THE EXPANSION OF THE TRIGGERING CREDITOR DOCTRINE IN AN ACTION TO AVOID FRAUDULENT TRANSFERS

MICHAEL H. STRUB, JR.* AND JEFFREY M. REISNER**

CONTENTS

INTRODUCTION 250
I. EVOLUTION OF THE LAW OF FRAUDULENT TRANSFER 254
II. FRAUDULENT TRANSFER LAW 256
    A. *Constructive Fraud* 256
    B. *Actual Fraud* 258
III. THE USE OF THE TRIGGERING CREDITOR DOCTRINE AFFIRMATIVE DEFENSES TO A CONSTRUCTIVE OR ACTUAL FRAUDULENT TRANSFER CLAIM ... 261
    A. *The Trustee Stands in the Shoes of Creditors for Purposes of Avoiding a Fraudulent Transfer* 261
    B. *The Use of the Triggering Creditor Doctrine in a Fraudulent Transfer Action* 263
    C. *Cases Holding That the Triggering Creditor Doctrine Can Insulate a Creditor from Affirmative Defenses Provided That There is Another Creditor in Existence Not Subject to Affirmative Defenses* 264
    D. *Cases Holding That the Triggering Creditor Doctrine Will Not Bar Affirmative Defenses Against a Non-Triggering Creditor Even If There Is Another Creditor in Existence Not Subject to Affirmative Defenses* 266
IV. THE USE OF THE TRIGGERING CREDITOR DOCTRINE TO VOID TRANSFERS THAT COULD NOT BE AVOIDED UNDER STATE LAW 270
    A. *Introduction* 270
    B. *The Federal Debt Collection Practices Act as "Applicable Law"* 270
    C. *A Combination of Federal Law and State Law as "Applicable Law"* ………………………………………………………….. . 272
V. REEXAMINING THE BASIS FOR EXPANDING THE TRIGGERING CREDITOR DOCTRINE 276
CONCLUSION... 277

---

* Michael H. Strub Jr. is counsel at Irell & Manella LLP, where his practice focuses on bankruptcy litigation, including contested matters and adversary proceedings. He earned his J.D. from the University of Texas School of Law and his B.S.F.S. from Georgetown University. He previously clerked for the Hon. Homer Thornberry in the Fifth Circuit Court of Appeals.

** Jeffrey M. Reisner is a partner at Irell & Manella LLP, where he serves as Chair of the Bankruptcy, Reorganization and Creditors' Rights practice. He represents clients in corporate, litigation and reorganization matters throughout the U.S., including clients reorganizing their financial affairs, and as creditors of others in financial distress. Reisner also represents creditors' committees, sellers/acquirers of assets, investors and creditors in bankruptcy and out of court restructurings. A Fellow of the American College of Bankruptcy, he earned his J.D. and M.B.A. from New York University and his B.S. from Cornell University.

INTRODUCTION

When a debtor files for bankruptcy, the Bankruptcy Code ("Code") gives the trustee certain rights and powers to maximize the property of the estate for the benefit of the debtor's creditors.[1] In a chapter 11 case, these rights and powers may be exercised by the debtor itself, as debtor-in-possession.[2] In addition, a debtor's plan may establish a litigation trust to pursue post-petition litigation on behalf of the estates.[3]

In each of these situations, one of the trustee's powers, provided by section 544(b) of the Code, is to avoid a transfer of an interest of the debtor in property or an obligation incurred by the debtor that is voidable under non-bankruptcy law by an actual, existing creditor holding an allowable unsecured claim.[4] When exercising his or her powers under section 544(b), the trustee utilizes the applicable non-bankruptcy fraudulent transfer statute and, thereunder, must identify that creditor, which is then known as the "triggering creditor" or "golden creditor."[5]

The trustee also has the power to void fraudulent transfers[6] under federal fraudulent transfer law codified in section 548 of the Code.[7] If the trustee uses the avoidance power in section 548, the trustee need not identify a triggering creditor, because the power to avoid the transfer under federal fraudulent transfer law does not depend on the rights of any particular creditor of the debtor.[8] In fact, the trustee can avoid the transfer even if no actual creditor could have done so prior to the filing of the debtor's bankruptcy.[9] The trustee's avoidance powers under section 548, however, are constrained by the fact that the transfer must have been "made or incurred on or within 2 years before the date of the filing of the petition."[10] State avoidance statutes typically contain longer limitations periods.

---

[1] 11 U.S.C. § 704 (2012).

[2] *Id.* § 1107(a).

[3] *Id.* § 1123(b)(3)(B) (stating "a plan may provide for the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest").

[4] *Id.* § 544(b).

[5] Alan N. Resnick, *Finding The Shoes That Fit: How Derivative Is the Trustee's Power to Avoid Fraudulent Conveyances Under Section 544(b) of the Bankruptcy Code*?, 31 CARDOZO L. REV. 205, 206 (2009) (citing MC Asset Recovery, LLC v. S. Co., No. 06-0417, 2006 WL 5112612, at *3, 2006 U.S. Dist. LEXIS 97034, at *9 (N.D. Ga. Dec. 11, 2006); Schaps v. Bally's Park Place, Inc., 58 B.R. 581, 584 (E.D. Pa. 1986), *aff'd*, 815 F.2d 693 (3d Cir. 1987); *In re* Wingspread Corp., 178 B.R. 938, 946 (Bankr. S.D.N.Y. 1995)).

[6] *Id*. at 207 ("[T]he trustee may avoid a fraudulent conveyance or obligation that was made or incurred within two years before the commencement of the bankruptcy case."). Whether a transaction is characterized as a "fraudulent conveyance" or "fraudulent transfer" depends on state law. Because most states have adopted statutes that characterize such transactions as "fraudulent transfers," this Article will use that terminology.

[7] 11 U.S.C. § 548.

[8] Resnick, *supra* note 5, at 207 (highlighting differences between sections 544 and 548).

[9] *Id*.

[10] 11 U.S.C. § 548(a)(1).

If the trustee seeks to avoid a transfer under section 544(b) of the Code, the selection of the proper triggering creditor can be an important tactical decision. Under the 1931 Supreme Court decision in *Moore v. Bay*,[11] the trustee can assert the rights of that creditor to avoid the transfer for the benefit of all the estate's creditors, even those who could not have avoided the transfer themselves.[12] For example, the trustee can stand in the shoes of a creditor without actual or constructive notice of a lien and avoid it for the benefit of creditors with actual notice,[13] and can recover the entire value of a transfer even if it far exceeded the amount of the triggering creditor's claim or the amount by which the transfer pushed the debtor over the line of solvency.[14] But because the trustee stands in the shoes of the triggering creditor, that creditor must actually have the required non-bankruptcy cause of action,[15] and the trustee is bound by any defenses that the transferee could assert against the unsecured creditor.[16]

Recently, trustees have relied on section 544(b) and the triggering creditor doctrine to expand their powers in two significant ways. The first is to bring claims through a triggering creditor for the benefit of co-participants in the transaction sought to be voided. In the case of common law fraud, absent unusual circumstances, a party that knowingly participated in a fraudulent transaction would be equitably barred from attacking that transaction or recovering the proceeds under doctrines such as ratification, consent, unclean hands, or *in pari delicto*.[17] Under fraudulent transfer law, an individual creditor who ratifies or participates in a fraudulent transfer also may be estopped from attacking the transfer.[18] But unpaid

---

[11] Moore v. Bay (*In re* Estate of Sassard & Kimball, Inc.), 284 U.S. 4 (1931).

[12] *Id.* at 5 (holding, under the Bankruptcy Act, a trustee could avoid a mortgage for the benefit of all creditors, including those who could not have voided the mortgage themselves). *See, e.g.*, Crescent Res. Litig. Tr. *ex rel.* Bensimon v. Duke Energy Corp., 500 B.R. 464, 480 (W.D. Tex. 2013) (stating "the recovery of the trustee is for the benefit of all creditors including those who had no right to avoid the transfer").

[13] *See*, *e.g.*, Miller v. Sulmeyer, 263 F.2d 513, 515 (9th Cir. 1959).

[14] *See, e.g.*, MC Asset Recover LLC v. Commerzbank A.G. (*In re* Mirant Corp.) 675 F.3d 530, 534 (5th Cir. 2012) (allowing trustee to rely on $500 claim to undo entire transfer); *In re* Musicland Holding Corp., 424 B.R. 95, 103 (Bankr. S.D.N.Y. 2010) (permitting a $35 million transfer to be set aside on the basis of a $500 triggering claim); *In re* Theisen, 45 B.R. 122, 126–27 (Bankr. D. Minn. 1984) ("If the transfer is avoidable at all by any creditor, it is avoidable in full for all creditors regardless of the dollar amount of the prevailing claim.").

[15] Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (*In re* Cybergenics Corp), 226 F.3d 237, 243 (3d Cir. 2000)*, rev'd on other grounds*, 330 F.3d 548 (3d Cir. 2003).

[16] *In re* Huff, 160 B.R. 256, 261 (Bankr. M.D. Ga. 1993) (holding trustee was bound by estoppel defense that applied to triggering creditor).

[17] *See, e.g.*, Pace v. Wainwright, 10 So. 2d 755, 756 (Ala. 1942) ("The general principle is well sustained that participation by one in a scheme whose purpose and tendency are to work a fraud upon another deprives him of standing in a court of equity to secure rights growing out of that transaction as against one *in pari delicto*, under the unclean hands maxim."); *In re* Davis' Estate, 101 P.2d 761, 763 (Cal. Dist. Ct. App. 1940) (indicating ancestor of decedent who participated in fraud cannot attack judgment on grounds that it was procured by fraud).

[18] Lane v. Eggleston, 284 F. 743, 745 (5th Cir. 1922) (holding a creditor who has voluntarily agreed to a transfer cannot avoid it); *In re* Dunn, Nos. CC-05-1406-MoSnK, CC-06-1046-MoSnK, 2006 WL 6810930,

lenders have begun using the trustee's ability to bring a claim through a triggering creditor to recover loan proceeds from the recipients that they would otherwise be barred from recovering under state law.

Two courts have held that the trustee's ability to bring a claim in reliance upon a triggering creditor prevents a defendant from successfully relying on state law affirmative defenses against other non-triggering creditors.[19] Two other courts have held that lenders with full knowledge of the circumstance of the loan were barred for equitable reasons from sharing in any recovery from the voided transaction.[20]

The second way in which trustees recently have relied on the triggering creditor doctrine to expand their powers is to use the United States government as the triggering creditor.[21] One advantage that this can convey is to permit the trustee to obtain the benefits of a longer statute of limitations applicable to claims by the federal government to avoid fraudulent transfers.[22] For example, many state fraudulent transfer statutes provide that the trustee must bring a claim within four years after the transfer.[23] The federal government, however, can bring a claim within six years after the right of action accrues,[24] and the Internal Revenue Code ("IRC") may provide a longer period for collection from a transferee of a creditor of the Internal Revenue Service ("IRS").[25] If the trustee can stand in the shoes of a governmental creditor, he or she can potentially void transfers that occurred long before the debtor's bankruptcy filing. Another advantage that this can convey is to permit the trustee to use an entire body of federal law, such as the Federal Debt

---

at *8 (B.A.P. 9th Cir. Oct. 31, 2006) ("A creditor who ratifies or participates in a fraudulent transfer may be estopped from attacking the transfer.").

[19] U.S. Bank Nat'l Ass'n v. Verizon Commc'ns Inc., 479 B.R. 405, 414 (N.D. Tex. 2012) (holding court must read the phrase estate to "include those standing in the shoes of the bankruptcy estate"); *In re* REFCO, Inc. Sec. Litig., No. 07 MDL 1902 GEL, 2009 WL 7242548, at *12 (S.D.N.Y. Nov. 13, 2009) (granting plaintiff the right to amend its complaint to include alleged facts against the potential triggering creditor).

[20] *In re* Yellowstone Mountain Club, LLC, 436 B.R. 598, 677–78 (D. Mont. 2010) [hereinafter *Yellowstone I*] (holding Credit Suisse and the Prepetition Lenders, which facilitated and encouraged fraudulent transfers because of the fat fees associated with such transactions, are precluded from recovery because the lenders were just as culpable in the fraudulent activity, invoking the *in pari delicto* defense); Crescent Res. Litig. Trust *ex rel.* Bensimon v. Duke Energy Corp., 500 B.R. 464, 482–83 (W.D. Tex. 2013) (allowing creditors to recover the loan proceeds after having received the benefit of their bargain with the ownership stake in Crescent Holdings would essentially allow lenders to make "off like bandits" and would limit recovery for the unsecured creditors other than the lenders, therefore, encouraging the banks to continue to engage in reckless lending behavior).

[21] *See In re* Alpha Protective Servs., Inc., 531 B.R. 889, 905 (Bankr. M.D. Ga. 2015) (trying to use the FDCPA as applicable law to qualify the IRS as a triggering creditor for the purposes of section 544(b)).

[22] *Cf. In re* Kaiser, 525 B.R. 697, 709 (Bankr. N.D. Ill. 2014) (illustrating the use of the IRS as a triggering creditor to utilize its extended statute of limitations).

[23] *E.g.*, CAL. CIV. CODE § 3439.09 (1985), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161).

[24] *See* 28 U.S.C. § 2415(a) (2012).

[25] *See* 26 U.S.C. § 6502(a) (2012) ("If a timely proceeding in court for the collection of a tax is commenced, the period during which such tax may be collected by levy shall be extended and shall not expire until the liability for the tax (or a judgment against the taxpayer arising from such liability) is satisfied or becomes unenforceable.").

Collection Practices Act ("FDCPA"),[26] to avoid claims on behalf of ordinary creditors who would otherwise be limited to proceeding under state fraudulent transfer laws.

As with the trustee's ability to use the triggering creditor doctrine to avoid the application of creditor-specific affirmative defenses, courts are split on the issue of whether the trustee can rely on the United States government as the triggering creditor under federal law.[27] Some courts believe that it is inappropriate for the trustee to take advantage of the special rights of the United States government as a sovereign for the benefit of other non-governmental creditors,[28] while others hold that this is irrelevant because the triggering creditor doctrine empowers the trustee to step into the shoes of any creditor for the benefit of other creditors.[29]

A factor that makes the expansion of the triggering creditor doctrine more important is the broad avoidance power conveyed by fraudulent transfer law. The initial purpose of fraudulent transfer laws was to enable a trustee to recover property of the debtor that was transferred intentionally to keep it out of the hands of creditors. The trustee's powers are not nearly so limited now, as they can include claims based on transfers for less than reasonably equivalent value regardless of the intention of the transferor. As we explain below, constructive fraudulent transfer actions are less like tort actions and more like equitable or quasi-contractual claims[30] because a trustee can recover property as a constructive fraudulent transfer even if it is clear that the transferor was not attempting to avoid paying its debts. In addition, a trustee can recover property as an "actual" fraudulent transfer even though an objective analysis would conclude that the transaction at issue was not fraudulent under any common understanding of that term and even though the transfer had no connection to the debtor's ultimate insolvency.

This Article discusses the legal and policy issues relating to the expansion of the triggering creditor doctrine. Those courts that have allowed the trustee to

---

[26] *See* 15 U.S.C. §§ 1692–1692p (2012) (providing consumer protection against abusive debt collection practices).

[27] *Compare In re Kaiser*, 525 B.R. at 714 (holding that trustee can rely on longer limitations period applicable to IRS), *In re* Porras, 312 B.R. 81, 97 (Bankr. W.D. Tex. 2004) (same), *and* additional cases discussed *infra*, *with In re* Vaughan Co., 498 B.R. 297, 305–06 (Bankr. D.N.M. 2013) (holding that trustee cannot rely on longer limitations period for IRS). *Compare In re* Tronox Inc., 503 B.R. 239, 272–73 (Bankr. S.D.N.Y. 2013) (holding that trustee could rely on six-year statute of limitations in Federal Debt Collection Procedures Act ("FDCPA")), *with* MC Asset Recovery LLC v. Commerzbank A.G. (*In re* Mirant Corp.), 675 F.3d 530, 535 (5th Cir. 2012) (holding that trustee could not rely on FDCPA limitations period).

[28] *See In re Vaughan Co.*, 498 B.R. at 304 ("Immunity from state statutes of limitation is a sovereign power of the United States. Such power may only be used to enforce public rights and protect public interests. Therefore, if an action brought in the name of the United States does not involve public rights or interests, state statutes of limitation typically apply.") (footnote and citations omitted).

[29] *See In re Kaiser*, 525 B.R. at 708 ("A trustee stands in the shoes of an actual unsecured creditor and becomes subject to the same rights and limitations that the actual unsecured creditor would be subject to outside of bankruptcy.") (citation omitted).

[30] 3 HOWARD J. STEINBERG, BANKRUPTCY LITIGATION § 17:99 (2d ed. 2012); *see* Jonathan C. Lipson, *First Principles and Fair Consideration: the Developing Clash Between the First Amendment and the Constructive Fraudulent Conveyance Laws*, 52 U. MIAMI L. REV. 247, 276 (1997) (positing "fraudulent conveyances laws are facially neutral, commercial laws of general application").

invoke broader avoidance powers have done so because they believed that this result is compelled by the language of the Code or governing precedent. Those that have refused to allow the trustee to invoke broader avoidance powers have done so based in large part on policy considerations. There is a third alternative, which the judicial decisions have not addressed, and which we discuss in Part VI, which is to limit the triggering creditor doctrine to its existing boundaries. Ultimately, however, the scope and breadth of a trustee's power to rely on a triggering creditor to avoid fraudulent transfers may have to be resolved by Congress or the United States Supreme Court.

I. EVOLUTION OF THE LAW OF FRAUDULENT TRANSFER

The evolution of the law regulating conveyances to defeat creditors has been extensively examined in the literature.[31] For purposes of this discussion, we will only briefly outline the evolution of the law.

"The modern law of fraudulent transfers had its origin in the Statute of 13 Elizabeth, which invalidated 'covinous and fraudulent' transfers designed 'to delay, hinder or defraud creditors and others.'"[32] Because subjective intent to defraud was difficult to prove, English courts developed objective factors that, if present, would strongly indicate that the transaction was fraudulent.[33] The first reported case to set out these factors was *Twyne's* Case.[34]

In *Twyne's* Case, a farmer owed one creditor, Twyne, £400, and another unnamed creditor £200.[35] He transferred all of his sheep to Twyne in satisfaction of the debt pursuant to a deed that expressly stated that the transfer was in good faith.[36] Despite the deed, the debtor remained in possession of the sheep and continued to maintain them as if he still owned them.[37]

---

[31] *See, e.g.*, Peter A. Alces & Luther M. Dorr, Jr., *A Critical Analysis of the New Uniform Fraudulent Transfer Act*, 1985 U. ILL. L. REV. 527, 529 (1985) (observing Anglo-American laws regulating fraudulent disposition of property date back to the sixteenth century); 1 GARRARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 58 (rev. ed. 1940) (remarking modern notion of the fraudulent conveyance traces back to a statute of Elizabeth, enacted in 1571 and commonly called the Statute of Fraudulent Conveyances).

[32] BFP v. Resolution Trust Corp., 511 U.S. 531, 540 (1994).

[33] *See* Batlan v. Bledsoe (*In re* Bledsoe), 569 F.3d 1106, 1114–15 (9th Cir. 2009) (discussing badges of fraud); Sharp Int'l Corp. v. State Street Bank & Tr. Co. (*In re* Sharp Int'l Corp. & Sharp Sales Corp.), 403 F.3d 43, 56 (2d Cir. 2005) (discussing the difficulty of proving actual intent for purposes of section 548(a)(1)(A)); *In re* Teague, No. 08-52088, 2013 WL 1796080, at *17 (Bankr. W.D.N.C. Apr. 29, 2013) *on reconsideration in part*, No. 08-51088, 2014 WL 911861 (Bankr. W.D.N.C. Mar. 7, 2014) (discussing evolution of badges of fraud). Courts perform the same analysis for other forms of fraud. *See, e.g.*, United States v. Pennell, 737 F.2d 521, 525 (6th Cir. 1984), *cert. denied*, 469 U.S. 1158 (1985) (stating because intent is often difficult to prove, "the defendant's objective conduct, taken as a whole, must unequivocally corroborate the required subjective intent to purchase or sell actual narcotics").

[34] (1601) 76 Eng. Rep. 809, 810; Co. Rep. 80b.

[35] *Id*.

[36] *Id*.

[37] *Id*. at 811.

The unpaid creditor sent the sheriff to repossess the sheep, but Twyne resisted, arguing that he had purchased the sheep.[38] The court disagreed and held that even if Twyne honestly intended that the purchase be valid, the hallmarks of the transaction indicated that it was to avoid the debt to the other creditor.[39] The six factors that the court noted were that: (1) the debtor transferred all his property; (2) the debtor continued to possess and use the property; (3) the transfer "was made in secret"; (4) the transfer was made while the opposing creditor's writ of possession was pending; (5) the parties created a trust to govern the use of the property; and (6) the deed explicitly recited that the transfer was made in good faith.[40] These six factors became known as the "badges of fraud," which, as discussed below, courts have gradually expanded.

When the trustee invokes non-bankruptcy law avoidance powers under section 544(b)(1) of the Code,[41] he or she usually is relying on state laws that prohibit fraudulent transfers or conveyances. Most states have adopted the Uniform Fraudulent Transfer Act ("UFTA");[42] Maryland and New York retain the older Uniform Fraudulent Conveyance Act ("UFCA");[43] and three—Alaska, South Carolina, and Virginia—have not adopted either statute.[44] Indeed, South Carolina continues to follow the Statute of Elizabeth.[45] In cases in which the IRS or a governmental entity is selected to be the triggering creditor, the trustee is relying on avoidance powers specific to that entity. In actions brought under section 544(b), the trustee's rights arise under federal law, but the extent of those rights depends on the scope of the applicable <u>non-bankruptcy</u> fraudulent transfer law.[46]

---

[38] *Id*. at 811–12.

[39] *Id.* at 812.

[40] *Id*. at 812–14.

[41] 11 U.S.C. § 544(b)(1) (2012) (enumerating the requirements for a trustee to avoid a transfer or obligation).

[42] A list of states that have adopted the UFTA is available at http://www.law.cornell.edu/uniform/vol7.html#frtra. For convenience, references will be made to California's version of the UFTA, Uniform Fraudulent Transfer Act, CAL. CIV. CODE §§ 3439–3439.12 (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161).

[43] *See* N.Y. DEBT. & CRED. LAW §§ 270–281 (2012) (regulating fraudulent conveyances in the State of New York); MD. COM. LAW § 15-201 (2015), et. seq. (defining key terms under Maryland's fraudulent transfer laws).

[44] *See* The Gilbert Law Office, *The Importance of Considering State Fraudulent Transfer Law in an Asset Protection Plan*, EVERY STATE'S FRAUDULENT TRANSFER LAWS, http://assetprotecting.com/creditor/fraudulent-transfers.php (last visited Sept. 9, 2015) (citing every state's fraudulent transfer law statutes).

[45] *See In re* Ducate, 369 B.R. 251, 258 (Bankr. D.S.C. 2007) (explaining South Carolina's Statute of Elizabeth allows for the avoidance of fraudulent transfers); Albertson v. Robinson, 638 S.E.2d 81, 83 (S.C. Ct. App. 2006) (explaining two conditions necessary for fraudulent transfers to be voided under South Carolina law).

[46] *See* Stettner v. Smith (*In re* IFS Fin. Corp.), 669 F.3d 255, 261 (5th Cir. 2012) (indicating trustee's successor rights depend on state law).

II. FRAUDULENT TRANSFER LAW

A. Constructive Fraud

As noted above, the original purpose of fraudulent transfer law was to prevent a debtor from hiding or concealing assets to avoid turning them over to a creditor;[47] in other words, to provide a creditor with a remedy if the debtor conveyed his or her assets with the actual intent to keep them out of the hands of the creditor. And while the term "fraud" remains embedded in the law, the word "fraud" is a misnomer when describing actions to recover a fraudulent transfer.[48]

The UFTA, the UFCA, and the Code provide two general mechanisms by which a creditor or trustee standing in the shoes of a creditor can avoid a transaction as fraudulent: constructive fraud and actual fraud. Although laws vary from state to state, and between states and the Code, generally speaking, for constructive fraud, the plaintiff must establish that (1) the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation; and (2) the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.[49] The UFTA and UFCA have slightly different tests governing constructive fraud,[50] and because Maryland and New York are the only states whose fraudulent transfer statutes are based on the UFCA, the remainder of this discussion will be based on the UTFA.

Under the constructive fraud provisions of the UFTA, whether the debtor was insolvent is generally determined by one of three alternative tests:

---

[47] *See* Decker v. Tramiel (*In re* JTS Corp.), 617 F.3d 1102, 1111 (9th Cir. 2010) ("Such laws were enacted to allow a creditor to avoid an improper transaction by a debtor who attempts to unjustly reduce assets and avoid his creditors' claims.").

[48] The amendments to the UFTA reflect the confusion that may be caused by using the word "fraud" to describe voidable transactions. The UFTA was drafted in the early 1980's to succeed the UFCA, which was promulgated by the Conference of Commissioners on Uniform State Laws in 1918. *See Amendments to Uniform Fraudulent Transfer Act*, NATIONAL CONFERENCE OF COMMISSIONERS OF UNIFORM STATE LAWS 1 (May 31, 2013), http://www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013AM_AUFTA_Draft.pdf (Draft Amendment). In 2014, the Commissioners approved a set of amendments to the UFTA. *See id*. One of the proposed amendments is to retitle the Act the "Uniform Voidable Transactions Act." *See id.* The stated purpose of that amendment is to eliminate confusion in the inconsistent uses of "voidable" and "fraudulent" in the current UFTA; the proposed definition of "voidable" simply denotes a transfer or obligation for which the Act proposes a remedy. *See id.*

[49] CAL. CIV. CODE § 3439.04 (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161) (changing the former reference to a "fraudulent" transfer or obligation to that of a "VOIDABLE" transfer or obligation); *see* 11 U.S.C. § 548(a)(1)(B) (2012).

[50] These differences are set out by the Committee on Uniform State Laws and Corporate Reorganization of the Association of the Bar of the City of New York in its December 19, 2006 letter to the legislature recommending that the state repeal the UFCA and replace it with the UFTA. Letter from David W. Dykhouse & Barbara L. Seniawski, to Joseph L. Bruno & Sheldon Silver Re: New York's Fraudulent Transfer Law, ASS'N OF THE B. OF N.Y.C. (Dec. 19, 2006); www.nycbar.org/pdf/report/uploads/20061311-UniformFradulentTransferAct.pdf.

- The first test is the balance sheet test, which asks whether the sum of the debtor's debts was greater than all of the debtor's assets at a fair valuation.[51] This is an objective test[52] that compares the fair market value of the company's assets, on a going concern basis, to its liabilities.[53]
- The second test is the timely payment test or the cash flow test, which asks whether the debtor intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.[54] This test is met if it can be shown that when the debtor made the transfer or incurred the obligation, the debtor either knew or reasonably should have known that subsequent creditors likely would not be paid.[55]
- The third test is the unreasonably small assets test or adequate capital test, which asks whether the debtor was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction.[56] Whether the debtor had sufficient assets is determined both by assets on its balance sheet as well as whether the debtor had access to additional funds, such as a loan.[57]

Because a defendant in a constructive fraud case can be forced to turn over money without any showing of ill intent, a defendant in an action for constructive fraud has a number of protections. For example, under the UFTA, if the trustee seeks to void a transfer for less than reasonably equivalent value because the debtor was "balance sheet" insolvent at the time of the transfer, the trustee must prove not only insolvency but also that there was a creditor in existence on the date of the transfer whose claim had not been paid at the time of the filing of the bankruptcy

---

[51] CAL. CIV. CODE § 3439.02(a) (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161) (stylistic changes); *see also* 11 U.S.C. § 101(32)(A) (2012) (demonstrating use of the balance sheet test under the United States Bankruptcy Code).

[52] *See* 5 NORTON BANKRUPTCY LAW & PRACTICE § 97:23 (William L. Norton, Jr. 3d ed. 2012) ("The UFTA adopts an objective 'balance sheet' test, reminiscent of the Bankruptcy Code, that compares the debtor's assets 'at a fair valuation to its liabilities.'").

[53] *See In re* Glob. Technovations, Inc., 431 B.R. 739, 772 (Bankr. E.D. Mich. 2010), *aff'd*, No. 10-12781, 2011 WL 1297356 (E.D. Mich. Mar. 31, 2011), *aff'd*, 694 F.3d 705 (6th Cir. 2012).

[54] *See In re* EBC I, Inc., 380 B.R. 348, 359 (Bankr. D. Del. 2008), *aff'd*, 400 B.R. 13 (D. Del. 2009), *aff'd*, 382 F. App'x 135 (3d Cir. 2010).

[55] *See In re* WRT Energy Corp., 282 B.R. 343, 414–15 (Bankr. W.D. La. 2001).

[56] *See* 11 U.S.C. § 548(a)(1)(B) (2012).

[57] *See In re* Autobacs Strauss, Inc., 473 B.R. 525, 554−55 (Bankr. D. Del. 2012) (stating "many a balance sheet insolvent debtor may be nonetheless solvent as a going concern"); *In re EBC I, Inc.*, 380 B.R. at 366 (concluding debtor was insolvent once 1999 agreement was terminated); *In re* Iridium Operating LLC*,* 373 B.R. 283, 296 (Bankr. S.D.N.Y. 2007) (finding "that the evidence presented by the Committee is insufficient to establish insolvency or unreasonably small capital"); Peltz v. Hatten, 279 B.R. 710, 748 (D. Del. 2002), *aff'd sub nom*. *In re* USN Commc'ns, Inc., 60 F. App'x 401 (3d Cir. 2003) (remarking court was not convinced that USN's financial situation made it insolvent enough to succeed on its fraudulent transfer claim); Moody v. Sec. Pac. Bus. Credit, Inc., 127 B.R. 958, 983−84 (W.D. Pa. 1991), *aff'd*, 971 F.2d 1056 (3d Cir. 1992) (reiterating conclusion that debtor was solvent is reasonable).

petition.[58] A trustee seeking to prove that a transfer was constructively fraudulent under the timely payment test must show that the debtor subjectively intended or believed or should reasonably have believed that, as a result of the transfer, its debts would not be paid.[59] And a trustee seeking to prove that a transfer left the debtor with inadequate assets to operate its business must prove that the transaction caused the debtor's business to fail.[60] Moreover, in the context of a leveraged buyout or similar financial restructuring, the defendant also may be entitled to an absolute defense against a constructive fraudulent transfer if the transaction was a settlement payment in connection with a securities transaction.[61]

B. Actual Fraud

The language of the UFTA governing transactions voidable as "actual" fraudulent transfers is concise and is similar to the language in the Statute of Elizabeth drafted 440 years ago:

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after

---

[58] *See* CAL. CIV. CODE § 3439.05 (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161); *In re* G-I Holdings, Inc., 313 B.R. 612, 632–33 (Bankr. D.N.J. 2004) (stating trustees bear the burden of proving existence of qualified unsecured creditors).

[59] *See* CAL. CIV. CODE § 3439.04(a)(2)(B) (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161); ASARCO LLC v. Americas Mining Corp., 396 B.R. 278, 399 (S.D. Tex. 2008) ("The subjective prong is met if it can be shown that 'the debtor made the transfer or incurred an obligation contemporaneous with an intent or belief that subsequent creditors likely would not be paid as their claims matured.'") (quoting *In re* WRT Energy Corp., 282 B.R. 343, 415 (Bankr. W.D. La. 2001); *In re WRT Energy Corp.*, 282 B.R. at 414–15 (stating timely payment test "is met if it can be shown that debtor made transfer or incurred obligation contemporaneous with intent or belief that subsequent creditors likely would not be paid as their claims matured").

[60] *See Moody*, 971 F.2d at 1061 (remarking that bankruptcy courts have held that debtor was left with unreasonably small capital even though they did not exhaust their credit lines); Dollar Tree Stores Inc. v. Toyama Partners LLC, 875 F. Supp. 2d 1058, 1079 (N.D. Cal. 2012) (arguing that Toyama's conduct was substantial factor in causing Dollar Tree's harm).

[61] *See generally* 11 U.S.C. § 546(e) (2012) (providing when a trustee may not avoid a transfer that is a settlement payment); Official Comm. of Unsecured Creditors of Quebecor World (USA) Inc. v. Am. United Life Ins. Co. (*In re* Quebecor World (USA) Inc.), 719 F.3d 94, 98 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 1278 (2014) (holding that pre-petition payment that debtor had transferred to repurchase and cancel promissory notes was settlement payment). *See, e.g.*, Peterson v. Somers Dublin Ltd., 729 F.3d 741, 747–48 (7th Cir. 2013) (pre-petition redemption payments made to investors by chapter 7 debtor-hedge funds, which were operated as a second-tier Ponzi scheme, fell within the Bankruptcy Code's "safe harbor" exception to the avoidability of settlement payments and could not be recovered by trustee except as "actually fraudulent" transfers); Lowenschuss v. Resorts Int'l, Inc. (*In re* Resorts Int'l, Inc.), 181 F.3d 505, 515 (3d Cir. 1999) (finding that a payment made to a shareholder as part of a leveraged buyout qualified as a settlement payment and was protected by section 546(e)). This is a rapidly developing *area* of bankruptcy law. *See also In re* Tribune Co. Fraudulent Conveyance Litig., 499 B.R. 310, 315 (S.D.N.Y. 2013) ("The term 'settlement payment' refers to any kind of payment that 'complete[s] a transaction in securities,' including a 'payment for shares during an LBO.' Section 546(e) makes one exception, however: a trustee may utilize Section 548(a)(1)(A) to avoid actually fraudulent transfers.") (citations omitted).

> the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation as follows:
> (1) With actual intent to hinder, delay, or defraud any creditor of the debtor.[62]

Section 548(a) of the Code[63] and the UFCA[64] include similar language, as do the statutes in the three states that have not adopted either uniform code.[65] Because the statute applies if the debtor is seeking to hinder, delay, *or* defraud creditors, a transfer can be set aside even if the debtor intended, ultimately, that all creditors be paid.[66]

Over the years, courts expanded the original six "badges of fraud" in *Twyne's* Case[67] to include a number of factors indicating that the transfer was improper,[68] and the UFTA lists eleven factors courts may consider "[i]n determining actual intent."[69] Courts have inconsistently interpreted and applied these criteria and have provided few clear lines that would permit a defendant to quickly and inexpensively escape liability for transactions that are not objectively fraudulent.[70] Often, courts simply articulate the standard without explaining what it means.[71] Other courts simply look at the checklist of the "badges of fraud," and some have held that the

---

[62] *See* CAL. CIV. CODE § 3439.04(a)(1) (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161).

[63] 11 U.S.C. § 548(a).

[64] *See, e.g.*, ALA. CODE § 8-9A-4 (2014); N.Y. DEBT. & CRED. LAW § 276 (2012).

[65] ALASKA STAT. § 34.40.010 (2014); S.C. CODE ANN. § 27-23-10 (2014); VA. CODE ANN. § 8.01-534(A)(4) (2015).

[66] Shapiro v. Wilgus, 287 U.S. 348, 354 (1932) ("A conveyance is illegal if made with an intent to defraud the creditors of the grantor, but equally it is illegal if made with an intent to hinder and delay them.").

[67] (1601) 76 Eng. Rep. 809, 810; Co. Rep. 80b.

[68] *See* Michael L. Cook, BANKR. LITIG. MANUAL § 11.02, at 11–22 n.48 (2014) (listing cases).

[69] *See* CAL. CIV. CODE § 3439.04(b) (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161) ("(b) In determining actual intent under paragraph (1) of subdivision (a), consideration may be given, among other factors, to any or all of the following: (1) Whether the transfer or obligation was to an insider. (2) Whether the debtor retained possession or control of the property transferred after the transfer. (3) Whether the transfer or obligation was disclosed or concealed. (4) Whether before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit. (5) Whether the transfer was of substantially all the debtor's assets. (6) Whether the debtor absconded. (7) Whether the debtor removed or concealed assets. (8) Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred. (9) Whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred. (10) Whether the transfer occurred shortly before or shortly after a substantial debt was incurred. (11) Whether the debtor transferred the essential assets of the business to a lienholder who transferred the assets to an insider of the debtor.").

[70] *See* Peter A. Alces & Luther M. Dorr, Jr., *supra* note 30, at 535–40 (discussing cases).

[71] See *In re* Pearlman, 440 B.R. 569, 574–75 (Bankr. M.D. Fla. 2010), *aff'd*, 478 B.R. 448 (M.D. Fla. 2012) (providing trustee must prove actual intent); *In re* Marketxt Holdings Corp., 361 B.R. 369, 395 (Bankr. S.D.N.Y. 2007) (stating "[u]nder the Bankruptcy Code, the plaintiff must establish the actual fraudulent intent of the transferor/debtor"); *In re* Sec. Inv'r Prot. Corp. v. R.D. Kushnir & Co., 274 B.R. 768, 780 (Bankr. N.D. Ill. 2002) ("Transfers are classified as fraudulent in fact when the debtor had the requisite intent to defraud its creditors.").

presence of very few of the eleven badges of fraud may be sufficient to conclude that a conveyance is actually fraudulent.[72]

The broad scope of the trustee's powers when seeking to void a transaction made "with actual intent to hinder, delay, or defraud"[73] provides an incentive to rely on this provision if the trustee is concerned about proving one of the elements of constructive fraud (including the valuation requirement) or if the defendant can mount a meaningful defense to an action based on constructive fraud. As a policy matter, this might not be a significant problem if the purpose of the action is to set aside a transaction that was designed to prevent existing creditors from recovering on their claims. For example, if creditors are in existence before a transaction, and the transaction hinders the creditors' ability to satisfy their claims, and the fact finder determines that this was the purpose of the transaction, the transfer fits squarely within the scope of transactions that fraudulent transfer law was intended to deter and unwind.[74]

But the scope of potential liability for actual fraudulent transfer is not so limited. The creditors need not have been defrauded at all, as the transaction can be avoided by a creditor regardless of "whether the creditor's claim arose before or after the transfer was made or the obligation was incurred."[75] Indeed, "[f]raud, in the sense of morally culpable conduct, need not be present in either category of fraudulent transfer. An actually fraudulent transfer could, in principle, occur without genuine fraud."[76] For example, a transaction by a debtor who is behind on car payments and transfers title to the car to a relative may be avoided as a fraudulent transfer even if the debtor had the genuine intent of catching up on the overdue payments and repaying the lender.[77]

Moreover, many of the protections available to defendants in an action for constructive fraud are not available in an action for actual fraud. In connection with an actual fraudulent transfer, the trustee need not prove that the debtor was

---

[72] Acequia, Inc. v. Clinton (*In re* Acequia, Inc.), 34 F.3d 800, 806 (9th Cir. 1994) ("The presence of a single badge of fraud may spur mere suspicion; the confluence of several can constitute conclusive evidence of actual intent to defraud, absent 'significantly clear' evidence of a legitimate supervening purpose"); United States v. Patras, 909 F. Supp. 2d 400, 412 (D.N.J. 2012) ("While a single badge of fraud may establish that a conveyance is fraudulent, 'the confluence of several in one transaction generally provides conclusive evidence of an actual intent to defraud.'"); MSKP Oak Grove, LLC v. Venuto, 875 F. Supp. 2d 426, 436 (D.N.J. 2012) ("As the New Jersey Supreme Court has held, the presence of a single badge of fraud is sufficient to cast suspicion on the transferor's intent.").

[73] *In re* Tronox, 503 B.R. 239, 277 (Bankr. S.D.N.Y. 2013).

[74] *See id.* at 280 (holding defendants orchestrated spinoff transaction to free substantially all of their assets from 85 years of environmental and tort liabilities, while assigning such liabilities to undercapitalized debtors, with actual intent to hinder or delay creditors).

[75] *See* CAL. CIV. CODE § 3439.04(a)(1) (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161).

[76] *In re* Cohen, 199 B.R. 709, 716 (B.A.P. 9th Cir. 1996).

[77] *In re* Ste. Jan-Marie, Inc., 151 B.R. 984, 987 (Bankr. S.D. Fla. 1993) ("[A]ctual intent to defraud will be found to exist even where the debtor's purpose is not ultimately to deprive creditors of payment, but merely to hinder or delay creditors.").

insolvent at the time of the transfer,[78] nor is it material what consideration was provided.[79] That is, the trustee need not prove that the transfer even diminished the estate or that another creditor was left unpaid in order to meet the burden of proof for an actual fraudulent transfer.[80] In addition, the safe harbor for settlement payments is not available in an action to avoid a transaction based on actual fraud.[81]

III. THE USE OF THE TRIGGERING CREDITOR DOCTRINE AFFIRMATIVE DEFENSES TO A CONSTRUCTIVE OR ACTUAL FRAUDULENT TRANSFER CLAIM

A. The Trustee Stands in the Shoes of Creditors for Purposes of Avoiding a Fraudulent Transfer

We turn now to the issue whether a person or entity that knowingly assisted the debtor in carrying out a constructive or actual fraudulent transaction can nevertheless receive the benefit of the avoided transaction through a triggering creditor not subject to affirmative defenses.

The bankruptcy estate is defined by section 541, and includes "all legal or equitable interests of the debtor in property as of the commencement" of bankruptcy, including causes of action.[82] Thus, in actions to collect property of the estate that could have been brought by the debtor prior to bankruptcy, the trustee stands in the shoes of the debtor,[83] and his or her claims are subject to the same defenses that could have been asserted had the debtor itself filed suit.[84] When the

---

[78] *In re Cohen*, 199 B.R. at 716–17 (stating "[n]either malice nor insolvency are required" when inquiring if an actual fraudulent transfer occurred).

[79] *In re* Lake States Commodities, Inc., 253 B.R. 866, 871 (Bankr. N.D. Ill. 2000) ("the adequacy or equivalence of consideration provided for the actually fraudulent transfer is not material to the question whether the transfer is actually fraudulent") (quoting *In re Cohen*, 199 B.R. at 716–17).

[80] *In re* Model Imperial, Inc., 250 B.R. 776, 794–95 (Bankr. S.D. Fla. 2000) (finding "diminution of the estate" was not an essential element of an actual fraudulent transfer claim).

[81] *See* Peterson v. Somers Dublin Ltd., 729 F.3d 741, 749 (7th Cir. 2013) (highlighting exceptions to safe harbor provisions when actual fraud is present); *In re* Tribune Co. Fraudulent Conveyance Litig., 499 B.R. 310, 315 (S.D.N.Y. 2013) (finding payment for shares during a leveraged buyout avoidable for actually fraudulent transfers).

[82] 11 U.S.C. § 541(a)(1) (2012); *see* Grayson Consulting, Inc. v. Wachovia Sec., LLC (*In re* Derivium Capital LLC), 716 F.3d 355, 367 (4th Cir. 2013) (finding trustee limited to bankruptcy estate's causes of action).

[83] *In re* Derivium Capital LLC, 716 F.3d at 367. *See* Vitro S.A.B. de C.V. v. Ad Hoc Grp. of Vitro Noteholders (*In re* Vitro S.A.B De C.V.), 701 F.3d 1031, 1049 n.20 (5th Cir. 2012) ("A debtor in possession stands in the shoes of the bankruptcy trustee, generally having the same rights, powers, duties and functions, with certain exceptions.") (quoting Soto–Rios v. Banco Popular de Puerto Rico, 662 F.3d 112, 115 n.2 (1st Cir. 2011)); Ahcom, Ltd. v. Smeding, 623 F.3d 1248, 1250 (9th Cir. 2010) ("The trustee 'stands in the shoes of the bankrupt corporation and has standing to bring any suit that the bankrupt corporation could have instituted had it not petitioned for bankruptcy.'").

[84] *See* Peterson v. McGladrey & Pullen, LLP, 676 F.3d 594, 596 (7th Cir. 2012) (stating trustee's claims were subject to the same defenses that could have been asserted had debtor itself filed suit); Official Comm. of Unsecured Creditors v. Baldwin (*In re* Lemington Home for the Aged), 659 F.3d 282, 292–93 (3d Cir. 2011), *as amended* (Oct. 20, 2011), *subsequent mandamus proceeding sub nom*. *In re* Baldwin, 700 F.3d 122

trustee is asserting powers under the "strong arm" provision of the Code as a hypothetical lien creditor, however, the trustee is standing in the shoes of a creditor and is subject to any defenses against that creditor.[85] Similarly, when a trustee is invoking the power of an actual creditor to avoid a fraudulent transfer, the trustee is not standing in the shoes of the debtor—he or she is standing in the shoes of a creditor.[86] And courts have held that the trustee's claim would be subject to defenses that could have been asserted against the triggering creditor.[87]

The application of fraudulent transfer law to leveraged buyouts, corporate spinoffs, and similar financial recapitalizations was once a debated proposition, [88] but is now well-established.[89] If these transactions do not succeed, the most significant creditor of the estate often is the lender that facilitated the transaction in the first place. If the loan is not guaranteed or is not recourse to the entity that received the funds from the debtor, the lender's only option may be to use fraudulent transfer law to recover those funds from its borrower's transferee if its borrower is unable to repay the loan. Absent a bankruptcy, the lender may be barred from any recovery from the transferee for equitable reasons or under contract law, but the lender may be able to overcome those hurdles by supporting an action by a trustee based on the standing of a non-lender creditor.

(3d Cir. 2012) (same); Mosier v. Callister, Nebeker & McCullough, P.C., 546 F.3d 1271, 1277 (10th Cir. 2008) (same); Yaquinto v. Segerstrom (*In re* Segerstrom), 247 F.3d 218, 224 (5th Cir. 2001) (same).

[85] *See* Carlton v. Baww, Inc., 751 F.2d 781, 785–86 (5th Cir. 1985) ("The [Bankruptcy] Code also gives the trustee a series of avoidance powers through which he can recapture property of the estate. Among these is section 544(b) which allows the trustee, as statutory successor to the debtor's creditors, to void fraudulent conveyances to the extent permitted by applicable non-bankruptcy law."); Am. Nat'l Bank of Austin v. MortgageAmerica Corp. (*In re* MortgageAmerica Corp.), 714 F.2d 1266, 1275 (5th Cir. 1983) ("The 'strong arm' provision of the current [Bankruptcy] Code, 11 U.S.C. § 544, allows the bankruptcy trustee to step into the shoes of a creditor for the purpose of asserting causes of action under state fraudulent conveyance acts for the benefit of all creditors.").

[86] *See* Jenner v. Neilson (*In re* Slatkin), 222 Fed. App'x 545, 546–47 (9th Cir. 2007) (noting for fraudulent transfer claims, trustee stands in shoes of creditors).

[87] *See* ASARCO LLC v. Ams. Mining Corp., 396 B.R. 278, 325 (S.D. Tex. 2008) ("The trustee stands in the shoes of the creditor and is subject only to the defenses that would be available against the creditor, not the debtor."); Buchman v. Am. Foam Rubber Corp., 250 F. Supp. 60, 72 (S.D.N.Y. 1965) ("Subject to the same defenses as the creditor in whose shoes he stands, the Trustee is entitled to assert fully the rights of that creditor.").

[88] *See, e.g.*, Kupetz v. Wolf, 845 F.2d 842, 848 (9th Cir. 1988) (noting courts should "hesitate to utilize constructive intent to frustrate the purposes intended to be served by what appears [to be] a legitimate LBO."); Credit Managers Ass'n v. Fed. Co., 629 F. Supp. 175, 187 (C.D. Cal. 1985) (finding company not undercapitalized after leveraged buyout even though financial projections turned out to be wrong); Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, J. ECON. PERSP. 121, 128 (2001); Steven N. Kaplan & Jeremy C. Stein, *The Evolution of Buyout Pricing and Financial Structure in the 1980s*, 108 Q.J. ECON. 313, 340–44 (1993); Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 830–35, 850–54 (1985).

[89] *See* Boyer v. Crown Stock Distribution, Inc., 587 F.3d 787, 792–93 (rejecting analysis of financial substance of transaction if the transaction is voidable under the literal words of the statute).

B. The Use of the Triggering Creditor Doctrine in a Fraudulent Transfer Action

The potential ability of co-participants in a transfer to reach the transferred assets is based on the 1931 United States Supreme Court decision in *Moore v. Bay*,[90] which held that the trustee can step into the shoes of any potential triggering creditor and avoid the entire transaction for the benefit of all the creditors.[91] Therefore, while the trustee stands in the shoes of creditors for the purpose of bringing a fraudulent transfer claim, he or she arguably can step into the shoes of a creditor not subject to the *in pari delicto* defense for the purpose of avoiding the transfer.

The opinion in *Moore v. Bay* arose from the bankruptcy of Sassard & Kimball, Inc., an automobile dealership.[92] The mortgagee had taken a mortgage in two of the debtor's cars as well as the debtor's furniture, showroom, and shop equipment.[93] The mortgagee, however, had failed to provide notice of its intention to take the security interest, as required by California law.[94] Under section 70e of the Bankruptcy Act of 1898,[95] the trustee was permitted to void any transfer that could be avoided by an actual creditor with a provable claim existing as of the date of the bankruptcy.[96] The mortgagee stipulated that the mortgage was invalid as to creditors who existed as of the date of the mortgage and creditors who came into existence between the date of the mortgage and the date it was recorded.[97] The issue, however, was whether the mortgage was void as to creditors who became creditors after the mortgage was recorded.[98] Under California law, the mortgage would be valid as to that class, but the Supreme Court held that the trustee was permitted to stand in the shoes of any creditor that could avoid the mortgage and distribute the proceeds to all unsecured creditors, even those who had no right to avoid the mortgage.[99]

The doctrine of *Moore v. Bay* was criticized shortly after the opinion was issued[100] and has been extensively criticized[101] since then. Nevertheless, it is

---

[90] Moore v. Bay (*In re* Sassard & Kimball, Inc.), 284 U.S. 4, 5 (1931) (holding under the Bankruptcy Act that a trustee could avoid a mortgage for the benefit of all creditors, including those who could not have voided the mortgage themselves).

[91] *See id.* (holding under the Bankruptcy Act that a trustee could avoid a mortgage for the benefit of all creditors, including those who could not have voided the mortgage themselves).

[92] Moore v. Bay (*In re* Sassard & Kimball, Inc.), 45 F.2d 449 (9th Cir. 1930), *rev'd*, 284 U.S. 4 (1931).

[93] *Id*.

[94] *Id*.

[95] Previously codified at 11 U.S.C. § 110(e)(1) (2012).

[96] Section 70e was the precursor of section 544(b). *See* Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1201 (9th Cir. 2005).

[97] *In re Sassard & Kimball, Inc.*, 45 F.2d at 449–50.

[98] *Id.* at 450.

[99] Moore v. Bay (*In re* Sassard & Kimball, Inc.), 284 U.S. 4, 5 (1931).

[100] *See* R. Carter Scott, Jr., *The Meaning of the Provisions for Recordation of a Transfer as Applicable to Preference Under the Bankruptcy Act and a Critique of the Decision of the United States Supreme Court in the Case of Moore v. Bay*, 18 VA. L. REV. 249, 265–69 (1932) (opining "the [Supreme Court *Moore v. Bay*] decision is unsound and . . . a contrary decision must necessarily have been reached").

[101] *See, e.g.*, *In re* Equip. Acquisition Res., Inc., 451 B.R. 454, 464–65 (Bankr. N.D. Ill. 2011), *aff'd*, 485 B.R. 586 (N.D. Ill. 2013), *rev'd*, 742 F.3d 743 (7th Cir. 2014) (noting Congress expressly retained the

accepted as "black-letter" law.[102] Over time, courts have expanded the *Moore v. Bay* doctrine to hold that a trustee is not bound by the amount of the triggering creditor's claim, so that a trustee can avoid a $10,000 transaction even if the triggering creditor only holds a $10 claim.[103] Moreover, the trustee can avoid the full amount of the transfer even if it exceeds the total amount of unpaid unsecured debt in the estate.[104] Once a trustee recovers property for the estate, the property must be equally distributed to all creditors of the same or higher priority.[105]

C. Cases Holding That the Triggering Creditor Doctrine Can Insulate a Creditor from Affirmative Defenses Provided That There is Another Creditor in Existence Not Subject to Affirmative Defenses

At common law, a co-participant in a fraudulent transfer would be barred by the *in pari delicto* doctrine from suing the transferee directly.[106] But at least two courts

controversial rule in enacting the 1978 Bankruptcy Act); *In re* C.F. Foods, LP, 265 B.R. 71, 86 (Bankr. E.D. Pa. 2001) (same); H.R. DOC. NO. 93-137, at 19–20 (1973) (discussing abolishing the doctrine); 5 COLLIER ON BANKRUPTCY, ¶ 544.06[4], at 544-28 (Alan N. Resnick & Henry J. Somme eds., 16th ed. 2012) (referring to the doctrine as "one of the most controversial in the entire field of bankruptcy law"); Andrea Coles-Bjerre, *Bankruptcy Theory and the Acceptance of Ambiguity*, 80 AM. BANKR. L.J. 327, 363–64 (2006) (discussing controversy of *Moore v. Bay*'s doctrine); Max Schwartz, *Moore v. Bay, Should Its Rule Be Abolished?*, 60 COM. L.J. 67, 68 (1955) ("[T]he advocates seeking to eliminate Moore v. Bay, urge that its rule is unduly harsh and unjust, and penalizes the secured creditors in that it gives rise to uncertainty as to the validity of security transactions.").

[102] Decker v. Tramiel (*In re* JTS Corp.), 617 F.3d 1102, 1112–13 (9th Cir. 2010) ("[T]he Supreme Court held that the creditor with a cause of action under § 70e would share any recovery equally with unsecured creditors who otherwise could not recover."); *In re* DLC, Ltd., 295 B.R. 593, 602 (B.A.P. 8th Cir. 2003), *aff'd sub nom*. Stalnaker v. DLC, Ltd., 376 F.3d 819 (8th Cir. 2004) (finding trustee was not barred by *res judicata* from standing in the shoes of a creditor for the purposes of avoiding the mortgage); Acequia, Inc. v. Clinton (*In re* Acequia, Inc.), 34 F.3d 800, 808 (9th Cir. 1994) (holding a trustee could invoke section 544(b) because he had an "interest in the outcome of the appeal"); *In re* AOV Indus., Inc., 792 F.2d 1140, 1156 (D.C. Cir. 1986) (stating "same treatment" is a requirement of the Bankruptcy Code); *In re* Daughtry, 221 B.R. 889, 890 (Bankr. M.D. Fla. 1997) (stating holding in *Moore v. Bay* requires an equal distribution scheme); *In re* Pepenella, 103 B.R. 299, 301 (M.D. Fla. 1988) (acknowledging when there is one joint creditor who may attach a property, that property may be reached by all unsecured creditors); Buchman v. Am. Foam Rubber Corp., 250 F. Supp. 60, 70 (S.D.N.Y. 1965) (relying on *Moore v. Bay* to distinguish the "proper application" of section 70e).

[103] *In re* Sheffield Steel Corp., 320 B.R. 423 (Bankr. N.D. Okla. 2004) ("[O]nce it is shown that on the petition date, a creditor existed who had the right to avoid a transfer under applicable state law, the trustee may recover to the extent set forth in section 550(a) for the benefit of all creditors, regardless of the amount of the claim of the 'triggering' creditor."). As noted above, under the balance sheet test, the trustee also must identify a creditor with an unpaid claim that pre-dated the transfer. *See supra* text accompanying note 56.

[104] *In re Acequia,* 34 F.3d at 807 (holding post-confirmation debtor who retained the right to pursue the debtor-in-possession's pre-confirmation claims could recover the full amount of a fraudulent transfer, even if all unsecured creditors had already been paid in full pursuant to a plan of reorganization).

[105] *In re* Monzon, 214 B.R. 38, 45 (Bankr. S.D. Fla. 1997) ("Under § 726, all creditors of equal rank share *pro rata* in any disbursement made by the trustee.").

[106] *See* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306–07 (1985) (discussing *in pari delicto* doctrine); *In re* Skyway Commc'ns Holding Corp., 389 B.R. 801, 809 (Bankr. M.D. Fla. 2008) ("The doctrine of *in pari delicto* is an equitable doctrine that states 'a plaintiff who has participated in wrongdoing

have held that the triggering creditor doctrine[107] can insulate lenders who facilitated a fraudulent transfer from affirmative defenses that would otherwise bar their claims.[108] The decision in *Verizon Communications* arose out of a 2006 transaction in which Verizon spun off its print and on-line directories business into an independent stand-alone company: Idearc, Inc. ("Idearc").[109] In exchange for receiving the assets of the business, Idearc paid Verizon almost $2.5 billion in cash as well as other consideration and became indebted to Verizon for over $7 billion.[110] Twenty-eight months after the spin-off transaction, Idearc petitioned for relief under chapter 11 of the Code, and in 2009 emerged from bankruptcy pursuant to a plan that, among other things, created a plaintiff trust and assigned to it fraudulent transfer claims against Verizon.[111] The primary beneficiaries of the trust were the bondholders who facilitated the transaction with claims totaling approximately $6 billion.[112]

Verizon moved for summary judgment on the grounds that there was no triggering creditor under section 544(b) that could have brought such an action when the bankruptcy petition was filed.[113] The court agreed with Verizon that the banks and bondholders who facilitated the transaction would have been barred from bringing fraudulent transfer claims on the date Idearc filed its bankruptcy petition because they not only knew that their loans would be used to pay Verizon, they actually required that their loans be used to pay Verizon.[114] The court held, however, if the trustee could identify any other unsecured creditor that was not barred from bringing a fraudulent transfer claim, the trustee could use the fraudulent transfer statutes "to recover the full extent of the fraudulently transferred property" for all creditors, including the banks and bondholders.[115] The trustee did identify such a creditor—a terminated employee with a judgment against Idearc for wrongful termination—and the court held that because the employee "was the

may not recover damages resulting from the wrongdoing.'") (quoting Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d 1145, 1152 (11th Cir. 2006)).

[107] Neither court addressed *Moore v. Bay* directly; they simply applied the rule that the case engendered without attributing it to the opinion.

[108] *See* Cybergenics Corp. v. Chinery, 330 F.3d 548, 568 (3d Cir. 2003) (stating creditors' abilities to obtain derivative standing is a "straightforward application of bankruptcy courts' equitable power").

[109] U.S. Bank Nat. Ass'n v. Verizon Commc'ns Inc., 817 F. Supp. 2d 934, 937 (N.D. Tex. 2011).

[110] *See id.* (noting as part of the transaction Idearc (1) issued Verizon over 145,000, 000 shares of its common stock; (2) furnished Verizon with two unsecured notes totaling $2.85 billion; (3) transferred nearly $2.5 billion in cash to VFS, Verizon's wholly owned subsidiary; and (4) became indebted to Verizon for $4.3 billion pursuant to a November 16, 2006 credit agreement).

[111] *See id*. at 938 (providing plan alleviated approximately $6 billion of Idearc's debt and appraised the reorganized company at approximately $4 billion).

[112] *See id*.

[113] *See* U.S. Bank Nat'l Ass'n v. Verizon Commc'ns Inc., 479 B.R. 405, 408, 410 (N.D. Tex. 2012) (stating Verizon and VFS observed that Idearc's banks and bondholders made loans to Idearc for the explicit objective of financing Idearc's procurement of Verizon's yellow pages business, and further, that the spin-off transaction required that these loans be utilized to pay for the yellow pages business).

[114] *See id*. at 411.

[115] *See id*. at 412.

requisite 'triggering' creditor, the plaintiff, standing in Idearc's shoes, can bring its fraudulent transfer claims."[116]

The court in *In re Refco*[117] reached a conclusion similar to the conclusion of the court in *Verizon Communications*.[118] This opinion emerged from one of the many lawsuits that arose out of the collapse of Refco Securities.[119] In the transaction at issue, Suffolk LLC had transferred funds to the bank defendants to purchase the stock of PlusFunds Group, Inc.[120] Suffolk later filed a petition for bankruptcy under chapter 7 of the Code, and Suffolk's trustee sought to recover the transfer primarily on behalf of Refco, which "was heavily involved in structuring the transaction for the purchase of PlusFunds shares."[121] The banks moved to dismiss the complaint on the grounds, among others, that the trustee had not identified a legitimate triggering creditor.[122] The only triggering creditor identified in the complaint was Refco, which the court held was "not a legitimate creditor because it was an active party to the fraud alleged in the complaint."[123] The court, however, granted the trustee leave to amend the complaint to set forth factual assertions and provide an explanation of why there was a legitimate triggering creditor.[124] The court concluded that if the trustee were able to establish the existence of a triggering creditor, "the trustee may seek to avoid a fraudulent transfer 'not only for the benefit of that creditor, but also for the benefit of all of the unsecured creditors of the estate,'" including Refco.[125]

D. Cases Holding That the Triggering Creditor Doctrine Will Not Bar Affirmative Defenses Against a Non-Triggering Creditor Even If There Is Another Creditor in Existence Not Subject to Affirmative Defenses

In contrast to the opinions in *Verizon Communications* and *Miller*, the courts in *Yellowstone*[126] and *Duke Energy*[127] held that a creditor who facilitated a fraudulent transfer could not use fraudulent transfer law to recover the proceeds of the transfer even if the trustee is able to identify a legitimate triggering creditor who did not participate in the transaction.[128]

---

[116] *See id*. at 412–13.
[117] *See In re* Refco, Inc. Sec. Litig., No. 07-MDL-1902 GEL, 2009 WL 7242548, at *9–10 (S.D.N.Y. Nov. 13, 2009).
[118] *See U.S. Bank Nat'l Ass'n*, 479 B.R. at 413.
[119] *See In re Refco, Inc. Sec. Litig.*, 2009 WL 7242548, at *1.
[120] *Id.*
[121] *Id*. at *11.
[122] *Id.* at *8.
[123] *Id*. at *10.
[124] *Id*. at *12.
[125] *Id*. at *9.
[126] *Yellowstone I*, 436 B.R. at 677–78.
[127] *Crescent Res. Litig. Trust*, 500 B.R. at 482–83.
[128] *Yellowstone I*, 436 B.R. at 675; *Crescent Res. Litig. Trust*, 500 B.R. at 482.

The *Yellowstone* decisions arose out of a loan arranged by Credit Suisse to a resort in Montana, the Yellowstone Club.[129] The Yellowstone Club filed a bankruptcy petition, and in July 2009, a trust was created to bring a fraudulent transfer claim against the Yellowstone Club's principal, Timothy Blixseth, to recover loan proceeds distributed to him.[130] The court ultimately found in favor of the trustee on the fraudulent transfer claims.[131] The court also held, however, that the trust could not collect the judgment on behalf of Credit Suisse or the other pre-petition lenders based on the affirmative defense of *in pari delicto*.[132] The court found that the pre-petition lenders had performed contemporaneous due diligence and had information available to them indicating the Yellowstone Club loan carried risk, that the loan agreement plainly disclosed that Blixseth could take and use the loan proceeds, and that the lenders knew that the loan was nonrecourse.[133] The court did not explain, however, why the assertion of affirmative defenses against Credit Suisse was not barred by the triggering creditor doctrine.

In *Duke Energy*, the District Court for the Western District of Texas reached a conclusion similar to that of the *Yellowstone* court but through a different mechanism.[134] Duke Energy owned a company—Crescent Resources—that was in the business of developing real estate and selling it to homebuilders.[135] In 2006, Duke Energy, Crescent Resources, and several related entities entered into a transaction through which Crescent Resources borrowed $1.225 billion from a syndicate of lenders secured by the assets of Crescent Resources and transferred $1.187 billion to Duke Energy.[136] In June 2009, after the collapse of the real estate market, Crescent Holdings, Crescent Resources, and various subsidiaries filed for bankruptcy.[137] As part of Crescent Resources' bankruptcy plan, the lenders received the real estate of Crescent Resources, which secured their loan, but had an unsecured deficiency claim of approximately $961 million.[138] The plan released the lenders from any liability in connection with Crescent Resources' bankruptcy and authorized the formation of a litigation trust to pursue fraudulent transfer claims against Duke Energy to recover the loan proceeds for the benefit of the lenders and other unsecured creditors.[139]

---

[129] *See Yellowstone I*, 436 B.R. at 675–77; *In re* Yellowstone Mountain Club, LLC, No. 08-61570-11, 2010 WL 3504210, at *5–7 (Bankr. D. Mont. 2010) [hereinafter *Yellowstone II*].
[130] *Yellowstone I*, 436 B.R. at 655.
[131] *Id.* at 660, 667–68.
[132] *Id.* at 679.
[133] *Id*. at 678.
[134] Crescent Res. Litig. Trust *ex rel.* Bensimon v. Duke Energy Corp., 500 B.R. 464, 178–80 (W.D. Tex. 2013). It should be noted that the judge in that case was Judge Sam Sparks, who has a reputation as "a colorful judge with a robust sense of humor" and who once compared bickering lawyers in his court to kindergarteners. David Lat, *Judge Sam Sparks Does It Again*, ABOVE THE LAW (May 1, 2007, 10:28 AM), http://abovethelaw.com/2007/05/judge-sam-sparks-does-it-again/.
[135] *Crescent Res. Litig. Trust*, 500 B.R. at 467.
[136] *Id*. at 468.
[137] *Id*. at 469.
[138] *Id*.
[139] *Id.*

The parties filed competing motions for summary judgment on the fraudulent transfer claims, and one of the arguments made by Duke Energy was that the trust could not recover the distribution of the term loan proceeds to Duke Energy on behalf of the lenders because if the lenders brought these claims on their own behalf, they would be barred by state-law defenses including *in pari delicto*.[140] The court agreed, holding that the trust could not stand in the shoes of the lenders to recover the distribution of the loan proceeds to Duke Energy.[141] The court heavily criticized the *Moore v. Bay* doctrine, but believed that it was bound to follow it and that the trust therefore could stand in the shoes of other unsecured creditors under section 544(b) and avoid the transfer on behalf of all the unsecured creditors, including the lenders.[142] But it found a different statutory mechanism to avoid what it perceived to be an inequitable result: section 550(a) of the Code.[143]

Section 550(a) provides, in relevant part, that "except as otherwise provided in this section, to the extent that a transfer is avoided under section 544 . . . of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property . . . ."[144] The court held that the power to avoid the transaction under section 544(b) did not mean that the trustee could recover the value of such property if it was not "for the benefit of the estate."[145] The court found that the lenders had received the benefit of their bargain by receiving full ownership of Crescent Holdings as well as several hundred million dollars in payments on the loan from Crescent Resources between the execution of the loan and the bankruptcy filing[146] and that allowing the trustee to recover the transfer for the benefit of the lenders would not be equitable and therefore would not benefit the estate.[147] It therefore held that it would limit any recovery pursuant to sections 544(b)(1) and 550(a) to the amount necessary to satisfy the claims of the unsecured creditors other than the lenders.[148]

While the court recognized the *Moore v. Bay* problem, relying on section 550(a)'s "benefit of the estate" language[149] to overcome it raises its own challenges. First, section 550 limits the trustee's power to recover property but has never been interpreted to limit a creditor's right to receive property. Once a transfer has been

---

[140] *Id*. at 477.

[141] *Id*. at 480 (noting though Congress may be in the business of bailing banks out, the Court is not).

[142] *Id*. at 481 (holding Duke "loses the battle on Section 544(b)").

[143] *Id.* at 483 (holding "even if the Trust's claims were not exempted by Section 546(e)" the recovery would be limited to the amount necessary to satisfy the Class A creditors under sections 544(b)(1) and 550(a)).

[144] 11 U.S.C. § 550(a) (2012).

[145] *Crescent Res. Litig. Trust*, 500 B.R. at 481 (citing 11 U.S.C. § 550(a)).

[146] *See id*. at 482.

[147] *Id*. at 482 ("Having made off like bandits, the banks will no doubt continue to engage in reckless lending behavior, satisfied the courts will intervene to save them from their bad bets in the future.").

[148] *Id*. at 483 (citing N.C. GEN. STAT. § 39-23.7(a)(1)).

[149] *Id*. at 481 ("'[T]o the extent that a transfer is avoided under section 544 . . . of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property.'") (citing 11 U.S.C. § 550(a)).

avoided, the transferred property becomes property of the estate, available for distribution to creditors. Section 550 simply provides the authority for the trustee to recover avoided transfer or its value if the transfer is not physically in the estate's possession.[150] Under *Moore v. Bay*, once the transfer is avoided, the avoidance is for the benefit of the entire estate including creditors who could not have avoided the conveyance themselves under state law.[151]

The purpose of the "benefit of the estate" language is to ensure that recovery will, in fact, have some economic benefit to the estate.[152] Thus, if the avoided transfer did not deplete the estate and would simply be returned to the creditor from whom it was recovered, the recovery would not benefit the estate.[153] And while the court in *Duke Energy* correctly noted that the phrase "benefit of the estate language" has been construed broadly,[154] the breadth of that construction has been cited to permit recovery by the trustee if there is any tangential benefit to the estate such as payment of administrative fees,[155] not to bar recovery by an individual creditor if that creditor should not receive a portion of the recovered assets.[156]

---

[150] S*ee In re* C.W. Mining Co., 477 B.R. 176, 184 (B.A.P. 10th Cir. 2012), *aff'd*, 749 F.3d 895 (10th Cir. 2014) ("While § 549 allows a trustee to avoid a post-petition transfer, § 550 contains the statutory mechanism to recover the asset transferred or, as in this case, its value.").

[151] *See Crescent Res. Litig. Trust*, 500 B.R. at 481 (quoting Cadle Co. v. Mims (*In re* Moore), 608 F.3d 253, 260 (5th Cir. 2010)).

[152] *See* Wellman v. Wellman (*In re* Wellman), 933 F.2d 215, 218 (4th Cir. 1991), *cert. denied*, 502 U.S. 925 (1991) (dismissing action that only benefited the debtor).

[153] *See In re C.W. Mining Co.*, 477 B.R. at 185 ("[W]here . . . there is was no actual depletion of the bankruptcy estate by the admittedly unauthorized post-petition Transfer, avoidance and recovery does not fulfill the purpose of § 549(a)."); Decker v. Tramiel (*In re* JTS Corp.), 617 F.3d 1102, 1114 (9th Cir. 2010) (determining trustee not entitled to further recovery under section 550(a) when estate was in the position that it would have been in had the transfer not occurred).

[154] *Crescent Res. Litig. Trust*, 500 B.R. at 481.

[155] *See, e.g.*, Acequia, Inc. v. Clinton (*In re* Acequia), 34 F.3d 800, 811 (9th Cir. 1994) (holding trustee could recover a fraudulent conveyance, despite all creditors being paid in full, because recovering the conveyance would help the estate secure its long term obligations and would reimburse the estate for its expenses in pursuing the litigation); *see also* MC Asset Recovery LLC v. Commerzbank A.G. (*In re* Mirant Corp.), 675 F.3d 530 (5th Cir. 2012) (holding an unsecured creditor may avoid a fraudulent transfer made on the eve of the bankruptcy petition, for the benefit of the estate); *In re* Furr's Supermarkets, Inc., 373 B.R. 691, 699 (B.A.P. 10th Cir. 2007) (holding a fraudulent conveyance recovery benefited the estate when the recovery went to administrative and secured creditors); Stalnaker v. DLC, Ltd., 376 F.3d 819, 823–24 (8th Cir. 2004) ("The trustee's recovery is not limited to the value of the claim of the unsecured creditor(s) he identifies."); *In re C.W. Mining Co.*, 477 B.R. at 185 ("The proper focus of recovery under § 550(a) is not on what the transferee grained but rather on what the bankruptcy estate lost as a result of the transfer."); *In re* Tronox Inc., 464 B.R. 606, 615–16 (Bankr. S.D.N.Y. 2012) ("The determination of whether a recovery would benefit the estate is done on a case-by-case basis."); *In re* Calpine Corp., 377 B.R. 808, 814–15 (Bankr. S.D.N.Y. 2007) (holding fraudulent conveyance recovery would benefit the estate by supplementing the reorganized debtor's value); *In re* Trans World Airlines, Inc., 163 B.R. 964, 972 (Bankr. D. Del. 1994) (holding fraudulent conveyance recovery benefited the estate by increasing the value of the unsecured creditors' equity interest in the reorganized debtor); *In re* Funding Sys. Mgmt. Corp., 111 B.R. 500, 523–24 (Bankr. W.D. Pa. 1990) (holding fraudulent conveyance recovery benefited the estate by increasing the reorganized debtor's asset base, making it easier to pay off creditors).

[156] *See* Harstad v. First Am. Bank (*In re* Harstad), 39 F.3d 898, 905 (8th Cir. 1994) (holding recovery of alleged preference would not benefit the estate where there was no proof that recovery would increase amount paid to creditors).

IV. THE USE OF THE TRIGGERING CREDITOR DOCTRINE TO VOID TRANSFERS THAT COULD NOT BE AVOIDED UNDER STATE LAW

A. *Introduction*

The second recent development in the triggering creditor doctrine is the use by the trustee of the United States government as the triggering creditor to take advantage of "applicable law" that applies only to claims by the government, often to obtain the benefit of sovereign immunity and longer limitations periods. Section 544(b)(1) provides, in relevant part, that "the trustee may 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 . . . ."[157] The phrase "applicable law" includes federal law as well as state law.[158] The question is whether the trustee can select the federal government as the triggering creditor so that the "applicable law" is non-bankruptcy federal law specific to the United States government which, in some cases, may not bind the government to any statute of limitations at all.

B. *The Federal Debt Collection Practices Act as "Applicable Law"*

In cases in which the unsecured creditor is the federal government bringing a claim under the Federal Debt Collection Practices Act ("FDCPA"), the question is simply whether the FDCPA is "applicable law" such that the trustee can stand in the shoes of the government and void the transfer under the FDCPA, just as he or she would stand in the shoes of any other creditor under the UFTA or UFCA. That is because the fraudulent transfer provisions of the FDCPA are general provisions for the recovery of fraudulent transfers by the United States government. The FDCPA was enacted to establish "a comprehensive statutory framework for the collection of debts owed to the United States government."[159] Subchapter D, codified at sections 3301 through 3308 of title 28, governs "fraudulent transfers involving debts" owed to the United States government. So if the triggering creditor is the United States government under the FDCPA, the "applicable law" is the FDCPA, and the trustee can potentially cloak himself or herself with the mantle of sovereign immunity which may shield the trustee from a limitations defense.

---

[157] 11 U.S.C. § 544(b)(1) (2012).

[158] *See* Patterson v. Shumate, 504 U.S. 753, 758 (1992) (construing "applicable non-bankruptcy law" in 11 U.S.C. § 541(c)(2) to apply to both federal law and state law); *In re* Velikopoljski, 54 B.R. 534, 541 (Bankr. S.D. Fla. 1985) (holding "applicable law" under section 544(b) was federal law for purposes of avoiding a mortgage on vessel of United States); 5 COLLIER ON BANKRUPTCY, ¶ 544.02, at 544-6 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2015) ("Most of the time applicable nonbankruptcy law is state law, but can also be federal.").

[159] H.R. REP. NO. 101-736, at 32 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6630, 6631.

In *MC Asset Recovery LLC v. Commerzbank A.G.* (*In re Mirant*),[160] the Fifth Circuit Court of Appeals held that the FDCPA was not "applicable law" under section 544(b).[161] Mirant Corporation ("Mirant") was an energy company located in Georgia.[162] Mirant acquired nine European power islands from General Electric through a subsidiary, which purchased the equipment through a loan that was guaranteed by Mirant.[163] The power island deal fell through, Mirant made payments pursuant to the guaranty, and subsequently sought bankruptcy protection.[164] Mirant sued the lenders to recover the guaranty payments as a fraudulent transfer under section 544(b) and sought to stand in the shoes of the United States government under the FDCPA, because Georgia's fraudulent transfer law, which may have governed the rights of other creditors, did not treat guarantees as transfers and therefore did not permit the trustee to void the transfer.[165] The Fifth Circuit rejected that argument. The court noted that section 3003(c) of the FDCPA states that the fraudulent transfer provisions of the FDCPA "shall not be used to *supersede or modify* the operation of—(1) title 11,"[166] and it held that "treating the FDCPA as applicable law under 544(b) would impermissibly modify the operation of Title 11."[167] The Fifth Circuit found additional support for its view in the statement of a committee chairman to the effect "that the Bankruptcy Code should be read as if the FDCPA did not exist."[168]

The reasoning by the Fifth Circuit seems circular. As noted above, "applicable law" includes federal law, and the only thing that the trustee was attempting to do was to use the FDCPA as the "applicable law" under section 544(b) to avoid the claims on behalf of all creditors, as the triggering creditor doctrine permits. This was the conclusion reached by the subsequent decision in *Tronox Inc. v. Kerr-McGee Corp.* (*In re Tronox Inc.*).[169] The *Tronox* decision arose out of Kerr–McGee Corporation's ("Kerr-McGee") attempt to spin off its chemical business and concomitant environmental and tort liabilities from its more profitable oil and gas business.[170] The chemical business was spun off to Tronox Inc. ("Tronox"), and Tronox made transfers to Kerr-McGee beginning in 2002 as payment for those assets.[171] Tronox sought bankruptcy protection in January 2009, and Tronox, as

---

[160] MC Asset Recovery LLC v. Commerzbank A.G. (*In re* Mirant Corp.), 675 F.3d 530 (5th Cir. 2012).
[161] *Id*. at 535 (disagreeing with MCR's assertion that FDCPA is applicable law under 11 U.S.C § 544(b)).
[162] *Id*. at 532.
[163] *Id.*
[164] *Id*.
[165] *Id*. at 535, 537.
[166] *Id*. at 535 (quoting 28 U.S.C. § 3003(c) (2012)).
[167] *Id*. Ultimately, the Fifth Circuit held that New York law, rather than Georgia law applied, and that the transfers were potentially voidable under New York law. *Id*. at 537.
[168] *Id.* at 535–36 (citing 136 CONG. REC. H13288 (daily ed. Oct. 27, 1990) (statement of Rep. Jack Brooks)).
[169] *In re* Tronox Inc., 503 B.R. 239, 273–74 (Bankr. S.D.N.Y. 2013).
[170] *Id*. at 248, 251.
[171] *Id*. at 252.

debtor-in-possession, sought to recover the substantial amounts that Tronox had paid to Kerr-McGee as a fraudulent transfer.[172]

The law of Oklahoma, which the parties agreed was the applicable state law for purposes of section 544(b), provides a four-year limitations period for claims of actual fraudulent conveyance and constructive fraudulent conveyance,[173] which would not have permitted the trustee to avoid transfers earlier than January 2005. The United States, however, was a significant unsecured creditor based on Tronox's environmental liabilities and had brought a claim against Kerr-McGee under the FDCPA,[174] which permits the government to avoid a fraudulent transfer within six years after the transfer was made or the obligation was incurred.[175] Relying on the *Mirant* decision, Kerr-McGee argued that FDCPA could not be "applicable law" under section 544(b).[176] The bankruptcy court rejected that argument, agreeing, instead, with a number of earlier decisions which held that "the FDCPA can be 'applicable law' for purposes of § 544(b), thereby affording the trustee use of the FDCPA statute of limitations."[177] The court held that allowing the use of the FDCPA to avoid transfers was not modifying or superseding the Code, but was consistent with the provisions of the Code, and it believed that the Fifth Circuit was placing too much weight on the committee chairman's statement.[178]

C. A Combination of Federal Law and State Law as "Applicable Law"

As discussed above, if the trustee is simply standing in the shoes of the United States government under the FDCPA, it is borrowing that entire body of law, including the limitations period, to avoid the transfer. A different issue is presented when the trustee seeks to use the limitations period that applies only to the federal government to bring claims under state fraudulent transfer law that would otherwise be barred by the limitations period of that state law. The typical creditor in this situation is the IRS.

Under section 6901(a)(1)(A) of the IRC, the IRS can collect tax liability from a transferee of the taxpayer's property under state fraudulent transfer laws.[179] The

---

[172] *Id*. at 247–48.

[173] *Id.* at 266–67 (Bankr. S.D.N.Y. Dec. 12, 2013) (rationalizing transactions could be collapsed and did not have to be viewed in isolation in assessing whether statute of limitations had already run prior to commencement of debtors' bankruptcy cases).

[174] *Id*. at 272.

[175] 28 U.S.C. § 3306(b)(1) (2012).

[176] *In re Tronox*, 503 B.R at 273. *See also In re* Pfister, No. ADV 10-80162-HB, 2012 WL 1144540, at *5 (Bankr. D.S.C. Apr. 4, 2012), *subsequently aff'd*, 749 F.3d 294 (4th Cir. 2014) (holding transfers were avoidable pursuant to § 544 (b)(1) and the FDCPA); *In re* Porter, No. 06-10119, 2009 WL 902662, at *20–21 (Bankr. D.S.D. Mar. 13, 2009) (holding trustee could step into the shoes of the Small Business Administration and assert fraudulent conveyance claims under the FDCPA and its six-year statute of limitations); *In re* Gurley, 222 B.R. 124, 132 (Bankr. W.D. Tenn. 1998), *as amended on reh'g* (June 15, 1998) (applying FDCPA and its "reach back period").

[177] *In re* Tronox, 503 B.R at 273.

[178] *Id*. at 274–75.

[179] 26 U.S.C. § 6901(a)(1)(A) (2012).

existence and extent of liability of the transferee of the property and the substantive rights of the IRS are determined by state law.[180] Section 6901 simply establishes the procedure that the IRS uses to collect the taxes.[181]

As noted above, the UFTA contains a four-year statute of limitations.[182] If the trustee is able to stand in the shoes of the IRS, however, the limitations period can be much longer. The statute of limitations for the IRS has two components: assessment and collection. The IRS generally has three years after the return was filed to assess the taxes owed against the taxpayer.[183] Section 6501 of the IRC, however, contains a number of exceptions that could extend this period. Indeed, if a false return was filed, or a return was filed as part of a willful attempt to evade taxes, or if no return was filed, the IRS can assess the taxes at any time; that is, there is no limitations period.[184] The IRS has one year after the expiration of the period of limitation for assessment against the transferor to assess liability against an initial transferee[185] and an additional period of time to assess liability against a transferee of a transferee.[186] The IRS is subject to a ten-year statute of limitations for collection, measured from the time the tax is assessed.[187]

In *Wagner v. Ultima Homes, Inc.* (*In re Vaughan Co.*),[188] a bankruptcy court in New Mexico held that the trustee could not circumvent New Mexico's four-year statute of limitations on fraudulent transfer claims by relying on the IRS as the triggering creditor.[189] The *Vaughan* case arose out of a Ponzi scheme operated by Douglas Vaughan through his company, Vaughan Company Realtors ("VCR").[190] The Ponzi scheme eventually collapsed, and VCR filed for bankruptcy on April 29, 2010.[191] One of the transfers that the chapter 11 trustee sought to avoid was a transfer by VCR to Ultimate Homes, Inc. ("Ultima") in 2004 or 2005 of $501,849.33 for the construction of Vaughan's personal residence.[192] Because New Mexico's version of the UFTA only allows a trustee to void fraudulent transfers that occurred within four years before the commencement of the bankruptcy case, and because the transfers to Ultima occurred more than four years before the commencement of the bankruptcy case, the trustee sought to use the IRS as the

[180] *See* Comm'r of Internal Revenue v. Stern, 357 U.S. 39, 47 (1958) (emphasizing in diversity cases, federal courts must apply state decisional law in defining state-created rights, obligations and liabilities).

[181] *See* Berliant v. C.I.R., 729 F.2d 496, 499 (7th Cir. 1984) (explaining section 6901 "merely establishes a procedure for tax collection," not liability of transferees).

[182] *E.g.*, CAL. CIV. CODE § 3439.09 (1986), *amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161) (codifying California's four year statute of limitations).

[183] *See* 26 U.S.C. § 6501(a) (2012).

[184] *See id.* § 6501(c).

[185] *See id.* § 6901(c)(1).

[186] *See id.* § 6901(c)(2).

[187] *See id.* § 6502(a)(1).

[188] 498 B.R. 297, 297 (Bankr. D.N.M. 2013).

[189] *Id.* at 303–06.

[190] *Id.* at 300–01.

[191] *Id.* at 301.

[192] *Id.*

triggering creditor under section 544(b) to obtain the benefit of the ten-year statute of limitations for collection of taxes.[193]

Although the court in *Vaughan* acknowledged that a number of courts had allowed a bankruptcy trustee to use the ten-year lookback period,[194] it reached a different outcome. The court held that the longer statute of limitations granted to the IRS was based on a doctrine known as *nullum tempus occurrit regi*—that is, "no time runs against the king."[195] And while the court recognized that "the Trustee may stand in the shoes of any unsecured creditor to set aside transfers to third parties," it did "not necessarily follow . . . that a bankruptcy trustee standing in the shoes of the IRS [was] immunized from state statutes of limitation."[196]

The court reasoned that the power to avoid state statutes of limitation was based on the sovereign power of the United States and that it did not believe that:

> Congress, by enacting Section 544(b), intended to vest sovereign powers in a bankruptcy trustee and thereby immunize her from the strictures of state law in the pursuit of her private interests. If the federal government were to delegate the exercise of its sovereign powers in such circumstances, it would pervert the purpose of *nullum tempus*, which is to immunize the *federal government* from certain state laws.[197]

The court went on to conclude that even if the trustee were permitted to use the IRS as the triggering creditor, the trustee still could not take advantage of the longer limitations period.[198] If the United States is a party to the lawsuit but is seeking to vindicate private rights, rather than public rights, the United States is bound by the state's statute of limitations.[199] The court held that in seeking to invoke the ten-year statute of limitations applicable to the IRS, the trustee was pursuing a private right of action for VCR's creditors generally, not to pursue a public right.[200] "Because the IRS is only permitted to use a ten-year look back period in order to perform a government function, the Trustee is likewise limited under section 544(b)."[201]

---

[193] *Id*. at 303.

[194] *Id*.

[195] *Id*. at 304.

[196] *Id*.

[197] *Id*. at 304–05.

[198] *Id.* at 305 ("[N]ot even the sovereign is immune from state statutes of limitation when an action, although brought in the name of the United States, involves no public rights or interests.").

[199] *See* United States v. Beebe, 127 U.S. 338, 347 (1888) (United States seeking to set aside a patent for the benefit of rightful owners to obtain a patent for land was acting as a conduit for the individuals and was bound by state limitations period); State v. Halter, 47 N.E. 665, 666 (Ind. 1897) (holding state statute of limitations applies if United States is seeking to enforce a private right); Shaw v. Bush, 61 S.W.2d 526, 529 (Tex. Civ. App. 1933) ("[W]here the suit, although brought in the name of the government, is for the use and benefit of [the insolvent bank's creditors], the statutes of limitation apply in the same manner as though the suit had been brought in the name of the real parties in interest.").

[200] *In re Vaughan*, 498 B.R. at 305.

[201] *Id*.

Finally, the court held that allowing the trustee to use the ten-year statute of limitations applicable to claims by the IRS would dramatically change the law, because, as the court reasoned, "The IRS holds an unsecured claim in a substantial portion of bankruptcy cases. If a bankruptcy trustee or debtor in possession could recover transfers made within ten years before the petition date, it would eviscerate the UFTA's four-year look back period in most bankruptcy cases."[202]

The opinion in *Vaughan* is at odds with those of other courts.[203] In an earlier case, a bankruptcy court in the District of Columbia considered whether the trustee could rely on claims by the Department of Health and Human Services ("HHS") and by the IRS to take advantage of the longer limitations period and concluded that it could.[204] The court rejected the sovereign immunity argument on which the *Vaughan* court relied, holding that the trustee was stepping into the shoes of the governmental creditor that was seeking to enforce public rights: in the case of the IRS, to collect taxes, and in the case of the HHS, the right to recover funds erroneously paid to a hospital.[205]

In *Ebner v. Kaiser* (*In re Kaiser*),[206] a bankruptcy court in the Northern District of Illinois also held that the IRS could serve as the triggering creditor.[207] That opinion followed the opinion in *Vaughan* and addressed it directly. The court in *Kaiser* held that the language of section 544(b) was clear: "Section 544(b) refers to 'applicable law' and does not limit applicable law to state fraudulent transfer laws."[208] It held that because the plain language of the statute was clear, the court would not "place policy concerns above the plain language of the statute."[209] It also disagreed that *Vaughan*'s concern that allowing the trustee to rely on the IRS as the triggering creditor would result in a flood of similar claims that would eviscerate the limitations period in state law, noting that "the cases addressing this are few and far between."[210]

---

[202] *Id*.

[203] *See, e.g.*, *In re* The Heritage Org., L.L.C., 413 B.R. 438, 460 (Bankr. N.D. Tex. 2009) ("[T]he IRS is a triggering creditor with respect to each of the Transfers."); *In re* Emergency Monitoring Tech., Inc., 347 B.R. 17, 19 (Bankr. W.D. Pa. 2006) (holding trustee could rely on the longer limitations period applicable to the IRS "by way of 11 U.S.C. § 544(b)"); *In re* Porras, 312 B.R. 81, 96–97 (Bankr. W.D. Tex. 2004) (holding IRS could be triggering creditor and that trustee could rely on longer limitations period); *In re* Polichuk, No. 08-10783ELF, 2010 WL 4878789, at *4 n.9 (Bankr. E.D. Pa. Nov. 23, 2010) (determining "the Trustee may step into the shoes of the IRS" and may take advantage of the longer lookback period).

[204] *See In re* Greater Se. Cmty. Hosp. Corp. I, 365 B.R. 293, 294–305 (Bankr. D.C. 2006) ("The unsecured creditor's ability to trump the applicable state stature of limitations might derive from its sovereign immunity, but the estate's representative's ability to override that same limitation derives from §544(b).").

[205] *See id*. at 304–05 (finding no "great injustice" allowing HHS or IRS to bring a claim without a set statute of limitations).

[206] *In re* Kaiser, 525 B.R. 697, 697 (Bankr. N.D. Ill. 2014).

[207] *Id.* at 709 (holding 11 U.S.C. § 544(b)(1) allows Trustees to use defenses "applicable to relevant (unsecured) creditors").

[208] *Id*. at 714.

[209] *Id*. at 711–12.

[210] *Id*. at 712.

V. REEXAMINING THE BASIS FOR EXPANDING THE TRIGGERING CREDITOR DOCTRINE

A common thread running through the debate over the expansion of the powers of the trustee through the triggering creditor doctrine is the assumption that, under that doctrine, the trustee becomes the triggering creditor for all purposes. For example, courts have assumed that if the trustee stands in the shoes of a creditor that did not participate in the transfer, the trustee is imbued with all the rights of that creditor, including the right to recover the value of the transfer for the benefit of co-participants. And courts have assumed that if the trustee stands in the shoes of the IRS, the trustee obtains all the rights of the IRS, including the right to recover the value of the transfer for the benefit of non-governmental entities.

Courts that have struggled with expanding the powers of the trustee have supported their opinions with the view that it would be contrary to sound policy to invest the trustee with these greater powers. Those policy concerns are most pronounced in the situation in which the beneficiary of the fraudulent conveyance action is a co-participant in the transfer. It is easy to understand why courts struggle with permitting a party that knowingly participated in and even facilitated an avoided transaction from recovering the proceeds of that transaction under circumstances that would preclude such party's recovery under common law, particularly if the co-participant is recovering money notwithstanding a contractual commitment from the transferee that it would not do so. In those circumstances, a creditor is better off financially if the transaction it facilitated is fraudulent than if it is not.[211]

The policy concerns in extending the statute of limitations will vary based on the circumstances. The beneficiaries of the transfers in *Kaiser*, for example, were relatives of the debtor[212] while the beneficiary of the transfer in *Vaughan* was a homebuilder who constructed the house but received the money from the owner's company rather than the owner himself.[213] And because the IRS cannot take advantage of the ten-year lookback period in all circumstances,[214] whether a transferee like the homebuilder can be compelled to disgorge a decade-old transfer will depend not only on whether the debtor owed money to the IRS but also on whether the debtor owed money to the IRS under the peculiar circumstances that would permit the IRS and trustee to rely on a ten-year lookback period.

One question that courts confronting these problems should be asking is whether the premise that the trustee receives all the rights of the triggering creditor

---

[211] *See, e.g*, United States Bank Nat'l Ass'n v. Verizon Commc'ns Inc., 479 B.R. 405, 414 (N.D. Tex. 2012) (characterizing defendants' argument that the outcome was a "mockery of justice" as "appealing," but holding "the court cannot ignore clearly established legal rules of general applicability simply to achieve or avoid a particular result").

[212] *In re Kaiser*, 525 B.R. at 702.

[213] *In re* Vaughan Co., 498 B.R. 297, 301 (Bankr. D.N.M. 2013).

[214] *See id.* at 305 (holding IRS is only permitted to use a ten-year look back period in order to perform a government function).

under the *Moore v. Bay* doctrine is correct. *Moore v. Bay* simply held that a trustee could stand in the shoes of a creditor who could avoid a lien and avoid that lien for the benefit of the entire estate.[215] Later courts have extended that doctrine to allow a creditor with a small claim to avoid a much larger transfer for the benefit of the estate. But courts often must decide how far beyond its particular facts the higher court precedent extends, and they routinely refuse to extend the reach of precedential decisions if doing so would lead to the wrong result.[216] And one issue is whether a lower court should consciously construe doctrine emanating from an 84-year-old Supreme Court decision in a manner that the Court did not consciously intend.[217]

CONCLUSION

In the context of corporate reorganizations, fraudulent transfer law can create significant liability risks for recipients of transfers if the transferor ultimately winds up becoming insolvent. One risk that transferees face is the risk that the lenders who facilitated the transaction could reclaim the loan proceeds in bankruptcy court when they would be prohibited from doing so outside of bankruptcy. Another risk is that a transfer that was assumed to be outside the window for recovery could be brought back into that window following a bankruptcy filing. Courts will no doubt continue to struggle with whether and how the triggering creditor doctrine of *Moore v. Bay* should be applied in these circumstances, and we are likely to see further disparate results based on the perceived equities or inequities of expanding that doctrine in specific circumstances.

---

[215] Moore v. Bay (*In re* Estate of Sassard & Kimball, Inc.), 284 U.S. 4, 5 (1931).

[216] *See* United States v. Gomez, 725 F.3d 1121, 1128 (9th Cir. 2013), *cert. denied*, 134 S. Ct. 1908 (2014) (refusing to deliver a ruling that would contradict Supreme Court precedent); United States v. Fulford, 662 F.3d 1174, 1178–79 (11th Cir. 2011); Edwards v. Prime, Inc., 602 F.3d 1276, 1298 (11th Cir. 2010) ("[R]egardless of what a court says in its opinion, the decision can hold nothing beyond the facts of that case."); Trenkler v. United States, 536 F.3d 85, 92 (1st Cir. 2008) (refusing to bound inferior courts to a case without precedential force beyond it specific facts); El Paso Co. v. United States, 694 F.2d 703, 711 (Fed. Cir. 1982) (stating present facts hold more value than dicta mentioned previously); Mut. Ben. Health & Accident Ass'n v. Cohen, 194 F.2d 232, 241 (8th Cir. 1952). *See also* Hubbard v. United States, 514 U.S. 695, 713 (1995) (accepting lower court holdings refusing to criminalize false statements made in judicial proceedings despite broad contrary language in prior Supreme Court decision of Supreme Court). *But see* United States v. Oakar, 111 F. 3d 146, 156 (D.C. Cir. 1997) (holding section 1001 was not intended to extend to the legislative branch).

[217] *Cf.* Massachusetts v. United States, 333 U.S. 611, 639–40 (1948) (Jackson, J., dissenting) ("Under these circumstances, except for any personal humiliation involved in admitting that I do not always understand the opinions of this Court, I see no reason why I should be consciously wrong today because I was unconsciously wrong yesterday.").