



AMERICAN  
BANKRUPTCY  
INSTITUTE

# 2019 Northeast Bankruptcy Conference and Northeast Consumer Forum

## **Not Your Parents' Fraudulent- Transfer Action**

**Andrew Z. Schwartz, Moderator**

*Foley Hoag LLP; Boston*

**Hon. Julie A. Manning**

*U.S. Bankruptcy Court (D. Conn.); Bridgeport*

**Harold B. Murphy**

*Murphy & King, PC; Boston*

**Suzanne B. Roski**

*Protiviti Inc.; Richmond, Va.*



## 25th Annual Northeast Bankruptcy Conference

### NOT YOUR PARENTS' FRAUDULENT TRANSFER ACTION

JULY 12 & 13, 2019

**Andrew Z. Schwartz, Moderator**  
Foley Hoag LLP; Boston

**Harold B. Murphy**  
Murphy & King, PC; Boston

**Hon. Julie A. Manning**  
U.S. Bankruptcy Court (D. Conn.); Bridgeport

**Suzanne B. Roski**  
Protiviti Inc, Richmond



## 25th Annual Northeast Bankruptcy Conference

### THE EXTRATERRITORIAL APPLICATION OF THE BANKRUPTCY CODE'S AVOIDANCE PROVISIONS

JULY 12 & 13, 2019

**Presented by:**  
**Andrew Z. Schwartz**  
**Christian A. Garcia**  
Foley Hoag LLP - Boston, MA



## The Presumption Against Extraterritoriality



- Longstanding principle “that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.” *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991).

### Rationales:

- The presumption guards against unintended conflicts between domestic and foreign laws. *Id.*
  - Courts should assume that Congress takes into account sovereign interests of other nations when enacting legislation. *Id.*
- 
- The Supreme Court articulated a two-step test in *Morrison v. Nat’l Austl. Bank Ltd.*, 561 U.S. 247 (2010):
    - (1) Whether the presumption against extraterritoriality has been effectively rebutted by the statute’s clear, affirmative indication that it applies extraterritorially.
      - Intent must be shown through “clear evidence,” either in the statutory text or the legislative purpose underlying it.
    - (2) If the presumption has not been rebutted, whether the case involves a domestic application of the statute by examining the statute’s “focus.”

---

3

## The Code’s Avoidance Powers



- 11 U.S.C. §544, 545, 547, 548, 549, 550, 553(b), 724(a).
- Under these provisions, estate representatives possess broad powers to avoid and unwind transactions to recover value for the estate’s creditors.
- As the volume of cross-border transactions increases with globalization, the issue whether these provisions apply to such transactions becomes increasingly important.

---

4

## Do the Code's Avoidance Powers Apply Extraterritorially?



### The courts are split

- Congress intended that the Code's avoidance provisions apply extraterritorially:
  - *French v. Liebmann (In re French)*, 440 F.3d 145 (4th Cir. 2006).
  - *Sec. Investor Prot. SIPA Liquidation Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 480 B.R. 501 (Bankr. S.D.N.Y. 2012) (permitting trustee's complaint against the Taiwanese Bureau of Labor Insurance to proceed).
  - *Weisfelner v. Blavatnik (In re Lyondell Chem. Co.)*, 543 B.R. 127 (Bankr. S.D.N.Y. 2016).
  - *Emerald Capital Advisors Corp. v. Bayerische Motoren Werke Aktiengesellschaft (In re Fah Liquidating Corp.)*, 572 B.R. 117 (Bankr. D. Del. 2017).
- Congress did not intend that the Code's avoidance provisions apply extraterritorially:
  - *Midland Euro Exchange Inc. v. Swiss Finance Corp. (In re Midland Euro Exchange Inc.)*, 347 B.R. 708 (Bankr. C.D. Cal. 2006).
  - *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 513 B.R. 222 (S.D.N.Y. 2014) (dismissing trustee's complaint against various CACEIS Bank entities).
  - *Sherwood Invs. Overseas Ltd., Inc. v. Royal Bank of Scot. N.V. (In re Sherwood Invs. Overseas Ltd., Inc.)*, No. 6:15-cv-1469-Orl-40TBS, 2016 U.S. Dist. LEXIS 136096 (M.D. Fl. Sept. 30, 2016).
  - *Spizz v. Goldfarb Seligman & Co. (In re Ampal-American Isr. Corp.)*, 562 B.R. 601 (Bankr. S.D.N.Y. 2017).

5

## Arguments Supporting Extraterritorial Application of the Code's Avoidance Provisions



Congress expressed clear intent for extraterritorial application “through interweaving terminology and cross-references to relevant Code provisions.” *Sec. Investor Prot. SIPA Liquidation Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 480 B.R. 501, 527 (Bankr. S.D.N.Y. 2012); see also *Weisfelner v. Blavatnik (In re Lyondell Chem. Co.)*, 543 B.R. 127, 153-154 (Bankr. S.D.N.Y. 2016).

“Property of the estate,” as defined in § 541, through the language “wherever located,” includes all property worldwide. *In re Lyondell Chem. Co.*, 543 B.R. at 152 n.155.

- The avoidance provisions in §544(b), 547, and 548 incorporate language found in § 541, “an interest of debtor in property.” *Sec. Investor Prot. SIPA Liquidation Corp.*, 480 B.R. at 527.
- Section 550 explicitly authorizes the recovery from subsequent transferees of all transfers that have been avoided under the avoidance provisions. *Id.*, at 528.

6

## Arguments Supporting Extraterritorial Application of the Code's Avoidance Provisions



- By incorporating the language of § 541 into the avoidance provisions to define what property a trustee may recover, Congress expressed its clear intent to permit a trustee to avoid any transfer of property that would have been “property of the estate” but for the fraudulent transfer. *Sec. Investor Prot. SIPA Liquidation Corp.*, 480 B.R. at 527-28 (citing *Begier v. I.R.S.*, 496 U.S. 53, 58 (1990) (concluding that “property of the estate” in § 547(b) is best understood as the “property that would have been part of the estate” but for the fraudulent transfer)).
- Congress could not have intended that property located abroad could become “property of the estate” under § 541(a)(3) once recovered, while at the same time confining the “tool” used to recover such property to domestic applications. *In re Lyondell Chem. Co.*, 543 B.R. at 154.

7

## Arguments Supporting Extraterritorial Application of the Code's Avoidance Provisions



- The overarching purpose of the Code, to promote equality among similarly-situated creditors, and the purpose of the avoidance provisions, to prevent debtors from illegitimately disposing of property of the debtor's estate, are both advanced with a finding that the avoidance provisions apply extraterritorially. *French v. Liebmann (In re French)*, 440 F.3d 145, 152 (4th Cir. 2006).
- Absent extraterritorial application of the avoidance provisions, “unscrupulous debtors” could structure deals around offshore transfers to escape the Code's reach. *Midland Euro Exchange Inc. v. Swiss Finance Corp. (In re Midland Euro Exchange Inc.)*, 347 B.R. 708, 718 (Bankr. C.D. Cal. 2006).

8

## Arguments Supporting Extraterritorial Application of the Code's Avoidance Provisions



- Dismissing domestic actions to unwind pre-petition transfers would force the estate to pursue recovery actions under foreign law in foreign jurisdictions.
- The efficacy of a bankruptcy proceeding is highly dependent upon a court's ability to control and marshal assets of the debtor, "wherever located." *In re Midland Euro Exchange Inc.*, 347 B.R. at 718.
- Concluding that the avoidance provisions do not apply extraterritorially results in a loss of value to the estate, confusion and chaos in administering a debtor's assets, and does not deter fraudulent transfers.

9

## Arguments Against Extraterritorial Application of the Code's Avoidance Provisions



- Nothing in the language nor the legislative history of the avoidance provisions suggests extraterritorial application. *In re Midland Euro Exchange Inc.*, 347 B.R. at 717.
- Section 541(a)(1) cannot supply the extraterritorial authority required to apply the avoidance provisions abroad because property subject to the avoidance provisions does not fall within § 541's "property of the estate." *Sec. Investor Prot. Corp. v. Bernard L. Madoff Sec. LLC*, 513 B.R. 222, 229-30 (Bankr. S.D.N.Y. 2014).
  - Property transferred to a third party prior to bankruptcy does not become "property of the estate" until after "it has been recovered by the [t]rustee . . . ." *Id.* at 229 (citing 11 U.S.C. § 541(a)(3)).
  - French's use of § 541 to supply extraterritorial authority to the avoidance provisions violates the maxim of statutory interpretation that holds that courts should attempt to give meaning and effect to every word and section of a statute because it fails to give meaning to § 541(a)(3). *In re Midland Euro Exchange Inc.*, 347 B.R. at 719.
  - The debtor does not retain a "legal or equitable interest" in property transferred to a third party pre-petition, and therefore has no interest in such property "as of the commencement of the case." *Id.*

10

## Arguments Against Extraterritorial Application of the Code's Avoidance Provisions



- The fact that § 541(a) contains extraterritorial language cuts against the argument that the Code's avoidance provisions apply extraterritorially. *Sec. Investor Prot. Corp.*, 513 B.R. at 230 (citing *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 265 (2010) (reasoning that § 10(b) of the Securities and Exchange Act of 1934 lacks what other surrounding provisions contain: "a clear statement of extraterritorial effect").
  - Presumably, if Congress wished for the avoidance provisions to apply extraterritorially, it would have included a "clear statement of extraterritorial effect" as it did in § 541. See *id.*
- Concluding that the Code's avoidance provisions apply extraterritorially may result in international discord. *Sec. Investor Prot. Corp.*, 513 B.R. at 231.
- There are certain cases where courts can reach the same decision without applying the Code extraterritorially (e.g., concluding that the transaction, while having an international component, has a "center of gravity" in the U.S.). See, e.g., *Arcapita Bank B.S.C.(c) v. Bahr. Islamic Bank (In re Arcapita Bank B.S.C.(c))*, 575 B.R. 229, 248 n.12 (Bankr. S.D.N.Y. 2017).

11

## In re Picard, 917 F. 3d 85 (2d Cir. 2019).



- The Second Circuit declined to reach the issue of whether the Code's avoidance provisions apply extraterritorially by concluding that Picard's use of § 550(a)(2) was a domestic application of the avoidance provisions.
- Picard, the SIPA-appointed trustee of Madoff Securities, sought to avoid certain subsequent transfers to foreign investors under § 550(a)(2).
  - Pre-petition, foreign investors requested that their capital, which was invested in Madoff Securities through foreign "feeder funds," be withdrawn.
  - In compliance with these requests, Madoff Securities, a domestic entity, transferred funds to the foreign feeder funds, which subsequently transferred those funds to foreign investors.
- The District Court for the Southern District of New York ruled that: (1) Picard's use of § 550(a)(2) was an extraterritorial application of the statute, barred by the presumption against extraterritoriality; and (2) international comity principles limit § 550(a)(2) to domestic application under these facts.

12

In re Picard, 917 F. 3d 85 (2d Cir. 2019).



- Applying *RJR Nabisco, Inc. v. European Cmty.*, 136 S.Ct. 2090 (2016), the Second Circuit concluded that “in recovery actions where a trustee alleges a debtor’s transfers are avoidable as fraudulent . . . § 550(a) regulates the transfer of property depleting the estate,” which had occurred domestically. *Picard*, 917 F.3d at 98.
  - A trustee cannot use § 550(a)(2) without avoiding a transfer under one of the avoidance provisions.
    - Thus, § 548 and § 550(a)(2) work “in tandem.” Indeed, § 550(a)(2) is a “utility provision” which “help[s] to execute the policy of § 548(a)(1)(A).” *Id.*
    - The harm being regulated by § 550(a)(2) is the fraudulent depletion of the debtor’s estate, not the subsequent transfer.
- The District Court erred in concluding that principles of “prescriptive comity” barred extraterritorial application of § 550(a)(2).
  - The U.S. has compelling interests in (1) ensuring that a domestic entity’s creditors and investors receive their fair share of estate property, making domestic investments more desirable to foreign investors, and (2) the orderly administration of domestic bankrupt estates.
  - Foreign jurisdictions have a minimal interest at least where there are no parallel foreign avoidance proceedings ongoing.

13

## Practical Implications – *Personal Jurisdiction*



A bankruptcy court has personal jurisdiction over a defendant if: (1) service of process has been made in accordance with Fed. R. Bankr. P. 7004(f); (2) the court has subject matter jurisdiction under § 1334 of the Code; and (3) exercise of jurisdiction is consistent with the Fifth Amendment. *In re HNRC Dissolution Co.*, No. 02-14261, 2018 Bankr. LEXIS 1739, at \*8-9 (Bankr. E.D. Ky. June 11, 2018).

- Rule 7004(f) provides that a bankruptcy court may exercise personal jurisdiction over a properly-served defendant “[i]f the exercise of jurisdiction is consistent with the Constitution and laws of the United States.”
- Personal jurisdiction in an adversary proceeding is constitutional if the defendant has “the requisite minimum contacts with the United States at large.” *O’Toole v. MyPlace Dev. SP. Z O.O. (In re Sledziejowski)*, Nos. 13-22050 (RDD) & 13-22748 (RDD), 2016 Bankr. LEXIS 3791, at \*12 (Bankr. S.D.N.Y. 2016).

14



## Practical Implications – *Personal Jurisdiction*



- In determining whether “minimum contacts” with the U.S. exist, courts differentiate between “specific” and “general” personal jurisdiction. *Id.* at \*13.
- Either is adequate to satisfy the Due Process Clause. *Id.* (citing *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 414-16 (1984)).
- General personal jurisdiction is based on a foreign defendant’s “continuous and systematic general business contacts” with the forum. *Id.* at \*14.
  - Although the hallmark for general personal jurisdiction is the foreign defendant’s domicile (or a corporation’s place of incorporation/principal place of business), general jurisdiction may be established where its affiliations with the forum are so “continuous and systematic” as to render it at home in the forum. *Hosking v. Hellas Telcoms. (Lux.) II SCA (In re Hellas Telcoms. (Lux.) II SCA)*, 524 B.R. 488, 501 (Bankr. S.D.N.Y. 2015).
- Specific personal jurisdiction is established where a foreign defendant “purposefully direct[s] his activities at residents of the forum and . . . the underlying cause of action arises out of or relates to those activities.” *Id.* at \*13.

15

## Practical Implications – *Personal Jurisdiction*



- Examples:
  - *O’Toole*, 2016 Bankr. LEXIS 3791 at \*20-22 (no specific personal jurisdiction found where the transactions at issue were wholly extraterritorial (foreign parties making investments in foreign real estate with foreign entities under foreign law); the defendant’s entering into a contract with a domestic entity was not sufficient to establish personal jurisdiction).
  - *Hosking*, 524 B.R. 488, 507-08 (concluding that general personal jurisdiction existed over an entity that maintained its Regional Head Office in N.Y., which served as a critical hub for its core banking operations).
  - *Levey v. Hamilton (In re Teknek, LLC)*, 354 B.R. 181, 198-99 (Bankr. N.D. Ill. 2006) (finding specific personal jurisdiction over two individuals who established an LLC in Illinois, used that entity to generate profits, and then transferred all funds out of the LLC, notwithstanding their foreign citizenship).
  - *AstroPower Liquidating Trust v. Xantrex Tech., Inc. (In re AstroPower Liquidating Trust)*, 335 B.R. 309, 318-20 (Bankr. D. Del. 2005) (finding specific personal jurisdiction over a Canadian company with U.S. operations or assets because it purposefully directed its activities towards a U.S. company when it offered to purchase the debtor’s stock and intentionally caused injury by breaching its duties as an agent and a fiduciary).

16



## 25th Annual Northeast Bankruptcy Conference

### THE IRS AS THE TRUSTEE'S "GOLDEN CREDITOR"

JULY 12 & 13, 2019

**Presented by:**  
**Harold B. Murphy**  
Murphy & King, P.C. – Boston, MA



### Section 544(b) of the Bankruptcy Code Extends Trustee's Fraudulent Transfer "Look-Back Period"



- Pursuant to Section 548 of the Bankruptcy Code, Trustee can avoid fraudulent transfers made by the debtor within 2 years of the petition date (the "look-back period").
- Under Section 544(b), Trustee can avoid a debtor's transfer that is voidable:
  - Under applicable law
  - By a creditor holding an allowable unsecured claim against the estate.
- Using state law as "applicable law" under Section 544(b), Trustee can extend look-back period.
  - UFTA in MA, NH, and RI provide 4 year look-back, ME provides 6 year look-back.

## The IRS as the “Creditor Holding an Allowable Unsecured Claims” Under Section 544(b)

---

MK MurphyBoggs

- Consensus holds that the Trustee can “step into the shoes” of the IRS as the triggering, or “golden” creditor for avoiding transfers under Section 544(b).
  - *Ebner v. Kaiser (In re Kaiser)*, 525 B.R. 697 (Bankr. N.D. Ill. 2014).
  - *Osherow v. Porras (In re Porras)*, 312 B.R. 81 (Bankr. W.D. Tex 2004).
  - *Shearer v. Tepsic (In re Emergency Monitoring Techs., Inc.)*, 347 B.R. 17 (Bankr. W.D. Penn. 2006).
  - *Alberts v. HCA Inc. (In re Greater S.E. Cmty. Hosp. Corp. I)*, 365 B.R. 293 (Bankr. D.D.C. 2006).
  - *Mukamal v. Citibank, N.A. (In re Kipnis)*, 55 B.R. 877 (Bankr. S.D. Fla. 2016).

---

19

## Threshold Issue: The Status of IRS’ (or any Creditor’s) Claim

---

MK MurphyBoggs

- MAJORITY: any existing tax liability is sufficient for IRS to constitute a creditor holding an allowable unsecured claim for purposes of § 544(b), whether or not (i) tax has been assessed, (ii) claim has matured, or (iii) proof of claim has been filed.
  - *Finkel v. Polichuk (In re Polichuk)*, 506 B.R. 405 (Bankr. E.D. Pa., 2014).
  - *Alberts v. HCA Inc. (In re Greater S.E. Cmty. Hosp. Corp. I)*, 365 B.R. 293 (Bankr. D.D.C. 2006).
- MINORITY: Where no proof of claim filed by or on behalf of IRS, the Trustee may not step into their shoes under § 544(b).
  - *Levey v. Gillman (In re Republic Windows & Doors, LLC)*, 2001 Bankr. Lexis 3936 (Bankr. N.D. Ill. 2011).

---

20

## The Effect of the Trustee's User of the IRS as a Triggering, "Golden" Creditor

MC Murphy & King

- In the shoes of IRS, Trustee can recover full amount of the transfers, recovery is not limited to amount of the IRS claim.
  - See *Moore v. Bay*, 284 U.S. 4 (1931).
  - “[A]n entire transfer may be set aside even though the creditor’s claim is nominal.” 5 Collier on Bankruptcy ¶ 544.09[5] (15<sup>th</sup> ed. Rev. 2009).
- Trustee’s goal in stepping into the shoes of IRS is to further extend look-back period for fraudulent transfer claims
- Two theories under which courts extend the look-back period of the Trustee in the shoes of the IRS
  - Federal Debt Collections Procedures Act, (28 U.S.C. 3301 *et seq.*) as “applicable law” - six year look-back period
  - State fraudulent transfer law as “applicable law” - 10 year statute of limitations for collection of taxes under 26 U.S.C. § 6501 is look-back period

21

## Federal Debt Collections Procedures Act Provides Six-Year Look-Back Period

MC Murphy & King

- FDCPA (28 U.S.C. 3301 *et seq.*)- fraudulent transfers may be avoided by the United States as a creditor within 6 years after transfer
- MAJORITY: FDCPA can constitute “applicable law” under § 544, and Trustee, when standing in shoes of IRS or other US government creditor, can use 6 year statute of limitations as look-back period
  - *Tronox, Inc. v. Kerr McGee Corp. (In re Tronox Inc.)*, 503 B.R. 239 (Bankr. S.D.N.Y. 2013)
  - *In re Pfister*, 2012 Bankr. Lexis 1456 (Bankr. D. S.C. 2012)
  - *In re Walter*, 462 B.R. 698 (Bankr. N.D. Iowa 2011)
  - *In re Gurley*, 222 B.R. 124 (Bankr. W.D. Tenn. 1998)
- MINORITY: FDCPA cannot constitute applicable law under § 544
  - *MC Asset Recovery LLC v. Commerzbank AG (In re Mirant Corp.)*, 675 F.3d 530 (5th Cir. 2012)

22

## Rationale of *Mirant* and Why Majority Disagrees



- *Mirant* based its holding on provision of FDCPA stating that “this chapter shall not be construed to supersede or modify the operation of title 11.” 28 U.S.C. § 3303(c).
  - Held that using FDCPA as applicable law under § 544(b) would supersede the operation of the Bankruptcy Code.
- Subsequent cases hold FDCPA can be “applicable law” under § 544(b) without modifying or superseding the operation of the Bankruptcy Code.
  - *Ebner v. Kaiser (In re Kaiser)*, 525 B.R. 697, 713 n.11 (Bankr. N.D. Ill. 2014).
  - *Hillen v. City of Many Trees, LLC (In re CVAH, Inc.)*, 570 B.R. 816, 827 (Bankr. D. Idaho 2017).
  - *Vieira v. Gaither (In re Gaither)*, 595 B.R. 201, 214 (Bankr. D.S.C. 2018).
  - *Gordon v. Harrison (In re Alpha Protective Servs.)*, 531 B.R. 889, 906 (Bankr. M.D. Ga. 2015).

23

## Internal Revenue Code Provides Ten-Year Look-Back Period



- Trustee uses state fraudulent transfer law as the “applicable law” to establish fraudulent transfer liability of debtor’s transferees.
  - *Frank Sawyer Trust of May 1992 v. Comm’r* 712 F.3d 597 (1st Cir. 2013) (IRS uses Massachusetts UFTA to avoid fraudulent transfers).
  - *Kaiser*, 525 B.R. at 709 (Trustee, in shoes of IRS, uses Illinois UFTA to establish liability for fraudulent transfers).
- State law statutes of limitations do not apply to causes of action brought by United States.
  - Grounded in ancient principle of *nullum tempus occurit regi*- no time runs against the king
  - *United States v. Summerlin*, 310 U.S. 414 (1940) (“It is well settled that the United States is not bound by state statutes of limitation . . . in enforcing its rights.”).
  - *United States v. Nemecek*, 79 F.Supp. 2d 821 (N.D. Oh. 1999) (state’s 4 year statute of limitations under UFTA does not apply to IRS’s prosecution of fraudulent transfer action).

24

## Internal Revenue Code Provides Ten-Year Look-Book Period

---

MC Murphy & King

- Courts look to the Internal Revenue Code to determine what statute of limitations applies to IRS fraudulent transfer action.
- The IRS may institute proceedings to collect a tax within 10 years of the timely assessment of that tax. 26 U.S.C. § 6502.
- The deadline for the IRS to assess a tax against a taxpayer is typically 3 years from the date a return is filed, subject to various tolling provisions. 26 U.S.C. § 6501.

---

25

## Internal Revenue Code Provides Ten-Year Look-Book Period

---

MC Murphy & King

- MAJORITY: So long as petition is filed within 10 years of assessment (or prior to expiration of deadline for IRS to assess tax), courts have applied a 10-year lookback period from the petition date.
  - *Finkel v. Polichuk (In re Polichuk)*, 506 B.R. 405 (Bankr. E.D. Penn., 2014).
  - *Osherow v. Porras (In re Porras)*, 312 B.R. 81 (Bankr. W.D. Tex. 2004).
  - *Shearer v. Tepsic (In re Emergency Monitoring Techs., Inc.)*, 347 B.R. 17 (Bankr. W.D. Penn. 2006).
- MINORITY: state law statutes of limitation apply to Trustee in shoes of IRS, Trustee does not get 10 year look-back period.
  - *Wagner v. Ultima Homes, Inc. (In re Vaughan Co., Realtors)*, 498 B.R. 297 (Bankr. D. N.M. 2013).

---

26

## The Rationale of *Vaughan* and Why the Majority of Courts Disagree

MC Murphy & Manning

- *VAUGHAN*: “*nullum tempus occurrit regi*” does not apply in an action brought by the government to vindicate a private interest.
  - Since Trustee’s fraudulent transfer action is for benefit of the debtor’s creditors generally, it should not have status of an action of the sovereign, should remain subject to state statute of limitation.
  - Noted policy concern- because IRS is a creditor in most cases, majority’s rule would create 10-year look-back period in most cases.
- MAJORITY: since the IRS, the creditor from whom Trustee derives its rights, would be performing public function if it had pursued the avoidance action under “applicable law,” Trustee gains status of the sovereign in bringing the action from Section 544(b)
  - Courts either disagree with *Vaughan*’s policy concern or hold that it is not for the courts to consider such policy concerns where the statutory language is clear.
    - *Mukamal v. Citibank N.A. (In re Kipnis)*, 555 B.R. 877 (Bankr. S.D. Fla. 2016).
    - *Ebner v. Kaiser (In re Kaiser)*, 525 B.R. 697 (Bankr. N.D. Ill. 2014).

27



## 25th Annual Northeast Bankruptcy Conference

HUSKY V. RITZ

JULY 12 & 13, 2019

**Presented by:**  
**Hon. Julie A. Manning**  
District of Connecticut

Husky Int'l Elecs., Inc. v. Ritz,  
136 S. Ct. 1581 (2016): 7-1 decision

---



- **Husky International Electronics, Inc. (Husky)** supplied components used in electronic devices. Between 2003 and 2007, Husky sold its products to **Chrysalis Manufacturing Corp., (Chrysalis)** and Chrysalis incurred a debt to Husky of \$163,999.38. During that time, **Daniel Lee Ritz, Jr. (Ritz)**, was a director of Chrysalis and owned at least 30% of Chrysalis' common stock.
- Husky, Chrysalis, and Ritz all agreed that between 2006 and 2007, Ritz drained Chrysalis of assets it could have used to pay its debts by transferring large sums of Chrysalis' funds to other entities Ritz controlled.

---

29

Husky Int'l Elecs., Inc. v. Ritz,  
136 S. Ct. 1581 (2016)

---



- Husky sued Ritz in state court seeking to hold him personally responsible for Chrysalis' \$163,999.38 debt. Husky argued that Ritz' intercompany-transfer scheme was "actual fraud" for purposes of a Texas law that allows creditors to hold shareholders responsible for corporate debt.
- Ritz then filed a Chapter 7 case in the United States Bankruptcy Court for the Southern District of Texas. Husky then commenced an adversary proceeding against Ritz seeking to hold him personally liable for Chrysalis' debt and asserting that Ritz could not discharge that debt because the intercompany-transfer scheme constituted "actual fraud" under 11 U.S.C. § 523(a)(2)(A).
- The bankruptcy court entered judgment in favor of Ritz and Husky appealed. The District Court held that Ritz was personally liable for the debt under Texas law, but the debt was not "obtained by ... actual fraud" under § 523(a)(2)(A) and could be discharged in his bankruptcy. Husky appealed to the Fifth Circuit.

---

30



Husky Int'l Elecs., Inc. v. Ritz,  
136 S. Ct. 1581 (2016)

---



- Husky argued to the Fifth Circuit that Ritz' asset-transfer scheme was effectuated through a series of fraudulent conveyances and that the transfers were a form of "actual fraud." The Fifth Circuit disagreed, holding that a necessary element of "actual fraud" is a misrepresentation from the debtor to the creditor.
- The Supreme Court **reversed** and held that the term "actual fraud" in § 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation.

---

31

Husky Int'l Elecs., Inc. v. Ritz,  
136 S. Ct. 1581 (2016)

---



- Supreme Court said--Although "fraud" connotes deception or trickery generally, the term is difficult to define more precisely. There is no need to adopt a definition for all times and all circumstances here because, from the beginning of English bankruptcy practice, courts and legislatures have used the term "fraud" to describe a debtor's transfer of assets that, like Ritz' scheme, impairs a creditor's ability to collect the debt.
- Supreme Court also noted that one of the first bankruptcy acts, the Statute of 13 Elizabeth, has long been relied upon as a restatement of the law of so-called fraudulent conveyances (also known as "fraudulent transfers" or "fraudulent alienations"). See generally G. Glenn, *The Law of Fraudulent Conveyances* 89-92 (1931).

---

32

## Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581 (2016)



Supreme Court further noted:

- Parliament made it fraudulent to hide assets from creditors by giving them to one's family, friends, or associates. The principles of the Statute of 13 Elizabeth—and even some of its language—continue to be in wide use today. See *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994) (“The modern law of fraudulent transfers had its origin in the Statute of 13 Elizabeth”).
- Equally important, the common law also indicates that fraudulent conveyances, although a “fraud,” do not require a misrepresentation from a debtor to a creditor. As a basic point, fraudulent conveyances are not an inducement-based fraud. Fraudulent conveyances typically involve “a transfer to a close relative, a secret transfer, a transfer of title without transfer of possession, or grossly inadequate consideration.” *BFP*, 511 U.S., at 540-541 (citing *Twyne's Case*, 3 Co. Rep. 80b, 76 Eng. Rep 809 (K.B. 1601)).
- Ritz concedes that fraudulent conveyances are a form of “actual fraud,” but contends that 11 U.S.C. § 523(a)(2)(A)’s particular use of the phrase means something else. ***Ritz’ strained reading of the provision finds little support.*** First, Ritz contends that interpreting “actual fraud” in § 523(a)(2)(A) to encompass fraudulent conveyances would render duplicative two other exceptions to discharge in § 523. Section § 523(a)(4) exempts from discharge “any debt ... for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” And § 523(a)(6) exempts “any debt ... for willful and malicious injury by the debtor to another entity or to the property of another entity.” ***There is, in short, overlap, but that overlap appears inevitable.***

33



## 25th Annual Northeast Bankruptcy Conference

### RECOVERY OF TUITION PAYMENTS

JULY 12 & 13, 2019

Presented by:  
**Suzanne B. Roski**  
Protiviti Inc - Richmond, VA

protiviti®

## Recovery of Tuition Payments

protiviti

- 1) One type of recovery action is increasing in frequency: recovery of pre-petition tuition payments by a debtor parent for his or her child's college education.
- 2) This type of action are interesting intersection of bankruptcy and / or state law and social and cultural values.
- 3) Courts have been split on rulings.
- 4) A 2015 Wall Street Journal article reported that from 2008 – 2015 at least 25 colleges and universities had been served recovery actions, with 12 returning payments. <sup>[1]</sup>
- 5) Attached case profile indicates pace of adversaries has accelerated.
- 6) A profile of recent rulings on this matter follows:

[1] Stech, Katy. "Bankruptcy Trustees Claw Back College Tuition Paid for Filers' Kids." *Wall Street Journal* 5 May 2015. Web. 28 Apr. 2019.

35

## Recent Rulings (Slide 1 of 2)

protiviti

	Case	Bankruptcy Court	Adv. Pro. Case No.	Ruling Date	Ruling For	Opinion
1	Bannerv. Lindsay (In re Lindsay)	S.D. of New York	08-09091	05/04/10	Plaintiff	No REV because there was no legal obligation to make tuition payments.
2	Gold v. Marquette Univ. (In re Leonard)	E.D. of Michigan	10-4608	04/08/11	Plaintiff	No REV because there was no legal obligation to make tuition payments.
3	Sikirica v. Cohen (In re Cohen)	W.D. of Pennsylvania	07-02517	02/23/13	Defendant	Payment of undergraduate tuition for child is reasonable and necessary for purposes of fraudulent transfer statutes.
4	Shearerv. Oberdick (In re Oberdick)	W.D. of Pennsylvania	08-02155	03/26/13	Defendant	Societal expectation that parents will assist with such expense if they are able.
5	Geltzerv. Our Lady of Mt. Carmel – St. Benedicta School <sup>[1]</sup>	E.D. of New York	13-01107	12/04/13	Defendant	Parochial school tuition payments for minor children were not avoidable.
6	DeGiacomo v. Sacred Heart Univ. Inc. (In re Palladino)	Massachusetts	15-01126	08/10/16	Defendant; APPEAL PENDING	Providing college education to make child financially self-sufficient provides financial benefit to parent who would otherwise continue to support child.
7	Roach v. Skidmore Coll. (Matter of Dunston)	S.D. of Georgia		01/31/17	Plaintiff	No REV because there was no legal obligation to make tuition payments.
8	Eisenberg v. Penn State Univ. (In re Lewis)	E.D. of Pennsylvania	16-0282 / 16-0284	04/07/17	Defendant	Funds from Parent Plus Loan; Proceeds were never in the debtor's possession or control. Had the debtor's child withdrawn from school, the court noted the loan proceeds would have been returned to the DOE — not the debtor.

[1] Elementary or secondary school, not college/university tuition.

36

## Recent Rulings (Slide 2 of 2)

	Case	Bankruptcy Court	Adv. Pro. Case No.	Ruling Date	Ruling For	Opinion
9	Geltzer v. Trey Whitfield School <sup>[1]</sup>	E.D. of New York	16-01122	09/18/17	Defendant	Elementary school tuition payments for minor children were not avoidable.
10	Boscarino v. Board of Trustees of Connecticut State University System (In re Knight)	Connecticut	15-020464	09/29/17	Plaintiff	No REV because there was no legal obligation to make tuition payments.
11	Slobodian v. Penn. State University	M.D. of Pennsylvania	17-00084	11/07/17	Plaintiff	Complaint to avoid college tuition survived motion to dismiss. Judge unable to determine amount of REV.
12	Novak v. University of Miami	Connecticut	17-02036	02/27/18	Defendant	Funds from Parent Plus Loan; The Court agreed with prior decisions that Parent Plus loan proceeds were never have been the debtor's property.
13	Boscarino v. Ithaca College	Connecticut	16-02002	02/27/18	Defendant	Funds from Parent Plus Loan; The Court agreed with prior decisions that Parent Plus loan proceeds were never have been the debtor's property.
14	Pergament v. Hofstra Univ. (In re Adamo)	E.D. of New York	18-02236	03/28/18 / 11/27/18 (Appeal)	Defendant	Since university accounts were in the name of the students, the students were the initial transferees. Appellate court agreed but remanded to determine if the accounts were funded before or after the payments were due.
15	Geltzer v. Oberlin College	S.D. of New York	18-01015	12/05/18	Plaintiff	No REV if child is beyond the age of majority (21 in NY); broke payments into three segments based on student's age.

[1] Elementary or secondary school, not college/university tuition.

37

## Geltzer v. Oberlin Coll. (In re Sterman) – SDNY

- In one of the most recent cases, Judge Glenn, Southern District of New York, ruled a debtor parent does not receive reasonably equivalent value in exchange for the payments parents make on behalf of children for college tuition -- if the child is beyond the age of majority (21 in New York).
- Debtor parents made transfers to Oberlin College for the benefit of two daughters.
- The Court held that the legal obligation in New York to support children up to the age of 21 constituted reasonably equivalent value.
- In holding that payments made after the daughters reached the age of 21 were voidable, Judge Glenn noted he was constrained by the language of the Bankruptcy Code and New York law.
  - Both statutes define “value” and “fair consideration” to require either the transfer of property or the satisfaction of an antecedent debt.
- Judge Glenn wrote that because there was no legal obligation to support children beyond the age of majority, there was no reasonably equivalent value.

38

## Recent Rulings – Rulings for Plaintiffs

protiviti

- In rulings for plaintiff trustees, courts have found:
  - Reasonably equivalent value (“REV”) was not exchanged for tuition payments
    - As of *Geltzer v. Oberlin College*, four bankruptcy courts had ruled parents do receive REV
    - With Glenn ruling – five ruled they do not
  - Parents have no legal obligation to pay tuition on behalf of their children beyond the age of majority:
  - Courts acknowledge no laws require parents to pay for a child’s college tuition
- On issue of REV, age of child matters
  - Judge Glenn ruled parents did not receive REV after child reached age of majority
  - However, he ruled that transfers prior to child reaching 21 were not voidable because legal obligation in New York to support child up to age of 21 constituted REV

[2] Lindsay.

## Recent Rulings – Rulings for Defendants

protiviti

- In findings for defendants, courts refer to:
  - Parents receive an economic benefit from tuition payments as they contribute to a child’s well-being and future self sufficiency
  - Tuition payments might be “reasonable and necessary” even after legal obligation of support for child ends<sup>[3]</sup>
  - Parents’ moral obligation to pay tuition:
 

“Even though there may not strictly be a legal obligation for parents to assist in financing their children’s undergraduate college education, there is something of a societal expectation that parents will assist with such expense if they are able to do so.”<sup>[4]</sup>

[3] Sikirca  
[4] Overdick.

## Structure of Payments / Financing Can Also Impact Rulings

protiviti®

- Defendants have prevailed based on the facts of the financial structure of the tuition payments.
- Three cases where Parent Plus loans were made in the name of the debtor. Courts noted the funds were never in the debtor's possession or control.
  - Novak v. University of Miami, Adv. Pro. No. 17-02036; Boscarino v. Ithaca College, Adv. Pro. No. 16-02002;
  - The Department of Education (“DOE”) makes Parent Plus loans to parents but pays proceeds directly to the school. If student withdraws, the unused proceeds are used to pay back the DOE.
- Where university is not the initial transferee, Court has denied recovery
  - In Pergament v. Hofstra Univ., after S.D. of NY ruled that since accounts created by the university to pay tuition were in the name of the students, then the students were the initial transferees.
    - E.g., universities that create accounts for and in the name of students – parents could not access accounts without students' permission
    - Judge Craig ruled that student accounts were “akin to bank accounts, with the Defendants as the financial institutions maintaining those accounts” such that university was “mere conduits in the initial transfer from the debtor to his children.”
    - University entitled to good faith defense under §550(b)
    - Child / student therefore has recovery exposure

41

## Other Issues

protiviti®

- Recoveries are unjust to colleges and universities that provided value to the debtor family.
- Children are often unable to graduate or receive transcripts if the recovery results in an outstanding financial obligation to the institution.
- Allowing recoveries might conflict with other social or fiscal policy:
  - The federal government created tax incentives for parents to contribute to their children's education. For instance:
    - the tax deduction for dependents includes students who have not yet attained the age of 24.
    - various savings plans, such as the 529 Plan, to encourage parents to save for their children's college education.
- Some domestic support agreements require parents to make tuition payments, irrespective of the child's age.
- For federal and state financial aid programs, undergraduate students under age 24 are considered dependents.
- The Federal Financial Aid Program requires dependent children and their families to use their combined assets to pay for the student's education.

[5] Exceptions include if student is i) married with dependents of his / her own; ii) a veteran; iii) a foster child; or iv) an unaccompanied homeless child.

42

## Outlook

protiviti

- Given high cost of tuition and potential magnitude of recoveries, actions likely to increase
- States may become active by enacting / changing statutes
  - In 2016, Connecticut passed a law amending the Connecticut Uniform Fraudulent Transfer Act to exclude tuition payments as transfers recoverable under Connecticut law
- Might federal legislation be coming?
  - In 2015, two congressmen introduced a bill known as “The PACT (Protecting All College Tuition) Act of 2015.”
  - It provided an exception to the avoidance of transactions by a bankruptcy trustee, under the Bankruptcy Code’s fraudulent transfer provision, where the transaction was a good faith payment by a parent of post-secondary education tuition for that parent’s child.
  - It would have added the following language “(f) A payment of tuition by a parent to an institution of higher education (as defined in either section 101 or 102 of the Higher Education Act) for the education of that parent’s child is not a transfer covered under paragraph (1)(B).” to the end of Section 548. Just to be sure I checked the 2017 version of the BK code and there is no section (f) added.
  - The bill was referred to the Subcommittee on Regulatory Reform, Commercial, and Antitrust law with no action after that referral.