AMERICAN BANKRUPTCY INSTITUTE

Northeast Bankruptcy Conference and Consumer Forum

Business Track

Avoidance Actions

Yvette R. Austin
Compass Lexecon | New York

Mark G. DeGiacomo
Murtha Cullina LLP | Boston

Edmond J. Ford
Ford, McDonald & Borden, P.A. | Portsmouth, N.H.

Hon. Elizabeth D. Katz
U.S. Bankruptcy Court (D. Mass.) | Springfield

Kathleen M. LaManna
Shipman & Goodwin LLP | Hartford, Conn.

CONCURRENT SESSION

2023

Preference Actions – Due Diligence Obligation

- Elements to be establish by plaintiff: Section 547(b)
- Defenses available to defendant: Section 547(c)

The "Problem"

- Everyone gets a demand letter or is served with an adversary complaint
  - Burden on defendant to prove defenses
  - Plaintiff will settle for set percentage
  - Defendant settles to avoid costs

The "Solution"

- Courts started pushing back
  - Rule 9011
  - Plaintiff must consider defenses
    - New value
    - Ordinary course
- Different rules of different judges
- Business community demands action

Due Diligence Obligation

- The Small Business Reorganization Act of 2019 amended Section 547(b) to impose a new due diligence requirement on the plaintiff prior to bringing a preference claim.
- "[T]he trustee may, based on ***reasonable due diligence*** in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c), avoid any transfer of an interest of the debtor in property . . . ."

Element v. Affirmative Defense

- *Husted v. Taggart (In re ECS Refining, Inc.)*, 625 B.R. 425 (Bankr. E.D. Cal. 2020): "This court believes that this condition precedent, i.e., due diligence and consideration of affirmative defenses, is an element of the trustee's prima facie case."

- *Pinktoe Liquidation Trust v. Charlotte Olympia Dellal (In re Pinktoe Tarantula Limited)*, 2023 WL 2960894, (Bankr. D. Del. Apr. 14, 2023): "Three subsections of § 547 lead me to conclude that the due diligence requirement is an element of a preference claim, not an affirmative defense.

    - First, subsection (b) establishes what transfers may be avoided and lists the five elements a debtor must prove to avoid a transfer as a preference.

    - Second, subsection (c) sets out the transfers that may not be avoided, thus establishing affirmative defenses.

    - Third, subsection (g) provides that the trustee/plaintiff has the burden of proving avoidability of a transfer under subsection (b) while the creditor/defendant has the burden of proving the nonavoidability of a transfer under subsection (c).

    - Because the due diligence requirement appears in subsection (b), not (c), the Court concluded that the due diligence requirement is an element of the claim, or something that must be proven by the trustee.

- Some courts have declined to rule on the issue, but find that the plaintiff sufficiently alleged that he/she conducted reasonable due diligence in bringing the claim.

Pleading Requirement

- There is no established pleading standard for the due diligence requirement, and it varies from court to court.

- For example:

    - Due diligence requirement falls outside of the *Iqbal* and *Twombly* standards, and requires only a general allegation the trustee performed due diligence. *Pinktoe Liquidation Trust v. Charlotte Olympia Dellal (In re Pinktoe Tarantula Limited)*, 2023 WL 2960894, (Bankr. D. Del. Apr. 14, 2023).

    - Allegations that the trustee reviewed the debtor's books, records, and other available information satisfied due diligence requirement. *Tese-Milner v. Lockton Cos. (In re Flywheel Sports Parent, Inc.)*, 2023 WL 2245382, at *4 (Bankr. S.D.N.Y. Feb. 27, 2023).

    - Allegations concerning the trustee's analysis of the transfers made to the defendant and whether such transfers were subject to any defense in Section 547(c), as well as concerning the trustee's demand letters "inviting an exchange of information regarding any potential defenses" stated plausible claim that trustee met the due diligence requirement. *Center City Healthcare, LLC v. McKesson Plasma & Biologics LLC (In re Center City Healthcare, LLC)*, 641 B.R. 793, 802 (Bankr. D. Del. 2022).

    - Where the Chapter 7 Trustee had been appointed for 18 months prior to the commencement of the adversary proceeding and was the custodian of the Debtor's records, notice style pleadings suggested a lack of pre-filing due diligence, and will not suffice. *Husted v. Taggart (In re ECS Refining, Inc.)*, 625 B.R. 425 (Bankr. E.D. Cal. 2020).

        - Reasonable inferences did not suggest that the Trustee considered whether the debt was antecedent, whether the transfers improved the defendant's position, or the applicability of affirmative defenses.
        - Due diligence is an objective standard, and is defined by a competent trustee practicing before the specific jurisdiction involved.
        - Motion to Dismiss granted with leave to file amended complaint to cure pleading deficiencies.

Considerations

- Does the demand letter indicate any due diligence?
  - Were documents concerning defenses provided to the plaintiff?
- Was there an invitation to provide information/documents concerning defenses?
- Does the complaint indicate due diligence?
  - How detailed?

Remedy

- File Motion to Dismiss
  - Sanctions?
  - Leave to amend?
  - Two year statute

Venue for Avoidance Actions

- 28 U.S.C. § 1409(a): Except as otherwise provided in subsections (b) and (d), a proceeding arising under title 11 or arising in or related to a case under title 11 may be commenced in the district court in which such case is pending.

- 28 U.S.C. § 1409(b): A trustee in a case under title 11 may commence a proceeding arising in or related to such case to recover . . . a debt (excluding a consumer debt) against a noninsider of less than $27,500, only in the district court for the district in which the defendant resides.

  - Enacted in 1984

  - Original threshold was $1,000.00

Decisions Affecting Venue

- *Mendelsohn v. Cent. Garden & Pet Co. (In re Petland Discounts, Inc.)*, 2021 WL 1535793 (Bankr. E.D.N.Y. Jan. 26, 2021): Preference claims ***arise under*** the Bankruptcy Code, and, therefore, are not subject to the venue exception set forth in 28 U.S.C. § 1409(b).

- *Heinrich v. Haley Tech., Inc. (In re Insys Theraputics, Inc.)*, 2021 WL 3508612 (Bankr. D. Del. June 17, 2021): Avoidance and recovery actions, including fraudulent conveyance claims under Section 548, ***arise under*** the Bankruptcy Code.

- *Richardson v. Cellco P'ship (In re Munson)*, 627 B.R. 507, 516 (Bankr. C.D. Ill. 2021): 28 U.S.C. § 1409 is unambiguous, and preference actions do not fall within the exception to the general rule that venue is proper in the district where the bankruptcy is pending.

- *Muskin, Inc. v. Strippit Inc. (In re Little Lake Indus., Inc.)*, 158 B.R. 478 (B.A.P. 9th Cir. 1993): "All proceedings arising under title 11 arise in the bankruptcy case for the purposes of § 1409(b). This resolution is consistent with the meaning of §§ 157 and 1334. Therefore, preference actions for recovery of less than $1,000 must be lodged in the district court for the district in which the defendant resides."

- *Dynaamerica Mfg., LLC v. Johnson Oil Co., LLC (In re Dynaamerica Mfg., LLC)*, 2010 WL 1930269, at *3 (Bankr. D. Del. May 10, 2020): Relying on legislative intent, the Court held that the absence of the "arising under" language in § 1409(b) was "unintentional," and that the venue provisions of § 1409(b) apply to avoidance actions.

PROBLEMS IN TIME AND AVOIDANCE

Edmond J. Ford
May 15, 2023
Ford, McDonald & Borden, P.A.
10 Pleasant Street, Suite 400
Portsmouth, NH. 03801
603-373-1600
eford@fordlaw.om

Basic time-lines everyone knows (in jargon)

Section 547 – 90 days

Section 547 – insider one year

Section 548 – two years

Section 544 - ???

Triggering Creditor UFTA Mass and NH Law – 4 years and 1 year for insider preferences.

Triggering Creditor UFTA – Maine 6. years including insider preferences.

Simple

QUOD NULLUM TEMPUS OCCURRIT REGI

No time runs against the king

The United States, acting through the IRS or any number of other agencies is immune from state-imposed statutes of limitations:

United States v. Summerlin, 310 U.S. 414, 416, 60 S. Ct. 1019, 1020 (1940).

A minority of one

All of the cases allow the IRS to be the triggering creditor. At least 13 cases allow the use of a statute applicable to the IRS.

- One dissent:

The minority view is that the *nullum tempus* doctrine is limited to the sovereign and then only when it is acting in pursuit of "public rights or interests." Wagner v. Ultima Homes, Inc. (In re Vaughan Co., Realtors), 498 B.R. 297, 304 (Bankr. D.N.M. 2013). In the view of the Vaughan Court,

> [t]he Court does 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.

THE IRS LABRINYTH

First Step – Assessment – Base rule, 3 years

If an honest return is filed then the IRS must make the assessment within three years of the return:

> Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed…

IRC Sec. 6501(a). If the return is early then three years from the date the return was last due. IRC Sec. 6501(b)(1).

Exception - fraud

(c) Exceptions.

(1) False return. In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

(2) Willful attempt to evade tax. In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B [26 USCS §§ 1 et seq. or 2001 et seq.]), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(3) No return. In the case of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

26 U.S.C.S. § 6501 (LexisNexis)

What is assessment

> the term "assessment" refers to little more than the calculation or recording of a tax liability··· "The Federal tax system is basically one of self-assessment," whereby each taxpayer computes the tax due and then files the appropriate form of return along with the requisite payment. 26 CFR § 601.103(a) (2003). In most cases, the Secretary accepts the self-assessment and simply records the liability of the taxpayer.

United States v. Galletti, 541 U.S. 114, 122, 124 S. Ct. 1548, 1553-54 (2004).

The 10 Year Period – forward looking from Assessment

(a) Length of period. Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by ··· a proceeding in court, but only if the proceeding begun—
(1) within 10 years after the assessment of the tax, or

(2) [dealing with installment agreements]···

…

26 U.S.C.S. § 6502 (LexisNexis)

What is the claw back period really?

Don't know –

If it is a fraudulent return the time to assess never ends.

If the time to assess never ends, the time for the IRS to sue also never ends.

Shortest time – 13 years from the due date for the return

Put it together

If the IRS can sue under state law and the UFTA to recover an otherwise unsecured tax debt, then, the IRS is not bound by the Statute of Limitations in state law.

The IRS can sue for 10 years after assessment and maybe longer.

If the IRS is an unsecured creditor then the estate representative can recover a fraudulent transfer without regard to the usual four-year limitation (six in Maine).

Is it a 10 year period or not? Differing Interpretations

Section 6502 of Title 26 limits the look back period to ten years.

Williamson v. Smith (In re Smith), Nos. 19-40964, 22-07002, 2022 Bankr. LEXIS 1533, at *21 (Bankr. D. Kan. June 2, 2022)

No limit

Section 6502 does not limit the look back to 10 years

The applicable statute of limitations for the Government's fraudulent conveyance-based claims is 26 U.S.C. § 6502(a), which provides the Government ten years from the date of the deficiency assessment to institute a proceeding to collect on the assessment. The trigger point is the date of assessment. It is the "assessment" itself that, once made, starts the running of the ten-year period within which the Government must commence efforts to collect taxes assessed. The conveyance dates are irrelevant.

United States v. Krause (In re Krause), Nos. 05-17429, 05-5775, 2007 Bankr. LEXIS 4068, at *23 (Bankr. D. Kan. Nov. 13, 2007)

Thus the transfer could take place well before ten years before the commencement of the suit and the suit could still be timely.

Halperin v. Morgan Stanley Inv. Mgmt. (In re Tops Holding II Corp.), 646 B.R. 617, 655 n.112 (Bankr. S.D.N.Y. 2022)

The Role of 26 U.S.C. 6901 – Transferee Liability

The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:

(1) Income, estate, and gift taxes.

(A) Transferees. The liability, at law or in equity, of a transferee of property…

26 U.S.C.S. § 6901 (a) (LexisNexis).

26 USC 6901 – limit – 1 year

(c) Period of limitations. The period of limitations for assessment of any such liability of a transferee or a fiduciary shall be as follows:

(1) Initial transferee. In the case of the liability of an initial transferee, within 1 year after the expiration of the period of limitation for assessment against the transferor;

26 U.S.C.S. § 6901 (LexisNexis)

But – IRS is not limited to Section 6901 – Can use State Law -the collection procedures of § 6901 are cumulative and alternative -- not exclusive or mandatory –" United States v. Russell, 461 F.2d 605, 607 (10th Cir. 1972)

FDCPA – Federal Debt Collection Practices Act

Basically a UFTA for the Federal Government – but 6 years and 2 years not unlimited.

28 U.S.C.S. § 3306 (LexisNexis)

Kittery Point Partners

Judge Fagone has suggested that the tax must be assessed before the case is filed for the ten year limitations period to be triggered. Kittery Point Partners, LLC v. Bayview Loan Servicing LLC (In re Kittery Point Partners, LLC), Nos. Chapter 11, 17-20316, 17-2065, 2018 Bankr. LEXIS 859, at *29-30 (Bankr. D. Me. Mar. 12, 2018). That is not clearly true. A reasonable argument can be made that the ability to avoid under state law is only dependent of the IRS' status as a creditor under state law and not on whether an assessment has occurred.

Takeaway

In sum, it is the law today that if the IRS holds an allowed unsecured claim in a bankruptcy case, the estate representative can challenge under state fraudulent transfer laws, through the use of 11 U.S.C. §544, transactions reaching back many years, perhaps with no clear limit.

Questions

1. **Have you ever had an avoidance action brought by an estate representative before you using the reach back period that is available to the IRS?**
   a. If so, what happened? Did you have to rule on it?
   b. If not, why do you think that is?
2. **What would your reaction be to a fraudulent conveyance action brought to recover a transaction twenty years ago (or some other extended period)?**

LIENS ON AVOIDANCE ACTION PROCEEDS AND RELEASE PROVISIONS IN DIP FINANCING AND CASH COLLATERAL ORDERS

ABI NORTHEAST BANKRUPTCY CONFERENCE
Newport, JULY 2023
Katie LaManna, Shipman & Goodwin LLP

Provisions **Granting Liens on Avoidance Action Proceeds** Contained in DIP Financing Orders and Orders Granting the Use of Cash Collateral:

Sample Language:

- As security for the DIP Obligations, effective immediately upon entry of this Interim Order, pursuant to sections 361, 362, 364(c)(2), 364(c)(3), and 364(d) of the Bankruptcy Code, the DIP Lender is hereby granted valid, binding, continuing, enforceable, non-avoidable, and automatically and properly perfected security interests and liens on all real and personal property, whether now existing or hereafter arising and wherever located, tangible or intangible, of each of the Debtors (the "DIP Collateral") including, without limitation . . . **subject to entry of a Final Order, the proceeds of any avoidance actions (such actions, "Avoidance Actions") brought pursuant to chapter 5 of the Bankruptcy Code or section 724(a) of the Bankruptcy Code or any other avoidance actions under the Bankruptcy Code or applicable state law equivalents (the "Avoidance Action Proceeds"); provided, that no liens shall attach to Avoidance Actions**.

- As security for the payment of the Adequate Protection Obligations, the Prepetition Secured Parties are hereby granted (effective and perfected upon the date of this Interim Order and without the necessity of the execution by the Debtors of security agreements, pledge agreements, mortgages, financing statements, or other agreements) a valid, perfected replacement security interest in and lien on all DIP Collateral, including, **upon entry of the Final Order, the Avoidance Action Proceeds (the "Adequate Protection Liens").**

Relevant Bankruptcy Code Provisions

- Proceeds of avoidance actions are property of the estate: § 541(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: (3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title;
- 11 U.S.C. 550: (a)Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 457, 548, 549, 553(b) or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred. . .
- Chapter 5 covers avoidance actions: § 544 transfers avoidable under state law; § 547 preferences; and § 548 fraudulent transfers.
- 11 U.S.C. § 364 provides that the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if – (A) the trustee is unable to obtain such credit otherwise; and (B) there is adequate protection of the interests of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.
- 11 U.S.C. § 363(c)(2) The trustee may not use, sell, or lease cash collateral . . . unless—(A) each entity that has an interest in such cash collateral consents; or (B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.
- Under Section 363(e), in order to use cash collateral, absent consent, adequate protection must be provided.

Why Grant Liens on Avoidance Actions?

- Critical need for funds and leverage of the Prepetition Secured Creditor or DIP Lender;
- Only terms available, lender will not provide DIP financing without lien on avoidance action;
- Funds needed to maintain operations, payroll;
- Preservation of upside potential;
- Funds needed to continue as going concern, maximize value for all;
- Without DIP Loan or use of cash collateral, everybody loses.

Why Deny Liens on Avoidance Actions?

- Avoidance actions intended to benefit all creditors; if all assets encumbered and value of collateral uncertain or low, bankruptcy may be for the benefit of secured creditors only;

- Avoidance actions not property of the estate –

  Note the distinction between liens on proceeds of avoidance action and liens on the actions themselves; liens on avoidance actions are problematic because of potential non-transferability of the action itself. Liens granted to DIP Lenders more likely to be successful if placed on proceeds rather than the avoidance actions themselves.

  See Claridge Associates, LLC v. Schepis (In re Pursuit Capital Management, LLC), 595 B.R. 631 (Bankr. D. Del. 2018 discussing In re Cybergenics Corp., 226 F.3d 237, 245 (3d Cir. 2000).

Bankruptcy Courts Give Careful Scrutiny to Provisions in DIP Financing Orders that Place Liens on Avoidance Actions

- Courts are generally sympathetic to unsecured creditors losing the benefit of avoidance action recoveries.
- The issue is not a new one. Historically, many Courts were not inclined to grant liens on proceeds of avoidance actions to DIP lenders. *See, e.g.*, Letter from Hon. Peter J. Walsh to Delaware Bankruptcy Counsel (Apr. 2, 1998), at 4 (liens should not be granted on avoidance actions "absent exigent circumstances.");
- The purpose of an avoidance action is "ensuring equitable distribution of the assets of an insolvent corporation among its creditors." In the context of an asset sale purporting to sell avoidance actions, the Court characterized a party seeking to pursue an avoidance action after buying the Debtor's assets as a "stranger to the bankruptcy" that sought its own interests over creditors'. In re Sapolin Paints, Inc., 11 B.R. 930, 938 (Bankr. E.D.N.Y. 1981).

- Common Bankruptcy Court Local Rules set a higher bar for granting liens on avoidance proceeds:

  Delaware - Bankr. D.Del. L.R. 4001-2(a)(i)(D) (**requiring motions for approval of proposed financing orders to identify and justify** "[p]rovisions immediately granting the prepetition secured creditor liens on the debtor's claims and causes of action arising under 11 U.S.C. §§ 544, 545, 547, 548, 549

  Massachusetts = Bankr. D.Mass. L.R. 4001-2(c)(3)(c) (. . . **the following provisions** contained in an agreement between the debtor and the holder of a secured claim as to use of cash collateral, obtaining credit, or adequate protection, or any interim or final order approving or authorizing the use of cash c collateral, obtaining credit, or adequate protection, **shall be unenforceable** . . .(3) [p]rovisions creating liens on bankruptcy causes of action: Provisions that grant liens on the estate's claims arising under 11 U.S.C. § § 506(d), 544, 545, 547(d), 548 or 549 . . .(d) **unless the proposed order or agreement specifically states that the proposed terms and conditions vary from the requirements of section (c), and (ii) any such proposed terms and conditions are conspicuously and specifically set forth in the proposed agreement or order.**

Despite Reservations, Courts Routinely Approve Lien Provisions

- Recent Courts have rejected the argument that avoidance actions must be preserved for unsecured creditors; *See, e.g.,* In re Revlon, Inc., No. 22-10760 (DSJ) (Bankr. S.D.N.Y. August 1, 2021) Hr'g Tr. 29:14–30:14 [Docket No. 332](granting lien to DIP Lender on avoidance actions and finding no legal basis for avoidance action funds to be set aside for unsecured creditors);

- *See also* In re TECT Aerospace Grp. Holdings, Inc., et al., No. 21-10670 (KBO) (Bankr. D. Del. May 11, 2021) Hr'g Tr. 67:25– 68:6 [Docket No. 172], and In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444 (Bankr. S.D. Ohio 2021).

A BALANCING ACT

- Balancing the need for cash, protection of employees and preserving value in a going concern against harm to potential recovery for unsecured creditors;

- Factors considered by the Courts include:

1) BENEFIT TO THE ESTATE

- Immediate apparent benefit going to the secured DIP Lender, but "maximizing value by maintaining a going concern" **;**
- Courts have analyzed the issue of "benefit to the estate" in a myriad of circumstance. " Unsecured creditors [need not] benefit from a favorable *result* in the avoidance action; the benefit may come from the transfer of the claim itself through, for example, settlement yielding a benefit to the unsecured creditors." In re Maxwell Newspapers, Inc., 189 B.R. 282, 287 (Bankr. S.D.N.Y. 1995).

2) THE EXTENT THE LIEN WOULD PRECLUDE RECOVERY TO OTHER CREDITORS/UNSECURED CREDITORS; and

3) NECESSITY OF THE LIEN or EXTRAORDINARY CIRCUMSTANCES

Release Provisions in DIP Financing Orders and Orders Granting the Use of Cash Collateral in favor of DIP Lenders and Prepetition Secured Creditors

Release Language in DIP Financing Orders:

Sample language

- The Debtors acknowledge and agree that . . . (a) the Prepetition Secured Obligations constitute legal, valid, binding, and non-avoidable obligations of the Debtors . . .; (b) no offsets, recoupments, challenges, objections, defenses, claims, or counterclaims by the Debtors of any kind or nature to any of the Prepetition Secured Obligations exist, and **no portion of the Prepetition Secured Obligations is subject to any challenge or defense including avoidance, disallowance, disgorgement, recharacterization, or subordination (equitable or otherwise) pursuant to the Bankruptcy Code or applicable non-bankruptcy law;** (c) the Debtors and their estates have no claims, objections, challenges, causes of action, and/or choses in action, including avoidance claims under Chapter 5 of the Bankruptcy Code or applicable state law equivalents or actions for recovery or disgorgement, against any of the Prepetition Secured Parties . . . arising out of, based upon or related to the Prepetition Secured Obligation Documents; (d) the Debtors have waived, discharged, and released any right to challenge any of the Prepetition Secured Obligations and the priority of the Debtors' obligations thereunder.
- **No Challenges/Claims. No offsets, challenges, objections, defenses, claims or counterclaims of any kind or nature to any of the Prepetition Liens or Prepetition Obligations exist, and no portion of the Prepetition Liens or Prepetition Obligations is subject to any challenge or defense including, without limitation, avoidance, disallowance, disgorgement, recharacterization, or subordination (equitable or otherwise) pursuant to the Bankruptcy Code or applicable non-bankruptcy law. The Debtors and their estates have no valid Claims (as such term is defined in section 101(5) of the Bankruptcy Code), objections, challenges, causes of action, and/or choses in action against any of the Prepetition Secured Parties . . . with respect to the Prepetition Documents, the Prepetition Obligations, or the Prepetition Liens, whether arising at law or at equity, including, without limitation, any challenge, recharacterization, subordination, avoidance, recovery, disallowance, reduction, or other claims arising under or pursuant to sections 105, 502, 510, 541, 542 through 553, inclusive, or 558 of the Bankruptcy Code or applicable state law equivalents.**
- The Debtors hereby stipulate that they forever and irrevocably release, discharge, and acquit each Prepetition Secured Party from all claims of any and every nature whatsoever relating to the prepetition Secured Documents, including, without limitation, (x) any and all claims and causes of action arising under the Bankruptcy Code, and (y) any and all claims and causes of action with respect to the validity, priority, perfection, **or avoidability** of the liens or claims of the Prepetition Secured Parties.

When Broad Release Provisions Are Silent as to Avoidance Actions

- Language waiving "any and all actions, causes of action, . . . claims and demands relating to the Debtors and their Chapter 11 cases only" against secured creditors was held to include the release of avoidance actions. In re Managed Storage Int'l, Inc., 601 B.R. 261 (Bankr. D. Del. 2019). The Managed Storage Court found that the debtor could not prove there was any intent in the initial waiver to exclude avoidance actions, and thus they were included.

- The 10th Circuit has similarly enforced release provisions where the Chapter 11 DIP financing order's language was "unambiguous." In re MS55, Inc., 477 F.3d 1131, 1133 (10th Cir. 2007).

- In Ms55, the DIP financing order language waived the DIP's right to pursue avoidance action, even though it did not explicitly name avoidance actions. It read: "[Debtor] shall be forever barred from asserting any and all claims on any basis or theory against the secured creditors."

A Few Final Thoughts:

- There appears to be a trend towards allowing DIP Financing Orders to grant liens in proceeds of avoidance actions for post-petition financing, as well as enforceable releases as to avoidance actions that might otherwise be brought against prepetition secured creditors;
- Liens on Avoidance Actions and Release Provisions in the context of DIP financing and use of cash collateral are ripe for negotiation between secured creditors and the Debtor in Possession/Unsecured Creditors' Committee/other creditors; however, these issues usually arise in the context of First and Second Day motions making post-filing negotiations diffiicult;
- Trends appear to be toward allowing such provisions but secured lenders can expect pushback and scrutiny should be expected as to necessity and balancing of the equities;
- Courts will likely continue to make calls on a case by case basis depending on the leverage held by the DIP Lender or Secured Creditor allowing the use of cash collateral.

COMPASS LEXECON

Fraudulent Conveyance, Financial Distress and Mass Torts

July 14, 2023

DISCLAIMER

The opinions expressed here are my own and do not necessarily represent the opinions of Compass Lexecon or any client of Compass Lexecon.

Furthermore, the opinions expressed herein are not legal opinions. This presentation contains excerpts of various legal pleadings and court opinions only as a means to motivate discussion of an economic or financial principle.

FRAUDULENT CONVEYANCE: THE LATEST REBUTTAL TO TEXAS TWO-STEP?

- Divisive mergers ("Texas Two-Step") have relied on funding agreements from a non-debtor parent to cover liabilities of a debtor subsidiary
- The recent dismissals of the LTL and Aearo bankruptcies have highlighted the tension between debtor subsidiary financial distress and sufficiency of the funding agreements
- Further, upon refiling by LTL, the tort claimant committee has sought standing to bring a fraudulent conveyance claim based on an alleged reduction in value of the revised funding agreement -- assuming, *arguendo*, LTL is found to be in financial distress
- Will the combination of (i) a requirement for sufficient subsidiary financial distress and (ii) remedies available for fraudulent conveyance be the death knell for the latest wave of "good company" "bad company" reorganizations?

IN THE NEWS …

Committee Representing Talc-Related Cancer Victims Files a Motion Seeking Standing to Pursue a $30 Billion Fraudulent Conveyance Complaint

NEWS PROVIDED BY
Official Committee of Talc Claimants
11 May, 2023, 17:51 ET

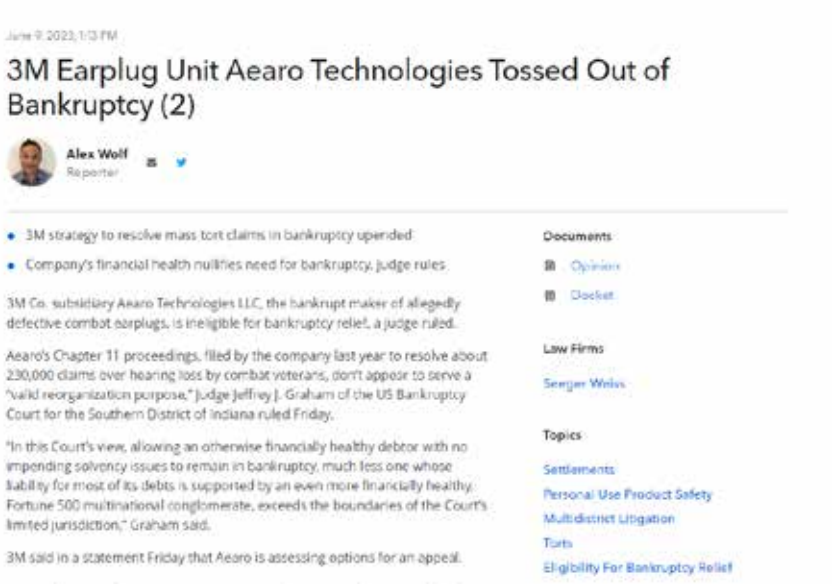
SHARE THIS ARTICLE

The Official Committee of the Talc Claimants seeks to avoid the transactions by which LTL gave away its largest asset prior to its second bad-faith bankruptcy filing

NEW YORK, May 11, 2023 /PRNewswire/ -- Today, the Official Committee of Talc Claimants ("TCC," "the Committee") filed a motion in the second bankruptcy case of LTL Management ("LTL," the "Debtor"), seeking standing to avoid what may be one of if not the largest fraudulent transfers in U.S. history. The TCC has already filed a motion to dismiss the case on the ground that, among other things, LTL cannot establish financial distress and, therefore, its second bankruptcy was not filed in good faith. The TCC's standing motion argues that if LTL is ultimately successful in establishing financial distress, it intentionally manufactured that distress by giving up contractual rights against its parent, Johnson & Johnson ("J&J"), worth billions of dollars. The TCC seeks standing to file a complaint to, among other things, avoid and recover that transfer for the benefit of all talc claimants, because "LTL is incapable of acting contrary to J&J's demands."

Source: TCC Press Release via Cision PR Newswire

IN THE NEWS …



June 9, 2023, 1:13 PM

3M Earplug Unit Aearo Technologies Tossed Out of Bankruptcy (2)

Alex Wolf
Reporter

- 3M strategy to resolve mass tort claims in bankruptcy upended
- Company's financial health nullifies need for bankruptcy, judge rules

3M Co. subsidiary Aearo Technologies LLC, the bankrupt maker of allegedly defective combat earplugs, is ineligible for bankruptcy relief, a judge ruled.

Aearo's Chapter 11 proceedings, filed by the company last year to resolve about 230,000 claims over hearing loss by combat veterans, don't appear to serve a "valid reorganization purpose," Judge Jeffrey J. Graham of the US Bankruptcy Court for the Southern District of Indiana ruled Friday.

"In this Court's view, allowing an otherwise financially healthy debtor with no impending solvency issues to remain in bankruptcy, much less one whose liability for most of its debts is supported by an even more financially healthy, Fortune 500 multinational conglomerate, exceeds the boundaries of the Court's limited jurisdiction," Graham said.

3M said in a statement Friday that Aearo is assessing options for an appeal.

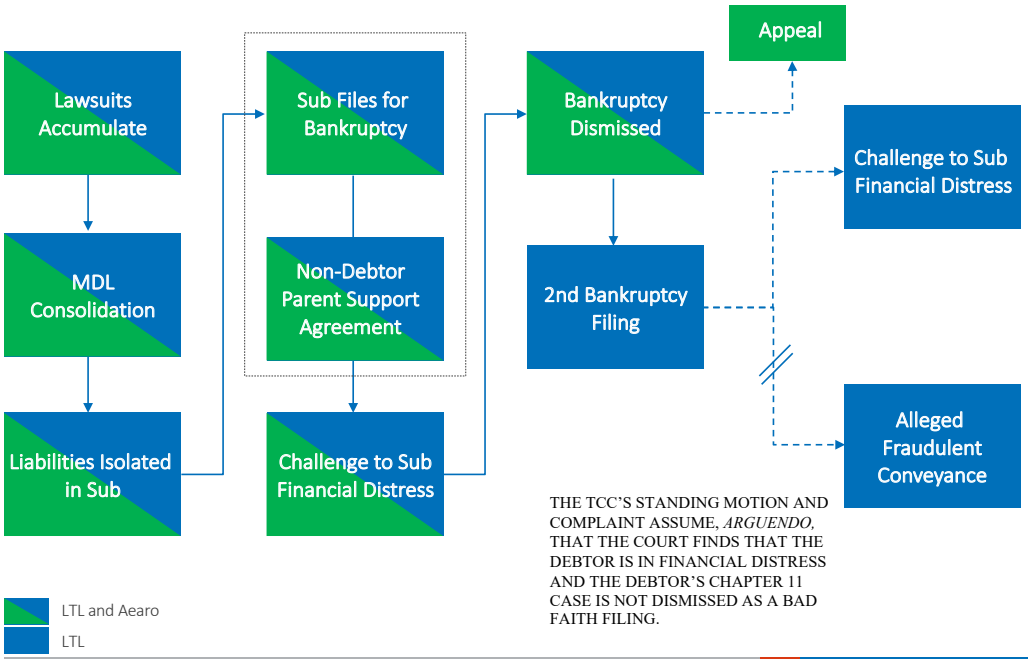
Documents
Opinion
Docket

Law Firms
Seeger Weiss

Topics
Settlements
Personal Use Product Safety
Multidistrict Litigation
Torts
Eligibility For Bankruptcy Relief

Source: Bloomberg Law

OVERVIEW OF SEQUENCE OF EVENTS



THE TCC'S STANDING MOTION AND COMPLAINT ASSUME, *ARGUENDO*, THAT THE COURT FINDS THAT THE DEBTOR IS IN FINANCIAL DISTRESS AND THE DEBTOR'S CHAPTER 11 CASE IS NOT DISMISSED AS A BAD FAITH FILING.

THIRD CIRCUIT ADDRESSES FINANCIAL DISTRESS IN LTL

The theme is clear: absent financial distress, there is no reason for Chapter 11 and no valid bankruptcy purpose.

But what degree of financial distress justifies a debtor's filing? To say, for example, that a debtor must be in financial distress is not to say it must necessarily be insolvent. We recognize as much, as the Code conspicuously does not contain any particular insolvency requirement.

Though insolvency is not strictly required … we cannot ignore that a debtor's balance-sheet insolvency or insufficient cash flows to pay liabilities (or the future likelihood of these issues occurring) are likely always relevant.

Financial distress must not only be apparent, but it must be immediate enough to justify a filing. "[A]n attenuated possibility standing alone" that a debtor "may have to file for bankruptcy in the future" does not establish good faith.

[W]e cannot agree LTL was in financial distress when it filed its Chapter 11 petition. The value and quality of its assets, which include a roughly $61.5 billion payment right against J&J and New Consumer, make this holding untenable.

In sum, while it is unwise today to attempt a tidy definition of financial distress justifying in all cases resort to Chapter 11, we can confidently say the circumstances here fall outside those bounds.

January 30, 2023 Opinion

THIRD CIRCUIT DESCRIPTION OF LTL I FUNDING AGREEMENT …

The Funding Agreement merits special mention. To recap, under it LTL had the right, outside of bankruptcy, to cause J&J and New Consumer, jointly and severally, to pay it cash up to the value of New Consumer as of the petition date (estimated at $61.5 billion) to satisfy any talc-related costs and normal course expenses. Plus this value would increase as the value of New Consumer's business and assets increased. … The Agreement provided LTL a right to cash that was very valuable, likely to grow, and minimally conditional. And this right was reliable, as J&J and New Consumer were highly creditworthy counterparties (an understatement) with the capacity to satisfy it.

January 30, 2023 Opinion

TCC SOUGHT STANDING TO BRING FC CLAIMS IN LTL II

From draft complaint …

Following LTL's ejection from bankruptcy for lack of financial distress, LTL purports to have created financial distress for itself within the 131 minutes prior to its second bankruptcy filing such that it qualifies for the protection of the Bankruptcy Code. Either it is wrong, and it is now a serial bad-faith bankruptcy filer, or it has confessed to conducting perhaps the largest fraudulent transfer in United States history.

If LTL is successful in showing it is (now) in immediate financial distress when,131 minutes beforehand it was not, that is cold comfort to LTL. It necessarily means that LTL and Johnson & Johnson ("J&J") engaged in transactions with the actual intent to hinder, delay, and defraud dying cancer victims and prevent such victims from exercising their Constitutional rights, and that LTL made a transfer where it did not receive reasonably equivalent value and, following such transfer, was insolvent, left with unreasonably small capital, or was left unable to pay its debts as they came due. It is, thus, a necessary conclusion that LTL and J&J have committed, and confessed to, what may be the largest fraudulent transfer in United States history. This Complaint is brought in the event that it is determined the latter is correct and, thus, every allegation set forth herein assumes, as threshold matter, that LTL has proven that it is in financial distress and eligible to be a debtor in a chapter 11 proceeding.

Source: LTL Docket 489, Exhibit B

SEVENTH CIRCUIT ADDRESSES "NEED" IN AEARO

[T]he Court is inclined to conclude that good faith is better measured by whether the Chapter 11 case serves "a valid reorganizational purpose," … and that a debtor's "need" for relief under the Chapter 11 is central to that inquiry.

It follows then that the "need" for Chapter 11 relief is inextricably tied to a bankruptcy "purpose." And this analysis often, if not always, warrants an examination of the debtor's financial condition.

Where the debtor is insolvent, a petition will almost invariably be consistent with the objectives of the bankruptcy laws. … Where the debtor is solvent, however, we begin to stray from Congress' intended application of the Code and valid bankruptcy purposes dwindle.

The LTL decision—issued just weeks before the Motions filed here—casts a particularly prominent shadow over Aearo's bankruptcy

While the Court would rather frame the issue in terms of a debtor's "need" rather than "financial distress," (lest "financial distress" be interpreted too literally and ignore the Code's lack of an insolvency requirement), the inquiry will often be the same: are the problems the debtor is facing within the range of difficulties envisioned by Congress when it crafted Chapter 11? In addition, a debtor's "need" for relief does not create a bar to seeking bankruptcy relief like "financial distress" seems to do.

KEY QUESTIONS?

If substantial liabilities are isolated in a subsidiary:

- Does the absence (or withdrawal) of a financial support agreement result in a fraudulent conveyance?
- Is non-debtor parent financial support incompatible with a showing of financial distress sufficient to warrant subsidiary protection under bankruptcy?
- *Assuming* financial distress sufficient to warrant bankruptcy protection, is that equivalent to:
  - Balance sheet insolvency?
  - Inability to pay debts?
  - Inadequate capital?

PROBLEMS IN TIME AND AVOIDANCE

Edmond J. Ford
May 15, 2023
Ford, McDonald & Borden, P.A.
10 Pleasant Street, Suite 400
Portsmouth, NH. 03801
603-373-1600
eford@fordlaw.om

"Time is on my side" – Jerry Ragovoy wrote and the Rolling Stones (among others) sang. A Trustee may sing the same refrain in viewing deadlines to bring an action under 11 U.S.C. §544.

I. ISSUES IN THE REACH BACK PERIOD FOR FRAUDULENT CONVEYANCES:

As befuddling to a trustee as it may be, commercial and transactional lawyers worry about whether a bankruptcy trustee (or debtor in possession[1] or litigation trust[2]) will undo their transaction as a fraudulent conveyance – just negotiate a fair deal and all is good. But somehow, that standard is not obvious nor always met.

[1] 11 U.S.C. § 1107(a)

[2] Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery, 330 F.3d 548, 580 (3d Cir. 2003),writ of cert. dismissed, Lincolnshire Mgmt., Inc. v. Official Comm. of Unsecured Creditors of Cybergenics Corp., 540 U.S. 1001, 124 S. Ct. 530 (2003) ("we are satisfied that bankruptcy courts can authorize creditors' committees to sue derivatively to avoid fraudulent transfers for the benefit of the estate."); Commodore Int'l v. Gould (in Re Commodore Int'l Ltd.), 262 F.3d 96, 100 (2d Cir. 2001) ("To recap, we hold that a creditors' committee may sue on behalf of the debtors, with the approval and supervision of a bankruptcy court, not only where the debtor in possession unreasonably fails to bring suit on its claims, but also where the trustee or debtor in possession consents. In the latter situation, however, suit by the creditors committee must be necessary and beneficial to the resolution of the bankruptcy proceedings.") ;In re Fin. Oversight & Mgmt. Bd. for P.R., No. 17 BK 3283-LTS, 2017 U.S. Dist. LEXIS 161535, at *4 (D.P.R. Aug. 10, 2017) ("With respect to the appointment of the Commonwealth Agent (as defined below), Bankruptcy Code sections 105(a), 503(b)(3)(B), 1103(c), and 1109(b) permit the Oversight Board to consensually grant standing to the Creditors' Committee (as defined below), when necessary and beneficial to do so."); Sunset Hollow Props., LLC v. Bank of W. Mass. (In re Sunset Hollow Props., LLC), 359 B.R. 366, 383 (Bankr. D. Mass. 2007) (Adopting the approach of the Second Circuit).

Second best, from a transactional lawyer's standpoint is an answer to the question: "when is the deal too old to be challenged?" The answer may be almost never, but let's go through some of the time periods:.

The easiest to grasp are the deadlines in the bankruptcy code sections 547 and 548. Section 547 is preference recovery and it has the familiar ninety (90) day reach-back for payments to anyone and a one year reach-back for payments to insiders. 11 U.S.C. §547(b)(4). Section 548 allows recovery of fraudulent transfers which occurred within two years before the petition date. 11 U.S.C. §548(a).

A transaction safe from Sections 547 and 548 may still be challenged under Section 544 – the Strong Arm Powers. We are all familiar with the standard problems under a Section 544 analysis: identifying a triggering creditor and the applicable non-bankruptcy law under which recovery may be had. Nevertheless, it may help to quote the applicable statutory language:

> …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 under section 502** of this title…

11 U.S.C.S. § 544 (LexisNexis) (emphasis added). The challenge is to find the "triggering creditor" and applicable law.

A. ***Can the Internal Revenue Service Act as the Triggering Creditor?***

The majority view is that the IRS can act as the triggering creditor. The language of the statute is unambiguous – if the IRS holds an allowable unsecured claim then the statute authorizes the trustee to avoid transfers which the IRS could avoid.

B. ***The Immunity of the United States from State Statutes of Limitations: Nullum Tempus***

The IRS as triggering creditor becomes interesting because the United States, acting through the IRS or any number of other agencies is immune from state-imposed statutes of limitations:

> [i]t is well settled that the United States is not bound by state statutes of limitation or subject to the defense of laches in enforcing its rights.

United States v. Summerlin, 310 U.S. 414, 416, 60 S. Ct. 1019, 1020 (1940).

That means that if the United States sues to recover a fraudulent conveyance under state law[3], it is not bound by the state law reach-back provision. Halperin v. Morgan Stanley Inv. Mgmt. (In re Tops Holding II Corp.), 646 B.R. 617, 653 (Bankr. S.D.N.Y. 2022) ("The *nullum tempus* doctrine enables the IRS to avoid fraudulent transfers that occurred outside of applicable state law limitations periods, provided that it was enforcing a public right or the public interest absent a clear showing of contrary congressional intent."); Bresson v. Commissioner, 213 F.3d 1173 (9th Cir. 2000) (Federal Plaintiff is not barred by state UFTA extinguishment provisions). The cases refer to the doctrine "*quod nullum tempus occurrit regi* (or 'no time runs against the king')." Tops Holding II, at 653.

The minority view (of one) does not challenge the conclusion that the IRS could act as a triggering creditor, but, instead, challenges the idea that the limitation on reach-back (if any) applicable to the IRS, a governmental agent, carries over to a private trustee. The minority view is that the *nullum tempus* doctrine is limited to the sovereign and then only when it is acting in

[3] As the United States did in Leighton v. United States, 289 U.S. 506, 509, 53 S. Ct. 719, 720 (1933) (which held that the United States did not have to assess the tax against the transferees but could sue to recover the funds); *cf.* United States v. Verduchi, 434 F.3d 17 (1st Cir. 2006) (applying Rhode Island law to determine if the transfer of assets was fraudulent.); United States v. Julius Nasso Concrete Corp., No. 96 CV 5340 (SJ), 2000 U.S. Dist. LEXIS 6516, 85 A.F.T.R.2d (RIA) 2000-2157 (E.D.N.Y. Mar. 31, 2000) (Applying New York Fraudulent Transfer law to tax recovery); cf. Ebner v. Kaiser (In re Kaiser), 525 B.R. 697, 710 (Bankr. N.D. Ill. 2014).("The IRS s ability to collect tax liability against a transferee of the taxpayer is dependent upon the IRS's ability to establish liability under state fraudulent-transfers law.")

pursuit of "public rights or interests." Wagner v. Ultima Homes, Inc. (In re Vaughan Co., Realtors), 498 B.R. 297, 304 (Bankr. D.N.M. 2013). In the view of the Vaughan Court,

> [t]he Court does 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.

Id.

No court has followed the Vaughan analysis. See, Williamson v. Smith (In re Smith), Nos. 19-40964, 22-07002, 2022 Bankr. LEXIS 1533, at *17 (Bankr. D. Kan. June 2, 2022) ("Although *Vaughan* was decided in 2013, to the Court's knowledge, no bankruptcy court has followed *Vaughan*."). The prevailing view is that the Section 544 is clear and the bankruptcy courts are bound to follow what it says without regard to their policy preferences. Halperin v. Morgan Stanley Inv. Mgmt. Inc. (In re Tops Holding II Corp.), No. 22-Civ-9450 (NSR), 2023 U.S. Dist. LEXIS 2749, at *10 (S.D.N.Y. Jan. 6, 2023) (Denying leave for interlocutory appeal the use of the IRS' limitations period because there is no "substantial ground for a difference of opinion."); Maxus Liquidating Tr. v. YPF S.A. (In re Maxus Energy Corp.), 641 B.R. 467, 545 (Bankr. D. Del. 2022) (Applying the doctrine to a trustee standing in the shoes of the EPA); Halperin v. Morgan Stanley Inv. Mgmt. (In re Tops Holding II Corp.), 646 B.R. 617, 653 (Bankr. S.D.N.Y. 2022)(applying the IRS as triggering creditor and lengthened limitations period); Pereira v. Omansky(In re Omansky), Nos. 18-13809 (LGB), 20-01091 (LGB), 2022 Bankr. LEXIS 2535, at *25 (Bankr. S.D.N.Y. Sep. 15, 2022) ("The majority of bankruptcy courts that have considered the question of whether 26 U.S.C. § 6502 may be utilized by a trustee as applicable law with the IRS as triggering creditor have held that the trustee may utilize the ten-year statute of limitations."); Mitchell v. Zagaroli (In re Zagaroli), Nos. 18-50508, 20-05000, 2020 Bankr. LEXIS 3111, at *5, 126 A.F.T.R.2d (RIA) 2020-6749 (Bankr. W.D.N.C.

Nov. 3, 2020) ("These decisions represent the majority view of courts that have addressed the issue and hold that the plain language of § 544(b)(1) permits the Trustee to step into the shoes of the IRS."); Vieira v. Gaither (In re Gaither), 595 B.R. 201, 208 (Bankr. D.S.C. 2018) ("The majority of courts, however, have addressed the same issue and concluded that § 544(b) does permit a trustee to step into the shoes of the IRS and avail herself of federal law."); Hillen v. City of Many Trees, LLC (In re CVAH, Inc.), 570 B.R. 816, 835 (Bankr. D. Idaho 2017) ("Respectfully, it is this Court's view that the analysis in *Vaughan* is premised upon a faulty conception about the purpose and operation of § 544(b)(1)"); Mukamal v. Citibank N.A. (In re Kipnis), 555 B.R. 877, 882 (Bankr. S.D. Fla. 2016) ("The fundamental problem with *Vaughan's* analysis is its failure to start where courts must start in interpreting statutes and that is to look at the statute's plain meaning."); Ebner v. Kaiser (In re Kaiser), 525 B.R. 697, 713 (Bankr. N.D. Ill. 2014) ("The view that the statute of limitations available to the IRS may not be invoked by a bankruptcy trustee has no basis in the plain language of section 544(b)."); Levey v. Gillman (In re Republic Windows & Doors, LLC), Nos. 08-34113, 10-2513, 2011 Bankr. LEXIS 3936, at *33 (Bankr. N.D. Ill. Oct. 12, 2011) ("The generous IRS limitation provision is not available unless the IRS files its own claim or the Trustee files a claim on behalf of the IRS."); Shearer v. Tepsic (In re Emergency Monitoring Techs., Inc.), 347 B.R. 17, 19 (Bankr. W.D. Pa. 2006) (denying motion to dismiss because "such 10-year limitations period had not passed as of the date of the Debtor's bankruptcy petition filing, and (e) the Trustee can access such conceivable action by the I.R.S. by way of 11 U.S.C. § 544(b)."); Alberts v. HCA Inc. (In re Greater Se. Cmty. Hosp. Corp. I), 365 B.R. 293, 306 (Bankr. D.D.C. 2006) (permitting liquidating trustee to use IRS as triggering creditor immune from state law four-year limit); Osherow v. Porras (In re Porras), 312 B.R. 81 (Bankr. W.D. Tex. 2004) (permitting Trustee to

use IRS as triggering creditor and the extended statute of limitations); but see, Kittery Point Partners, LLC v. Bayview Loan Servicing LLC (In re Kittery Point Partners, LLC), Nos. Chapter 11, 17-20316, 17-2065, 2018 Bankr. LEXIS 859 at * 29-30 (Bankr. D. Me. Mar. 12, 2018), (denying application of the ten-year statute: "Kittery Point does not cite any controlling authority establishing that the IRS can assess a tax (or here, a penalty) after a bankruptcy case is filed, and thereby permit the trustee to look back more than six years prior to the petition date to avoid transfers.").[4]

C. ***What Statute of Limitations Applies to the IRS?***

The usual recitation is that the IRS's limitation periods begin with the time for assessment: 26 U.S.C. §6501. If an honest return is filed then the IRS must make the assessment within three years of the return[5]:

> Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed…

IRC Sec. 6501(a). If the return was not filed, was "false or fraudulent with the intent to evade tax", or was a willful attempt to defeat or evade tax" then the assessment may be made by the IRS at any time. IRC Sec. 6501(c)(1) – (3). The deadline to make the assessment may be extended by the taxpayer and the government by agreement or may be extended in a wide variety of other scenarios. IRC Sec. 6501(c)(4) – (12). In summary, in the "best" of all possible worlds the IRS has three years from the filing of the tax return to make an assessment, but, the time to make an assessment may never expire.

Assessment is the recording of the tax liability:

> the term "assessment" refers to little more than the calculation or recording of a tax liability… "The Federal tax system is basically one of

[4] *aff'd on other grounds*, 623 B.R. 825 (B.A.P. 1st Cir. 2021), *aff'd*, 858 Fed. Appx. 386 (1st Cir. 2021).
[5] If the return is early then three years from the date the return was last due. IRC Sec. 6501(b)(1).

> self-assessment," whereby each taxpayer computes the tax due and then files the appropriate form of return along with the requisite payment. 26 CFR § 601.103(a) (2003). In most cases, the Secretary accepts the self-assessment and simply records the liability of the taxpayer.

United States v. Galletti, 541 U.S. 114, 122, 124 S. Ct. 1548, 1553-54 (2004).

From the date that the tax is assessed, the IRS has ten years to sue.

> Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—
>
> (1) within 10 years after the assessment of the tax, or …

IRC Sec. 6502 (a). The lawsuit can be against the taxpayer or otherwise to recover from persons secondarily liable:

> Once a tax has been properly assessed, nothing in the Code requires the IRS to duplicate its efforts by separately assessing the same tax against individuals or entities who are not the actual taxpayers but are, by reason of state law, liable for payment of the taxpayer's debt. The consequences of the assessment--in this case the extension of the statute of limitations for collection of the debt--attach to the tax debt without reference to the special circumstances of the secondarily liable parties.

United States v. Galletti, 541 U.S. 114, 123, 124 S. Ct. 1548, 1554 (2004).

Once the federal tax has been assessed, the IRS can pursue recovery for a period of ten years after assessment and the assessment may be made within three years of a properly filed tax return.

Most courts hold that because the IRS can pursue the claim in litigation for a period of ten years after assessment, it can during that period, avoid any transfers made before then by a taxpayer that are otherwise voidable fraudulent conveyances. See, Section B above.

D. ***The Role of 26 U.S.C. §6901 – Transferee liability – Cumulative and Alternative..***

The Internal Revenue Code has a provision for transferee liability. It reads (in part):

> The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:
>
> (1) Income, estate, and gift taxes.
>
> (A) Transferees. The liability, at law or in equity, of a transferee of property…

26 U.S.C.S. § 6901 (a) (LexisNexis). The transferee liability is assessed as would a tax be assessed and the statute limits the time for that assessment to "within 1 year after the expiration of the period of limitation for assessment against the transferor…" 26 U.S.C.S. § 6901 (c)(1) (LexisNexis). On its face, Section 6901 would seem to limit the ability of the IRS to pursue transferees.

Despite appearances, Section 6901 does not limit the ability of the IRS to pursue fraudulent conveyances under state law. Instead, "the collection procedures of § 6901 are cumulative and alternative -- not exclusive or mandatory –" United States v. Russell, 461 F.2d 605, 607 (10th Cir. 1972); *citing and following,* Leighton v. United States, 289 U.S. 506, 53 S. Ct. 719 (1933); Hillen v. City of Many Trees, LLC (In re CVAH, Inc.), 570 B.R. 816, 833 (Bankr. D. Idaho 2017) (IRS can use either Section 6901 or state law fraudulent conveyance claims and a trustee's reliance on section 6901 is therefore "misplaced."); Vieira v. Gaither (In re Gaither), 595 B.R. 201, 212 (Bankr. D.S.C. 2018) ("Thus, when the IRS seeks to avoid a fraudulent transfer, it is not limited to the procedures set forth in § 6901 of the Internal Revenue Code"); Williamson v. Smith (In re Smith), Nos. 19-40964, 22-07002, 2022 Bankr. LEXIS 1533, at *12 (Bankr. D. Kan. June 2, 2022) (IRS is not limited to Section 6901: "Thus, the IRS may use state fraudulent conveyance statutes and other laws to collect the tax from a person receiving property from the taxpayer.")

E. ***Is an Assessment Necessary to Trigger the IRS' Ability to Pursue Fraudulent Transfers?***

Judge Fagone has suggested that the tax must be assessed before the case is filed for the ten year limitations period to be triggered. Kittery Point Partners, LLC v. Bayview Loan Servicing LLC (In re Kittery Point Partners, LLC), Nos. Chapter 11, 17-20316, 17-2065, 2018 Bankr. LEXIS 859, at *29-30 (Bankr. D. Me. Mar. 12, 2018). That is not clearly true. A reasonable argument can be made that the assessment is only dependent of the IRS' status as a creditor under state law. As Judge Drain said:

> *Kittery Point Partners, LLC v. Bayview Loan Servicing LLC* (*In re Kittery Point Partners, LLC*), also cited by the [Defendants], assumed, based on its reading of 26 U.S.C. § 6502(a)(1), that the IRS's tax assessment triggered its right to avoid a transfer and that the automatic stay precluded such an assessment. As discussed above, however, while it is the timely assessment that starts the limitations period running, it is the IRS's status as a creditor in connection with the transfer that triggers its right to avoid the transfer.

Halperin v. Morgan Stanley Inv. Mgmt. (In re Tops Holding II Corp.), 646 B.R. 617, 655-56 (Bankr. S.D.N.Y. 2022).

In sum, it is the law today that if the IRS holds an allowed unsecured claim in a bankruptcy case, the estate representative can challenge under state fraudulent transfer laws, through the use of 11 U.S.C. §544, transactions reaching back many years, perhaps with no clear limit.

Faculty

Yvette R. Austin is a senior managing director and chair of Compass Lexecon's Global Finance Practice in New York. She specializes in M&A, financing and bankruptcy disputes with subject-matter expertise in valuation; credit and solvency analysis; and other financial damages. Ms. Austin provides testifying and consulting expert services in litigation and disputes related to breach of representation and warranties, breach of fiduciary duty, material adverse effect, dissenting shareholder actions, leveraged buyouts, financing transactions, debt recharacterization, avoidance actions and antitrust damages. She also has served as an expert in international trade subsidy disputes. Ms. Austin has submitted expert oral and written testimony in multiple venues including state courts in Delaware, New York, and California; U.S. federal bankruptcy and district courts; international courts in Canada, Australia and the United Kingdom; and the World Trade Organization and other international arbitration forums. In addition to providing expert testimony, she advises special board committees on M&A litigation matters and serves as a bankruptcy trustee. Ms. Austin has written a number of publications and presented on valuation and credit analysis for organizations such as the American Bar Association, ABI, the National Conference of Bankruptcy Judges, the Delaware State Bar Association, Thomson Reuters and Bloomberg Law. She is a contributing author to the *Model Merger Agreement for the Acquisition of a Public Company*, published by the ABA's Mergers and Acquisitions Committee, and a contributing researcher to *The Standard & Poor's Guide to Fairness Opinions: A User's Guide for Fiduciaries*. Ms. Austin also has been a member of the teaching faculty of Harvard University Extension School, where she taught a graduate finance course (Business Analysis and Valuation), and a past faculty member of the American Bar Association's National Institute of Negotiating Business Acquisitions. Earlier in her career, she provided investment banking advisory services, including mergers and acquisitions, fairness opinions, solvency opinions and commercially reasonable debt opinions. Ms. Austin received her A.B. in government and philosophy from Harvard College and her M.B.A in finance from Columbia University.

Mark G. DeGiacomo is a partner at Murtha Cullina LLP in Boston, where his practice focuses on his work as a chapter 7 and chapter 11 bankruptcy trustee, as well as his representation of clients in bankruptcy cases and representation of clients involved in commercial litigation. Since 1995, he has been a member of the eight-member Boston trustee panel from which the Department of Justice selects bankruptcy trustees. He has served as a bankruptcy trustee in thousands of cases and in that capacity has operated, sold and liquidated numerous businesses. Mr. De Giacomo also serves as counsel to the bankruptcy estate in all cases for which he has been appointed trustee. In addition to representing the bankruptcy estates, he represents other trustees, creditor committees in chapter 11 cases, business debtors in chapter 7 and 11 cases, secured and unsecured creditors in chapter 7, 11 and 13 cases, defendants in bankruptcy preference and/or fraudulent conveyance adversary proceedings, and commercial landlords. Mr. DeGiacomo has litigated dozens of cases in the Massachusetts bankruptcy courts and represented numerous clients in appeals brought before the U.S. District Court, the Bankruptcy Appellate Panel, the U.S. Court of Appeals for the First Circuit and the U.S. Supreme Court. HIs litigation experience includes representation of clients in all types of commercial litigation including director and officer cases, attorney malpractice, accountant malpractice and contract & construction matters. Mr. DeGiacomo is listed as leading bankruptcy lawyer in *Chambers USA*, and in *The Best Lawyers in America* in the areas of Bankruptcy and Creditor/Debtor Rights/Insolvency

and Reorganization Law since 2009 and Commercial Litigation since 2013. He also was listed in *New England Super Lawyers* for Business Litigation and Bankruptcy & Creditor/Debtor Rights from 2005-18 and is rated AV-Preeminent by Martindale-Hubbell. Mr. DeGiacomo received his B.S. *cum laude* from Boston College in 1978 and his J.D. in 1981 from Suffolk University Law School.

Edmond J. Ford is a shareholder in the firm of Ford, McDonald & Borden, P.A. in Portsmouth, N.H. He was admitted to the Bar in New Hampshire in 1982 and has been with his current firm or its predecessors since 1991. In addition to New Hampshire, Mr. Ford is a member in good standing of the bars of Massachusetts and Maine. He has been on the panel of chapter 7 trustees for the state of New Hampshire since 1998. Mr. Ford has published numerous articles on bankruptcy-related matters and has presented at multiple Continuing Legal Education seminars. He is a member of ABI and the National Association of Bankruptcy Trustees. He also is a member of the New Hampshire Board of Bar Examiners and the New Hampshire Bar Association's CLE Committee. Mr. Ford graduated *magna cum laude* from Dartmouth College in 1978 with a degree in economics and received his J.D. *cum laude* from the University of Pennsylvania Law School in 1982.

Hon. Elizabeth D. Katz is a U.S. Bankruptcy Judge for the District of Massachusetts in Springfield, appointed on March 13, 2017, and assigned to the Western and Central Divisions. On April 17, 2018, she was appointed to the First Circuit Bankruptcy Appellate Panel. From 1995-2007, Judge Katz was an assistant district attorney for the Northwestern District Attorney's Office, and she was chief of the District Court Prosecutors from 2000-07. She also was an associate at the firm of Katz, Argenio and Powers, PC from 2007-08 and later became an associate at the Ostrander Law Office from 2008-13, where she concentrated her practice on bankruptcy law. At Ostrander Law Office, she represented a chapter 7 trustee in adversary proceedings, counseled individuals and businesses in financial distress, and represented clients in bankruptcy cases. In 2013, she formed and operated The Law Office of Elizabeth D. Katz, focusing on criminal defense and bankruptcy law. Immediately prior to her appointment, she had been a founding partner at Rescia, Katz & Shear, LLP since 2015. An active member of the Hampshire County, Hampden County and Massachusetts Bar Associations, Judge Katz served as president of the Hampshire County Bar Association from 2012-14. She also was co-chair of both the Massachusetts Bar Association's Western Massachusetts Bankruptcy Symposium and the Western Division of the M. Ellen Carpenter Financial Literacy Program. In 2016, Judge Katz was awarded the Massachusetts Bar Association's Community Service Award. In addition, she has been a frequent panelist and lecturer on the topics of both criminal and bankruptcy law. Since 2019, Judge Katz has taught consumer bankruptcy at Western New England University School of Law. She received her undergraduate degree from the University of Vermont in 1991 and her J.D. from Boston University School of Law, where she received the Edward F. Hennessey Award in 1994.

Kathleen M. LaManna is a partner in Shipman & Goodwin LLP's Corporate Trust Practice Group and its Bankruptcy and Creditors' Rights Practice Group in Hartford, Conn., and she served for many years as chair of both practice groups. She represents clients in commercial litigation, defaults, bankruptcies, workouts, contract disputes, and other creditors' rights matters, practicing in bankruptcy and civil courts across the country. Ms. LaManna has broad litigation and chapter 11 bankruptcy experience, as well as experience guidingher clients through forbearance negotiations and documentation, debt-refinancing, corporate trust amendments, waivers and negotiated resolutions. She has particular experience representing banks in their roles as trustee, collateral agent and administrative agent for

public and private debt, in connection with defaulted secured and unsecured financings and debtor-in-possession financing in bankruptcy proceedings. She also represents clients in more general state and federal civil litigation matters relating to contract disputes, business litigation and commercial defaults, as well as in preference and avoidance actions in bankruptcy courts. Ms. LaManna is rated AV-preeminent by Martindale-Hubbell, has been named a *Connecticut Super Lawyer* since 2014, was selected as one of *Lawdragon*'s 500 Leading U.S. Bankruptcy and Restructuring Lawyers, and is a Fellow in the Litigation Counsel of America, Trial Lawyer Honorary Society. She received her B.A. *cum laude* in 1992 from Boston College and her J.D. in 1995 from the University of Connecticut School of Law.