UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

RICHARD PENEPENT — Case No. 99-13022 K

Debtor

John H. Ring III, as Chapter 7 Trustee
of the Estate of Richard S. Penepent

Plaintiff

-vs- — AP No. 02-1013 K

Hodgson Russ LLP f/k/a
Hodgson, Russ, Andrews, Woods &
Goodyear, LLP

Defendant

John H. Ring, Esq.
360 Dingens Street
Buffalo, New York 14206

Trustee/Plaintiff

William H. Gardner, Esq.
Hodgson Russ Andrews Woods & Goodyear LLP
One M & T Plaza, Suite 2002
Buffalo, New York 14203-2391

Attorneys for Defendant

The Trustee's Complaint seeks "turnover." It does not cite any statute. Turnover is usually sought under 11 U.S.C. § 542. By its terms, that statute applies (in pertinent part) only to "property that the trustee may use, sell, or lease under [11 U.S.C. § 363], or that the debtor may exempt under [11 U.S.C. § 522]."

Paragraphs 15(i) and (j) of the "Declaration of William H. Gardner in support of Motion of Hodgson Russ LLP for Summary Judgment Dismissing Complaint" point out that (1) the Trustee has not sued M & T for a declaration that the draw-down of the line of credit could not and did not impair the estate's interest in the mortgaged real property, and (2) the Trustee has not commenced litigation against the Debtor's spouse to the extent, if any, that any declaration of rights as between the Debtor's estate and M & T requires her participation as a defendant party. Thus, at paragraph 23 of the Declaration, the law firm states that "while there may be grounds for the Trustee to seek relief against Mr. and/or Mrs. Penepent and/or some entitlement to adjustment as to the allocation of funds from any mortgage foreclosure proceeding that might hereafter occur, there is not even a scintilla of support for the Trustee's claim that he is entitled to a 'turn-over' of funds by Hodgson Russ or any other kind of monetary judgment herein against Hodgson Russ."

The Trustee, however, argues that it is his choice to proceed either against M & T or Hodgson Russ LLP "the latter obtaining funds representing the proceeds of improper borrowing. . . . The debtor's attorney, Hodgson Russ LLP, has a duty in a Chapter 7 case to request information pertaining to where the monies Mr. Penepent paid them came from."

Paragraphs 10 and 11 of the Trustee's "Affidavit in Opposition."

The Trustee's position presupposes that "the $15,000 . . . becomes property of the estate in that it represents the borrowing against property of the estate. Therefore, the Trustee has a duty to follow the proceeds of such borrowing and to obtain the proceeds for the benefit of the estate because that borrowing created a lien against estate property." The firm, on the other hand, presupposes that the Debtor's spouse, who is not a party to this action, "has a legal obligation to repay all sums owing under [the line of credit agreements and mortgage], whether or not she personally borrowed funds thereunder and whether or not Richard S. Penepent is liable to pay the same and whether or not the subject $15,000 borrowing created a legal lien as to Richard S. Penepent's interest in the property (insofar as the same became assigned to, and owned by, plaintiff Trustee)." Neither of these propositions are properly presented here.

The Court notes, however, that there is still a little time left under the 11 U.S.C. § 549(d) limitations period, and that the question that is truly presented here is whether it is the Trustee or the firm who must bear the burden of establishing that the estate has or has not been harmed. The firm is correct that if the Trustee were to commence an action against M & T and, if necessary, the Debtor's spouse, and were successful in establishing that as a matter of law any lien that the bank might purport to have in connection with this borrowing is set aside under 11 U.S.C. § 549, then the only "damage" to the estate would be the cost of such action. But if the Court orders turnover and imposes on the firm the burden to file a claim against the funds and to establish its entitlement thereto, then it may well be that the costs and risks of the litigation would be borne by the firm; if the § 549(d) limitations period expires in the meantime, the legal

picture may change dispositively.

It is implicit in the Trustee's arguments that it is extremely difficult to liquidate a debtor's undivided entireties interest in a marital residence in which the spouse is not a co-debtor. It is much easier, given that this Debtor has conveniently converted equity in the property into a fund of cash, to begin with the assumption that the equity that has been converted is the Debtor's equity - indeed the Debtor's non-exempt equity - and then attempt to seize the cash. That is what the Trustee is attempting to do, of course.

Given the fact that § 542 turnover is not an adjudication of ownership, what set of presumptions apply (if any) in deciding whether the property in question is property that the Trustee may "use, sell, or lease" for purposes of § 542(a).[1]

In the Court's view, § 542 turnover on some set of presumptions is inappropriate. The present complaint seeks to shortcut the "avoidance" of a post-petition transfer under 11 U.S.C. § 549 and jump immediately to the ability of a trustee to select which transferee he will pursue under § 550. Section 550 does indeed permit a trustee to recover an unauthorized post-petition transfer from either the initial transferee or any "immediate or mediate transferee," with certain exceptions. But that statute has no application except "to the extent that a transfer is avoided under section . . . 549." And in this Court's view, § 549 does not permit the Trustee to

[1]This Court explained in the case of *In re Zwiczynski*, 210 B.R. 924 (Bankr. W.D.N.Y. 1997), that the issue of custody and control could serve to obviate issues of sovereign immunity that were raised by the State of New York. If a Trustee were entitled to custody and control, a state would have to decide whether to waive sovereign immunity by pursuing a claim of ownership in this Court; otherwise, such a trustee who had no assets with which to pursue a State Court cause of action against a state would have no remedies at all. But that case involved $10,000 deposited in a bank, which $10,000 clearly was deposited by that debtor as security. Here it is not clear whether the funds held by the firm are M & T's funds, the Debtor's funds (to the extent of $10,000), his spouse's funds, and so forth.

select his defendant of choice from among the various parties to the unauthorized transfer that has remained unsued.

The Trustee asserts that he is simply "following the money" - following the fruits of an unauthorized transfer into the hands of the law firm. There certainly are provisions of the Bankruptcy Code that permit such a remedy in certain instances. So, for example, where a pre-petition creditor seizes property of a debtor in violation of the automatic stay, a trustee may "follow the property," by motion, as a remedy for the violation. Similarly, if the law firm here had not earned this fee, 11 U.S.C. § 329 is ample authority to compel the return of any amount that exceeds the "reasonable value" of the firm's services. And § 542, standing alone, has many appropriate uses. But skipping past a § 549 "avoidance" action is not one of them, and an appropriate § 549 action in this case would necessitate suit against M & T as well as the firm. And M & T might choose third-party practice against the Debtor (on the exemption issue) and against the non-debtor spouse as well. In a § 549 action the competing sets of presumptions and suppositions would present themselves as "arguments," solidly founded in whatever the evidence shows and the Court would adjudicate whether it is the transfer of funds to the law firm that is to be avoided, or the transfer of a lien on estate assets to M & T that is to be avoided, or nothing to be avoided.

Ease of recovery of cash for the estate does not empower the Court to circumvent the "avoidance and recovery" structure of the Code.[2]

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[2] "Section 550 prescribes the liability of a transferee of an avoided transfer, and enunciates the separation between the concepts of avoiding a transfer and recovering from the transferee." H. Rept. No. 95-595 to accompany H.R. 8200, 95th Congress, 1st Sess. (1977), pp. 375, 376.

The Cross Motion for Summary Judgment dismissing the Complaint is granted, but without prejudice. This Adversary Proceeding is dismissed. However, the firm will bear the costs of all actions subsequent to this one,[3] that are reasonably incurred by the Trustee to establish that the estate has suffered no loss by the firm's failure to assure that the funds it accepted would not create administrative expenses for the estate.

SO ORDERED.

Dated: Buffalo, New York
December 9, 2002

/s/ Michael J. Kaplan

Michael J. Kaplan, U.S.B.J.

[3] Thus, if M & T agrees that it has no lien on the Debtor's half interest, this matter is at an end, without further litigation.