

## **What Can You Do if You Purchase a Business and Find out Later that a Prior Owner Filed for Bankruptcy?**

By Camille J. Iurillo and Gina M. Pellegrino

Scenario: Person A sells a business to Person B. Then Person C buys the business from Person B, paying the agreed upon purchase price. Person C takes possession of the business and begins its operations. A few months later, Person B tells Person C that prior to Person C's purchase of the business, Person A had filed for bankruptcy. Person C had no knowledge of Person A's bankruptcy filing prior to Person C's purchase of the business. If the bankruptcy trustee sues Person C, asserting that the property purchased by Person C belonged to Person A's bankruptcy estate at the time of the purchase, does Person C have a defense?

A debtor may be deemed to have fraudulently transferred property to a transferee prior to filing for bankruptcy based on actual fraud or constructive fraud, if the property was sold for less than fair market value. *See*, 11 U.S.C. § 548(a)(1)(A) and (B). In such a case, the bankruptcy trustee will sue the transferee, in a fraudulent transfer cause of action, in order to recover the actual property that was transferred to the transferee by the debtor, or the value of the property. The purpose of the trustee doing this is to obtain funds to pay the debtor's creditors. If the trustee recovers the actual property from the transferee, the trustee will sell the property and distribute the sale proceeds to the debtor's creditors.

Pursuant to section 549(a) of the Bankruptcy Code, a trustee may seek to avoid a transfer of property that belongs to the bankruptcy estate, if the transfer occurs after the commencement of the bankruptcy case and is not authorized by the Bankruptcy Code or by the court. *See*, 11 U.S.C. § 549(a). However, section 549(c) of the Bankruptcy Code sets forth an exception to this rule. According to section 549(c), a trustee may not seek to avoid a transfer of property that belongs to the bankruptcy estate if the property is transferred to "a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value." 11 U.S.C. § 549(c); *see also*, In re McDonald, 210 B.R. 648, 649-50 (Bankr. S.D. Fla. 1997); and In re Berkley Multi-Units, Inc., 88 B.R. 394, 397-8 (Bankr. M.D. Fla. 1988).

The Bankruptcy Code also states that a trustee may not recover in a lawsuit against "any immediate or mediate good faith transferee." 11 U.S.C. § 550(b)(2); *see also*, In re Paramount Citrus, Inc., 268 B.R. 620, 626-7 (Bankr. M.D. Fla. 2001); and In re Trauger, 109 B.R. 502, 503-5 (Bankr. M.D. Fla. 1989). In our scenario, the property was transferred from Person A to Person B to Person C. Person B received the property directly from Person A, who filed for bankruptcy. Person C was a "good faith transferee" because Person C did not have knowledge of Person A's bankruptcy filing when Person C purchased the business from Person B and Person C paid Person B present fair equivalent value for the property.

In conclusion, Person C has a good faith purchaser defense to the trustee's lawsuit and the trustee may not recover the actual property transferred or the value of the property from Person C.

**Iurillo & Associates, P.A.**, located in downtown St. Petersburg, is comprised of **Camille J. Iurillo**, Shareholder, **Gina M. Pellegrino**, Associate, and **Sabrina C. Beavens**, as Of Counsel. **Ms. Iurillo** has been active in the St. Petersburg Bar Association for several years, including her current position as President Elect. In addition, she is a member of the Board of Directors of the St. Petersburg Bar Foundation and the Chair of The Florida Bar's Practice Management and Development Section. **Ms. Pellegrino** joined the Firm in the summer of 2006 and is a member of the St. Petersburg Bar Association.

The primary areas of practice of **Iurillo & Associates, P.A.** are Commercial and Bankruptcy Litigation and Debtors'/Creditors' Rights.