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Code to Code

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Continued Disagreement

Use of Federal Debt Collection Laws to Expand Fraudulent Transfer Look-Back Periods

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In *Ebner v. Kaiser (In re Kaiser)*,[1] the U.S. Bankruptcy Court for the Northern District of Illinois allowed a bankruptcy trustee to employ the 10-year look-back[2] period, available to the Internal Revenue Service (IRS) under the Internal Revenue Code (IRC), in seeking to recover prepetition fraudulent transfers pursuant to 11 U.S.C § 544(b). This allowed the trustee to escape the effect of Illinois's generally applicable four-year look-back period for the recovery of fraudulent transfers under its version of the Uniform Fraudulent Transfer Act (UFTA).[3] The decision also appears to be the second explicit rejection, following *Tronox Inc. v. Kerr McGee Corp. (In re Tronox Inc.)*,[4] of the Fifth Circuit's contrary holding in *MC Asset Recovery LLC v. Commerzbank AG (In re Mirant Corp.)*,[5] which concluded that the Federal Debt Collection Procedures Act (FDCPA)[6] was not "applicable law" as that phrase is employed in § 544(b)(1). The *Kaiser* and *Tronox* decisions, and the contrary authorities that they reject, evidence continued disagreement over whether bankruptcy trustees or debtors in possession (DIPs) may co-opt the sometimes-advantageous look-back periods available to the federal government when seeking to recover fraudulent transfers.

Section 544(b)(1) and Selection of a Triggering Creditor

Section 548 allows trustees to avoid actually and constructively fraudulent transfers occurring within the two years preceding a debtor's filing of a bankruptcy petition. Section 544(b)(1) also confers authority upon trustees to avoid "any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502." Stated otherwise, § 544(b)(1) "enables a trustee to do in a bankruptcy proceeding what a creditor would have been able to do outside of bankruptcy — except the trustee will recover the property for the benefit of the estate."[7] This component of a trustee's so-called "strong arm" powers is commonly used to expand § 548's two-year look-back period to the often more generous look-back periods available under states' fraudulent transfer laws.[8]

In order to proceed under § 544(b)(1), a trustee must establish that he/she represents the interests of a "creditor of the debtor that actually has the requisite nonbankruptcy cause of action."[9] The selection of such a creditor, sometimes referred to as a triggering or golden creditor, has important implications for a trustee's cause of action because the trustee becomes subject to the same defenses that a defendant could have raised against the triggering creditor, including the expiration of a statute of limitations.[10] Therefore, in order to successfully challenge a fraudulent transfer outside of the typical four-year look-back period found in state fraudulent

1 A.P. No. 13-ap-01243, 2014 Bankr. LEXIS 5202 (Bankr. N.D. Ill. Dec. 31, 2014).
2 To avoid confusion due to the extension of unexpired statutes of limitation by 11 U.S.C. § 546, the phrase "look-back period" is used instead of "statute of limitations" to refer to the period during which a cause of action would remain viable outside of bankruptcy.
3 740 ILCS 160/10(a) and (b).
4 503 B.R. 239 (Bankr. S.D.N.Y. 2013).
5 675 F.3d 530 (5th Cir. 2012).
6 28 U.S.C. §§ 3001, *et seq.*
7 *In re Kaiser*, 2014 Bankr. LEXIS 5202, at *24-25 (quoting *In re Equip. Acquisition Res. Inc.*, 724 F.3d 743, 746 (7th Cir. 2014)).
8 The vast majority of states have enacted the UFTA, which generally provides a four-year look-back period. However, the UFTA's look-back period is one of the more commonly modified provisions of the UFTA. Most state laws provide for fraudulent transfer look-back periods of between two and four years, although some are longer.
9 *In re Kaiser*, 2014 Bankr. LEXIS 5202, at *25 (quoting *In re Equip. Acquisition Res. Inc.*, 724 F.3d at 746).
10 *In re Equip. Acquisition Res. Inc.*, 742 F.3d at 746 (stating that "if the [triggering] creditor could not succeed for any reason — whether due to statute of limitations, estoppel, *res judicata*, waiver, or any other defense — then the trustee is similarly barred and cannot avoid the transfer.").

transfer statutes, a trustee must select a triggering creditor who enjoys a longer look-back period.

Examples of Statutes Providing Advantageous Look-Back Periods

The cases considering the selection of a governmental entity as a triggering creditor disclose examples of laws providing advantageous look-back periods. For example, subject to special collection mechanisms found elsewhere in federal law, the FDCPA "provides the exclusive civil procedures for the United States — (1) to recover a judgment on a debt; or (2) to obtain, before judgment on a claim for a debt, a remedy in connection with such claim."[11] The FDCPA includes provisions allowing for the avoidance of actually and constructive fraudulent transfers by the federal government that are substantively similar to the provisions of the UFTA, the Uniform Fraudulent Conveyance Act and 11 U.S.C. § 548.[12] The FDCPA generally provides a six-year look-back period for fraudulent transfer claims.[13]

Several cases address trustees' efforts to co-opt advantageous look-back periods available under laws other than the FDCPA. Trustees have commonly sought to use the IRS as a triggering creditor in order to take advantage of the 10-year statute of limitations available to the IRS for the collection of taxes pursuant to 26 U.S.C. § 6502.[14] Alternatively, trustees have sought to employ the six-year look-back period that is available to the Department of Health and Human Services (pursuant to 28 U.S.C. § 2415)[15] and the 10-year look-back period available to one state's environmental authorities.[16]

Due to the advantageous look-back periods available to many governmental creditors and the frequency with which debtors enter bankruptcy owing a debt to some governmental entity, the FDCPA and analogous statutes may provide powerful tools where traditional fraudulent transfer claims are subject to shorter look-back periods. Assuming the existence of an appropriate governmental creditor, whether the FDCPA or some analogous statute is available to the trustee, depends on whether it is considered "applicable law" under § 544(b)(1). Recent decisions indicate that there is no judicial consensus concerning the issue.

In re Mirant Corp.'s Rejection of FDCPA as "Applicable Law"

In *In re Mirant Corp.*,[17] the U.S. Bankruptcy Court for the Northern District of Texas held that the FDCPA was not applicable law under § 544(b)(1) because, the court believed, the FDCPA evinces a congressional intent that it should be employed solely for the benefit of the U.S.[18] The bankruptcy court based its reasoning on the fact that under "section 3306 of the FDCPA, transfers may be avoided 'to the extent [that is] necessary to satisfy the debt to the United States.'"[19] According to the bankruptcy court, an interpretation of the FDCPA and § 544(b)(1), which allowed trustees to employ the FDCPA, would greatly expand fraudulent transfer defendants' potential liability by allowing avoidance of the entirety of a large transaction even if the claim of the U.S., as triggering creditor, was comparatively small.[20] In addition, the bankruptcy court reasoned that the FDCPA's purpose of assisting the U.S. in debt collection would be frustrated if recoveries were shared *pro rata* with other creditors.[21]

> **Given the regularity of fraudulent transfer litigation in bankruptcy and the regularity with which the federal government holds claims in bankruptcy, it is surprising that the [use of governmental look-back periods] remains unaddressed in so many jurisdictions. Rejection of *Mirant* by *Tronox* and *Kaiser* indicates that the issue will remain the subject of controversy until more courts confront it.**

On appeal, the Fifth Circuit agreed —for two different reasons — that the FDCPA was not an "applicable law" under § 544(b).[22] First, the court noted that the FDCPA provides, in part, that "[t]his chapter shall not be construed to *supersede or modify* the operation of — (1) title 11."[23] The court then drew an analogy to an Employee Retirement Income Security Act of 1974 (ERISA) provision, which provided that "[n]othing in [ERISA] shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States … or any rule or regulation issued under such law."[24] With respect to that ERISA provision, the court had previously held that ERISA could not pre-empt a state exemption statute because it would result in ERISA modifying or impairing an exemption statute incorporated into the Bankruptcy Code by 11 U.S.C. § 522(b)(2).[25] Against this backdrop, the court held that "treating the FDCPA as applicable law under [§] 544(b) would impermissibly modify the operation of Title 11. Therefore, 28 U.S.C. § 3003(c) does not permit the FDCPA to be used as applicable law under § 544(b)."[26]

Second, the court referred to legislative history in which a representative remarked that the FDCPA "was carefully

11 28 U.S.C. § 3001.
12 *See* 28 U.S.C. §§ 3301-3305.
13 28 U.S.C. § 3306.
14 *See, e.g., Alberts v. HCA Inc.(In re Greater Se. Cmty. Hosp. Corp. I)*, 365 B.R. 293 (Bankr. D.D.C. 2006) (allowing trustee of liquidating trust to employ 10-year look-back period applicable to IRS pursuant to 26 U.S.C. § 6502); *Shearer v. Tepsic (In re Emergency Monitoring Tech. Inc.)*, 347 B.R. 17 (Bankr. W.D. Pa. 2006) (same); *Osherow v. Porras (In re Porras)*, 312 B.R. 81 (Bankr. W.D. Tex. 2004) (same).
15 *See In re Greater Se. Cmty. Hosp. Corp. I*, 365 B.R. at 299.
16 *See G-I Holdings Inc. v. Those Parties Listed on Exhibit A (In re G-I Holdings Inc.)*, 312 B.R. 612, 634-35 (Bankr. D.N.J. 2004).
17 *MC Asset Recovery LLC v. Commerzbank AG (In re Mirant Corp.)*, Adv. NO. 05-04142, 2010 Bankr. LEXIS 6389 (Bankr. N.D. Tex. April 22, 2010).
18 *Id.* at *43. A similar line of reasoning was in *Wagner v. Ultima Homes Inc. (In re Vaughn Co. Realtors)*, 498 B.R. 297 (Bankr. D.N.M. 2013). In that case, the court held that the only intended beneficiary of the 10-year look-back period for the collection of taxes pursuant to 26 U.S.C. § 6502 was the U.S. acting in its sovereign capacity. 498 B.R. at 304-05.
19 *Id.*
20 *Id.* at *43-44.
21 *Id.* at *44-45.
22 *MC Asset Recovery LLC v. Commerzbank AG (In re Mirant Corp.)*, 675 F.3d 530, 535 (5th Cir. 2012).
23 *Id.* (quoting 28 U.S.C. § 3003(c)).
24 *Id.* (quoting *Matter of Volpe*, 943 F.3d 1451 (5th Cir. 1991), and 29 U.S.C. § 1144(d)).
25 *Id.* (quoting *Matter of Volpe*, 943 F.3d at 1452-53).
26 *Id.*

worded to make [it] clear that the act would have absolutely no effect on the Bankruptcy Code; even provisions of the Bankruptcy Code making reference to nonbankruptcy law are to be read as if [the FDCPA] did not exist."[27] Based on this statement and its prior analogy to the ERISA provision at issue in *Matter of Volpe*, the court concluded that the FDCPA was not applicable law under § 544(b)(1). Notably, the very reasons given by the Fifth Circuit for deciding that the FDCPA was not applicable law under § 544(b)(1) had been previously rejected in the bankruptcy court.[28]

Rejection of *In re Mirant Corp.*: *In re Tronox Inc.* and *In re Kaiser*

The bankruptcy courts in *In re Tronox Inc.* and *In re Kaiser* explicitly rejected the Fifth Circuit's holding in *In re Mirant Corp.* and respectively concluded that the FDCPA and the IRC's 10-year look-back period constitute applicable law under § 544(b). In *Tronox*, the debtors sought to avoid, as a fraudulent transfer, a spinoff transaction through which they were left with minimal assets and substantial environmental and tort liabilities.[29] In response to the defendants' statute-of-limitations defense, the debtors argued that their claims were viable due to the six-year look-back period provided under the FDCPA. The defendants, relying on *Mirant*, responded that the FDCPA was not applicable law under § 544(b).

The bankruptcy court rejected the defendants' arguments and *Mirant*'s reasoning. With respect to the *Mirant* bankruptcy court's belief that the FDCPA was intended for the exclusive use of the federal government and the Fifth Circuit's conclusion that its use by bankruptcy trustees would modify the Bankruptcy Code, the *Tronox* court stated:

> The ... UFTA is also a remedy for the "exclusive use" of creditors who can sue under that statute. It is incorporated in Federal law because of the operation of § 544(b), not because of anything contained in its own text, and there is no reason to treat the FDCPA any differently.[30]

Similarly, *In re Kaiser* held that § 544(b) permitted the trustee to co-opt the IRS's 10-year look-back period under 26 U.S.C. § 6502.[31] In finding § 544(b) to be plain and unambiguous, the court asked the following question: "Why, then, would the trustee be forced to do anything other than choose the optimal [triggering] creditor? To hold otherwise would be to set policy contrary to law; to force the trustee to do something other than what the plain language of the statute provides."[32]

As in *Mirant*, the defendants complained that the trustee's recovery might be disproportionate to any claim that the IRS might hold. The court, citing *Moore v. Bay*,[33] noted that this had been a familiar characteristic of fraudulent transfer litigation even before the Bankruptcy Code was enacted. The court also considered a litany of policy considerations raised by the *Kaiser* defendants and the courts in *Mirant* and *In re Vaughn Co. Realtors*: (1) that trustees would intentionally overlook valid objections to IRS claims, (2) that incorporation of government look-back periods through § 544(b) would alter the Bankruptcy Code, and (3) that use of governmental look-back periods would improperly vest sovereign powers in bankruptcy trustees.[34] The court decided that these policy concerns were irrelevant given § 544(b)'s lack of ambiguity, and further, that the concerns were misplaced.[35]

With respect to trustees overlooking valid objections to IRS claims, the court responded that a trustee's statutory duties would prevent such gamesmanship.[36] With respect to the concern that the use of the FDCPA would modify the operation of the Bankruptcy Code, the court responded that "[s]ection 544 is simply an enabling formula. What variables are input into section 544 will always change the result, but that is not a modification of either section 544's operation or the operation of Title 11 as a whole."[37] Finally, with respect to the concerns that incorporation of the government's advantageous look-back periods would vest sovereign powers in a bankruptcy trustee, the court responded that although the government "creditor's ability to trump the applicable state statute of limitations might derive from its sovereign immunity ... the estate representative's ability to override that same limitation derives from § 544(b)."[38]

Conclusion

Whether the use of governmental look-back periods is an impermissible exercise of sovereign authority by a bankruptcy trustee or the unsurprising result of § 544(b)'s plain language is subject to ongoing judicial disagreement. Given the regularity of fraudulent transfer litigation in bankruptcy and the regularity with which the federal government holds claims in bankruptcy, it is surprising that the issue remains unaddressed in so many jurisdictions. Rejection of *Mirant* by *Tronox* and *Kaiser* indicates that the issue will remain the subject of controversy until more courts confront it. abi

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27 *Id.* (quoting 136 Cong. Rec. H13288 (daily ed. Oct. 27, 1990) (statement of Rep. Jack Brooks)).
28 *See In re Mirant Corp.*, 2010 Bankr. LEXIS 6389, at *35-38.
29 503 B.R. at 266.
30 *Id.* at 274.
31 2014 Bankr. LEXIS, at * 33.
32 *Id.* at *32.
33 284 U.S. 4, 4-5, 52 S. Ct. 3, 76 L. Ed. 133 (1931).
34 *Id.* at *32-37.
35 *Id.* at *33-34.
36 *Id.* at *17-18.
37 *Id.* at *36, n.11.
38 *Id.* at *37-38 (quoting *In re Greater Se. Cmty. Hosp. Corp. I*, 365 B.R. at 304).