtor's affairs in one forum. The Second Circuit recognized the import of this policy. The FDIC's valuation and disposition of the assets it recovers also would impact a trustee's marshaling of the debtor's assets, as the trustee would be forced to accept the FDIC's numbers. Additionally, if the FDIC released a transferee, it is not clear what effect that release would have on the trustee's right of recovery in light of the FDIC's "superior" right in that regard.

On the other hand, the FDIC suffers far less harm from the stay as compared with other creditors. As noted, the FDIC may move for relief from the stay and (if it is wary of the bankruptcy court's "agenda") may request that the district court withdraw its reference to the bankruptcy court. In either court, the FDIC's "superior" right in the recovered property will be recognized. Furthermore, the FDIC has significantly more resources to follow a wide number of bankruptcy cases than does a typical trustee because it receives significant funding and recovers before general (non-depositor) creditors from the failed institutions it manages. Thus, in reality, the automatic stay does not preclude the FDIC from satisfying the requirements and goals of its statutory scheme. Rather, the stay prevents the FDIC from acting unnecessarily to the detriment of other creditors.

In *Colonial Realty*, the FDIC also argued that it would lose the benefit of specific tools if it were required to first seek relief from the automatic stay.¹⁶⁶ These tools, such as the modified temporary restraining order standards of section

U.S.C. § 157(d) is mandatory when there is a conflict between the Bankruptcy Code and another federal statute. *Id.* at 128 n.5, 134.

¹⁶⁶ *Id.*

1821(d)(18)-(19), enable the FDIC to act quickly, enhancing the likelihood of its recovery. As the Second Circuit pointed out, however, there is nothing in the Act that would preclude the bankruptcy court from granting such relief, even on an *ex parte* basis.¹⁶⁷ Provided the FDIC made the required showings under its statutory scheme, there is no reason why a bankruptcy court would be disinclined to grant the requested relief, particularly because such relief only seeks to maintain the status quo; it does not harm, and indeed may benefit, the bankruptcy estate. Thus, by showing the compatibility of the two statutory schemes, the Second Circuit persuasively demonstrated that the rights of the FDIC would be protected in bankruptcy.

The Second Circuit's discussion of the impact of the anti-injunction provision reveals that the dispute between the FDIC and the trustee was illusory. In essence, the parties were comparing apples to oranges. The FDIC assumed that the automatic stay was not applicable and, therefore, that it needed to address the injunction issue. The trustee, although he cited the various injunction/anti-injunction cases, relied on the applicability of the automatic stay, which as a congressionally mandated stay did not run afoul of the terms of the FDIC's anti-injunction statute.

The Second Circuit, however, did review the anti-injunction cases cited by the parties, and agreed with the holdings of those courts that the anti-injunction provision permits a court-ordered restraint only when the FDIC is acting outside the scope of its authority.¹⁶⁸ While not explicitly stated, the decision indicates that the Second Circuit would have found the section 105 injunction in contravention of the FDIA section 1821(j) had it not been based on the automatic stay. The case law supports that holding.

Two appellate decisions merit comparison with *Colonial Realty* on the interaction of the automatic stay and the anti-injunction provision. Contrary to *Colonial Realty*, those decisions indicate that the anti-injunction provision of 12 U.S.C. § 1818(i)(1) supersedes the automatic stay. As described above, the Supreme Court's decision in *MCorp* was grounded in its

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 135-37.

determination that the administrative proceedings (regarding source-of-strength violations) sought to be enjoined by MCorp were excepted from the automatic stay as the legitimate exercise of a "governmental unit's police or regulatory power."¹⁶⁹ The Court seemed to imply that the enforcement of an administrative order against a bank holding company in bankruptcy may not be subject to the automatic stay. The Supreme Court did state that the mere "possibility" of the entry of an order affecting the debtor's control over its property was insufficient to justify the operation of the stay.¹⁷⁰ The Court then acknowledged that if such an order were issued, "it may well be proper for the bankruptcy court to exercise its concurrent jurisdiction."¹⁷¹ Up to this point, the Court's decision appears to indicate that administrative proceedings, without any enforcement action, are excepted from the automatic stay, but that enforcement actions likely would be subject to the stay.

Because of its determination of the applicability of the "police and regulatory power" exception, however, the Court expressly declined to address the Federal Reserve's Board of Governors' suggestion that its anti-injunction statute would preclude application of the automatic stay to an enforcement action.¹⁷² After addressing the bankruptcy court's concurrent jurisdiction over certain bankruptcy-related civil proceedings handled by other courts and noting that the Board was merely an administrative agency, the Supreme Court curiously concluded that it "agree[d] . . . that the specific preclusive language [of the anti-injunction act of] 12 U.S.C. § 1818(i)(1) is not qualified or superseded by the general provisions governing bankruptcy proceedings on which MCorp relies."¹⁷³ It is not clear whether this statement applies with equal force to enforcement actions by the Board or other administrative agencies that otherwise would appear to fall squarely within the protection of the automatic stay.

The Fourth Circuit's decision in *Carlton v. Firstcorp, Inc.* interpreted MCorp in just that way.¹⁷⁴ In *Firstcorp*, the debt-

¹⁶⁹ MCorp, 112 S. Ct. at 464 (quoting 11 U.S.C. § 362(b)(4)).

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.* at 464 n.11 (citing 12 U.S.C. § 1818(i)(1)).

¹⁷³ *Id.* at 465.

¹⁷⁴ 967 F.2d 942 (4th Cir. 1992).

or—a bank holding company—filed for protection under Chapter 11 and commenced an adversary proceeding against the Office of Thrift Supervision. Firstcorp sought to restrain the enforcement of temporary cease and desist orders that required it to transfer assets to troubled subsidiaries under capital maintenance agreements.¹⁷⁵ The Fourth Circuit held that the automatic stay was superseded by the anti-injunction provision of 12 U.S.C. § 1818(i)(1).¹⁷⁶ The court explained that the enforcement against Firstcorp is part of “a unified regulatory scheme which under MCorp is free from the intrusion of bankruptcy’s automatic stay.”¹⁷⁷ Finally, in a strong concluding statement, the Fourth Circuit stated:

[I]t seems clear to us that by devising a comprehensive scheme governing the oversight of financial institutions, from administrative control through judicial review of the administrative agency’s actions, and by explicitly making the scheme exclusive, Congress intended to exclude other methods of interfering with the regulatory action.¹⁷⁸

Thus, contrary to *Colonial Realty*, MCorp can be (and has been) interpreted to hold, as Firstcorp holds, that the anti-injunction provisions of Title 12 trump the automatic stay of Title 11. That those courts failed to address the fact that the automatic stay is the result of congressional mandate, rather than court exercise of “jurisdiction to effect by injunction [12 U.S.C. § 1818(i)(1)]” or court “action . . . to restrain [12 U.S.C. § 1821(j)]” makes the reasoning of those cases suspect. Notably, the Second Circuit believed that Firstcorp was contrary to MCorp.¹⁷⁹ Because *Colonial Realty* is the more recent decision, other courts hopefully will adopt the simple, yet cogent, reasoning of *Colonial Realty*.¹⁸⁰

¹⁷⁵ *Id.* at 943.

¹⁷⁶ *Id.* at 945-46.

¹⁷⁷ *Id.* at 946.

¹⁷⁸ *Id.* In a footnote, the court noted that its holding on the anti-injunction provision rendered unnecessary a discussion of the “police and regulatory powers” exception relied upon in MCorp. *Id.* at 946 n.5.

¹⁷⁹ *Colonial Realty*, 980 F.2d at 137. *Colonial Realty* did not further address this apparent conflict.

¹⁸⁰ The bankruptcy court in First City Asset Servicing Co. v. FDIC (*In re First City Asset Servicing Co.*), 158 B.R. 78 (Bankr. N.D. Tex. 1993), appears to have expressly adopted the *Colonial Realty* reasoning. *Id.* at 81.

CONCLUSION

In *Colonial Realty*, the Second Circuit demonstrated through rudimentary analysis that a balance between two ostensibly conflicting statutes could be achieved and the purposes and policies of each harmonized without violence to either. There is nothing in the Federal Deposit Insurance Act that would prevent the FDIC from seeking its rights and remedies through the bankruptcy court. Likewise, as noted by the Second Circuit, there is nothing in the Bankruptcy Code that would preclude the bankruptcy court (or the district court, were the reference to the bankruptcy court withdrawn) from granting the provisional and final relief sought by the FDIC.

The FDIC's appellate briefs and actions in the *Colonial Realty* case, not surprisingly, evidence that the agency was not interested in this "compromise" decision. The FDIC was hopeful that another appellate court would find its nascent powers truly "super."

In addition to becoming one of the first (if not the first) court of appeals to find bankruptcy and bank insolvency law compatible, the Second Circuit, through its adoption of the *Saunders* reasoning, became the first to reject the strained analysis of *MortgageAmerica* and its progeny. It is now clear that the impact of the automatic stay on third-party actions against fraudulent transfer recipients is based on the fact that such actions seek to recover claims against the debtor rather than the fiction that the debtor retains a legal or equitable interest in such property. The Second Circuit's *Colonial Realty* decision is to be commended.

