

Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

JANUARY 2017

EDITOR'S NOTE: CROSS-BORDER HARMONY: WHAT WE ALL HOPE FOR IN THE NEW YEAR

Victoria Prussen Spears

MODIFICATION OF CHAPTER 15 RECOGNITION ORDER WARRANTED TO AVOID PREJUDICE TO U.S. CREDITORS

Veerle Roovers and Mark G. Douglas

CREATIVE FINANCE: U.S. BANKRUPTCY COURTS WILL NOT TOLERATE MANIPULATION OF COMI AND BAD FAITH USES OF CHAPTER 15 Michael B. Schaedle

A FEW THOUGHTS ON THE FAIRMONT GENERAL HOSPITAL AND LOWER BUCKS HOSPITAL CASES AND PROPOSALS FOR A BETTER PATH TO COLLATERAL SECURITY FOR BOND INVESTORS: PERFECTION BY OPERATION OF LAW FOR DTC BOOK ENTRY ONLY SECURITIES—PART II

Steven M. Wagner

AÉROPOSTALE BANKRUPTCY COURT DENIES MOTION TO EQUITABLY SUBORDINATE OR RECHARACTERIZE SECURED LENDERS' CLAIMS OR TO LIMIT LENDERS' CREDIT BIDDING RIGHTS

Brad B. Erens and Mark G. Douglas

TIMING IS EVERYTHING: THE SEVENTH CIRCUIT CLARIFIES THE ORDINARY COURSE OF BUSINESS PREFERENCE DEFENSE

Michael D. Jankowski and Peter C. Blain

COURT ADOPTS MAJORITY VIEW IN SANCTIONING BANKRUPTCY TRUSTEE'S USE OF TAX CODE LOOK-BACK PERIOD IN AVOIDANCE ACTIONS

Amanda A. Parra Criste and Mark G. Douglas

BANKRUPTCY COURT WEIGHS IN ON DELAWARE'S PROHIBITION ON DEEPENING INSOLVENCY CLAIMS AND CLAIMS AGAINST DIRECTORS BASED ON RELATIONSHIP WITH MAJORITY SHAREHOLDER

Adam M. Lavine

WATERSHED RULING IN U.S. REJECTS OW BUNKER'S MARITIME LIEN CLAIMS Andrea J. Pincus and Jane Freeberg Sarma



LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 13

NUMBER 1

JANUARY 2017

Editor's Note: Cross-Border Harmony: What We All Hope for in the New Year Victoria Prussen Spears	1
Modification of Chapter 15 Recognition Order Warranted to Avoid Prejudice to U.S. Creditors Veerle Roovers and Mark G. Douglas	4
<i>Creative Finance</i>: U.S. Bankruptcy Courts Will Not Tolerate Manipulation of COMI and Bad Faith Uses of Chapter 15 Michael B. Schaedle	12
A Few Thoughts on the Fairmont General Hospital and Lower Bucks Hospital Cases and Proposals for a Better Path to Collateral Security for Bond Investors: Perfection by Operation of Law for DTC Book Entry Only Securities—Part II Steven M. Wagner	18
Aéropostale Bankruptcy Court Denies Motion to Equitably Subordinate or Recharacterize Secured Lenders' Claims or to Limit Lenders' Credit Bidding Rights Brad B. Erens and Mark G. Douglas	29
Timing Is Everything: The Seventh Circuit Clarifies the Ordinary Course of Business Preference Defense Michael D. Jankowski and Peter C. Blain	37
Court Adopts Majority View in Sanctioning Bankruptcy Trustee's Use of Tax Code Look-Back Period in Avoidance Actions Amanda A. Parra Criste and Mark G. Douglas	41
Bankruptcy Court Weighs in on Delaware's Prohibition on Deepening Insolvency Claims and Claims Against Directors Based on Relationship with Majority Shareholder Adam M. Lavine	47
Watershed Ruling in U.S. Rejects OW Bunker's Maritime Lien Claims Andrea J. Pincus and Jane Freeberg Sarma	51

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D., at 415-908-3207

Email: kent.hanson@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at (800) 833-9844

Outside the United States and Canada, please call (518) 487-3000

Fax Number (518) 487-3584

Customer Service Web site <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call

Your account manager or (800) 223-1940

Outside the United States and Canada, please call (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [article title], [vol. no.] PRATT’S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the “Rescue and Recovery” Culture for Business Recovery*, 10 PRATT’S JOURNAL OF BANKRUPTCY LAW 349 (2014)

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. A.S. Pratt is a registered trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2017 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

An A.S. Pratt® Publication

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW  BENDER

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF

STEVEN A. MEYEROWITZ

President, Meyerowitz Communications Inc.

EDITOR

VICTORIA PRUSSEN SPEARS

Senior Vice President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Scott L. Baena

*Bilzin Sumberg Baena
Price & Axelrod LLP*

Thomas W. Coffey

Tucker Ellis & West LLP

Stuart I. Gordon

Rivkin Radler LLP

Leslie A. Berkoff

*Moritt Hock & Hamroff
LLP*

Michael L. Cook

Schulte Roth & Zabel LLP

Matthew W. Levin

Alston & Bird LLP

Ted A. Berkowitz

Farrell Fritz, P.C.

Mark G. Douglas

Jones Day

Patrick E. Mears

Barnes & Thornburg LLP

Andrew P. Brozman

Clifford Chance US LLP

Timothy P. Duggan

Stark & Stark

Alec P. Ostrow

Stevens & Lee P.C.

Kevin H. Buraks

*Portnoff Law Associates,
Ltd.*

Gregg M. Ficks

*Coblentz, Patch, Duffy &
Bass LLP*

Deryck A. Palmer

*Pillsbury Winthrop Shaw
Pittman LLP*

Peter S. Clark II

Reed Smith LLP

Mark J. Friedman

DLA Piper

N. Theodore Zink, Jr.

Chadbourne & Parke LLP

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company, Inc. Copyright 2017 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. All rights reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from *Pratt's Journal of Bankruptcy Law*, please access www.copyright.com or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844.

Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz,

Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 718.224.2258. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, Attn: Customer Service, 9443 Springboro Pike, Miamisburg, OH 45342-9907.

Court Adopts Majority View in Sanctioning Bankruptcy Trustee’s Use of Tax Code Look-Back Period in Avoidance Actions

*By Amanda A. Parra Criste and Mark G. Douglas**

In a recent decision, the U.S. Bankruptcy Court for the Southern District of Florida held that a Chapter 7 trustee could effectively circumvent Florida’s four-year statute of limitations for fraudulent transfer actions by stepping into the shoes of the Internal Revenue Service, which is not bound by Florida law, but instead, the 10-year statute of limitations for collecting taxes specified in the Internal Revenue Code. The authors of this article discuss the decision and its implications.

The ability of a bankruptcy trustee or Chapter 11 debtor-in-possession (“DIP”) to avoid fraudulent or preferential transfers is an important tool promoting the bankruptcy policy of equality of distribution among creditors. One limitation on this avoidance power is the statutory “look-back” period during which an allegedly fraudulent transfer can be avoided—two years for fraudulent transfer avoidance actions under Section 548 of the Bankruptcy Code and, as generally understood, from three to six years if the trustee or DIP seeks to avoid a fraudulent transfer under Section 544(b) and state law by stepping into the shoes of a “triggering” creditor plaintiff.

The longer look-back periods governing avoidance actions under various state laws significantly expand the universe of transactions that may be subject to fraudulent transfer avoidance. A ruling recently handed down by the U.S. Bankruptcy Court for the Southern District of Florida, however, suggests that the look-back period in avoidance actions under Section 544(b) may be much longer—10 years—in bankruptcy cases where the Internal Revenue Service (the “IRS”) or another governmental entity is the triggering creditor. In *Mukamal v. Citibank (In re Kipnis)*,¹ the court, adopting the majority approach, held that a Chapter 7 trustee could effectively circumvent Florida’s four-year statute of limitations for fraudulent transfer actions by stepping into the shoes of the IRS, which is not bound by Florida law, but instead, the 10-year statute of

* Amanda A. Parra Criste is a Miami-based associate in the Business Restructuring & Reorganization Practice of Jones Day. Mark G. Douglas is the firm’s New York-based restructuring communications coordinator and is a member of the Board of Editors of *Pratt’s Journal of Bankruptcy Law*. They can be contacted at aparracriste@jonesday.com and mgdouglas@jonesday.com, respectively.

¹ 555 B.R. 877 (Bankr. S.D. Fla. 2016).

limitations for collecting taxes specified in the Internal Revenue Code (the “IRC”).

DERIVATIVE AVOIDANCE POWERS UNDER SECTION 544(B) OF THE BANKRUPTCY CODE

Section 544(b)(1) of the Bankruptcy Code provides in relevant part as follows:

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 or that is not allowable only under section 502(e) of this title.²

Thus, a trustee (or DIP pursuant to Section 1107(a)) may seek to avoid transfers or obligations that are “voidable under applicable law,” which is generally interpreted to mean state law.³

State fraudulent transfer statutes (generally, versions of the Uniform Fraudulent Conveyance Act or the Uniform Fraudulent Transfer Act (the “UFTA”), which was recently amended and renamed the Uniform Voidable Transactions Act) have a look-back period of three to six years. For example, Florida’s version of the UFTA provides that avoidance actions are time-barred unless brought within four years from the time the transfer was made or the obligation was incurred.⁴

Longer-Look Back Period for Certain Governmental Entities

However, the federal government is generally not bound by state statutes of limitations.⁵ Instead, various federal statutes or regulations specify the statute of limitations for enforcement actions. For example, the IRC provides that, with certain exceptions, an action to collect a tax must be commenced by the IRS no later than 10 years after the tax is assessed.⁶ The rationale behind a longer federal statute of limitations is that public rights and interests that the federal government is charged with defending should not be forfeited due to public

² 11 U.S.C. § 544(b).

³ See *Ebner v. Kaiser (In re Kaiser)*, 525 B.R. 697, 709 (Bankr. N.D. Ill. 2014); *Wagner v. Ultima Holmes (In re Vaughan)*, 498 B.R. 297, 302 (Bank. D.N.M. 2013).

⁴ See Fla. Stat. § 726.110.

⁵ *Vaughan*, 498 B.R. at 304.

⁶ See 26 U.S.C. § 6502(a).

officials' negligence.⁷

Based on the plain meaning of Section 544(b), nearly all of the courts that have considered the issue have concluded that a trustee or DIP bringing an avoidance action under that section may step into the shoes of the IRS to utilize the IRC's 10-year statute of limitations.⁸

Vaughan is the only published decision to the contrary. The *Vaughan* court reached its conclusion after considering policy and legislative intent. It noted that the IRS is not bound by state law statutes of limitations because it exercises sovereign powers and is therefore protected by the doctrine of *nullum tempus occurrit regi* ("no time runs against the king"). According to the court in *Vaughan*, Congress did not intend for Section 544(b) to vest sovereign power in a bankruptcy trustee, and allowing a trustee to take advantage of the IRC's 10-year statute of limitations would be too broad an interpretation of the provision.

Triggering Creditor Must Have an "Allowable Claim"

Avoidance under Section 544(b) is permitted only if a transfer could be avoided under applicable law by a creditor holding an "allowable" unsecured claim. The term "allowable" is not defined in the Bankruptcy Code. However, Section 502(a) provides that a claim for which the creditor files a proof of claim is deemed "allowed" unless a party in interest objects. Rule 3003(c) of the Federal Rules of Bankruptcy Procedure provides that, in a Chapter 9 or Chapter 11 case, a creditor need not file a proof of claim if the claim is listed on the debtor's schedules in the proper amount and is not designated as disputed, contingent or unliquidated.

Thus, if an unsecured creditor has not filed a proof of claim and if, in a Chapter 9 or Chapter 11 case, its claim is either not scheduled in any amount or scheduled as disputed, contingent or unliquidated, a handful of courts have concluded that the claim is not "allowable" and the trustee or DIP may not step into the creditor's shoes to bring an avoidance action under Section 544(b).⁹

⁷ *Vaughan*, 498 B.R. at 304.

⁸ See, e.g., *Kaiser*, 525 B.R. at 711–12; *Finkel v. Polichuk (In re Polichuk)*, 2010 Bankr. LEXIS 4345 (Bankr. E.D. Pa. Nov. 23, 2010); *Alberts v. HCA Inc. (In re Greater Southeast Cmty. Hosp. Corp. I)*, 365 B.R. 293, 299–306 (Bankr. D.D.C. 2006); *Shearer v. Tepsic (In re Emergency Monitoring Technologies, Inc.)*, 347 B.R. 17, 19 (Bankr. W.D. Pa. 2006); *Osherow v. Porras (In re Porras)*, 312 B.R. 81, 97 (Bankr. W.D. Tex. 2004).

⁹ See *In re Republic Windows & Doors*, (Bankr. N.D. Ill. Oct. 17, 2011) (Chapter 7 trustee could not take advantage of the IRC's 10-year statute of limitations because the IRS had not filed a proof of claim in the case); *Campbell v. Wellman (In re Wellman)*, (Bankr. D.S.C. June 2, 1998) ("[A]s Robert McKittrick was the only creditor of these three [creditors] to file a proof of claim,

However, the majority approach is otherwise. Most courts have held that the allowability of a claim for purposes of Section 544(b) should be determined as of the petition date, and therefore, that the failure to file a proof of claim does not disqualify a creditor from being the triggering creditor.¹⁰ In *Polichuk*, the court applied a broad definition of “allowable” in ruling that a Chapter 7 trustee could step into the shoes of the IRS even though it had not filed a proof of claim.

In addition, when the deadline for filing a proof of claim has not passed, the court may be more inclined to allow the trustee or an estate representative to go forward.¹¹ In *Kipnis*, the bankruptcy court considered whether a Chapter 7 trustee could step into the shoes of the IRS for purposes of Section 544(b).

KIPNIS

In June 2003, the IRS notified Donald Jerome Kipnis (the “debtor”) that his 2000 and 2001 taxes were under investigation. The investigation ultimately resulted in a 2012 tax court ruling in favor of the IRS affirming tax deficiencies exceeding \$1 million.

The debtor filed for Chapter 11 protection in the Southern District of Florida on January 21, 2014. The IRS filed a proof of claim in the case for \$1.9 million, of which it asserted that approximately \$25,000 was unsecured.

After the case was converted to Chapter 7, the trustee filed two adversary proceedings in January 2016 seeking to avoid as fraudulent, under the Florida UFTA, transfers of a bank account and a condominium in 2005 to the debtor’s wife (the “defendant”). The defendant moved to dismiss, arguing that both actions were barred by Florida’s four-year statute of limitations and Section 544(b) did not give the trustee the right to step into the shoes of the IRS and apply the 10-year IRC look-back period.

he is the only one with an allowable claim into whose shoes the [Chapter 7] Trustee may step pursuant to § 544(b).”).

¹⁰ See, e.g., *Whittaker v. Groves Venture, LLC (In re Bolon)*, 538 B.R. 391, 408 n.8 (Bankr. S.D. Ohio 2015); *Finkel v. Polichuk (In re Polichuk)*, 506 B.R. 405, 432 (Bankr. E.D. Pa. 2014); *In re Kopp*, 374 B.R. 842, 846 (Bankr. D. Kan. 2007).

¹¹ See *In re GI Holdings, Inc.*, 313 B.R. 612, 636 (Bankr. D.N.J. 2004) (permitting the asbestos claimants’ committee in a Chapter 11 case to step into the shoes of the New Jersey Department of Environmental Protection for purposes of Section 544(b), and to take advantage of the 10-year statute of limitations period for asserting fraudulent transfer actions made applicable to the governmental entity, even though it had not filed a proof of claim), *vacated in part, affirmed in part and remanded, Official Comm. of Asbestos Claimants v. Bank of New York (In re G-I Holdings, Inc.)*, 2006 BL 71226 (D.N.J. June 21, 2006).

THE BANKRUPTCY COURT'S RULING

Explaining that no other court in the U.S. Court of Appeals for the Eleventh Circuit had considered the issue to date, the court canvassed relevant case law elsewhere and concluded that *Kaiser's* plain reading approach was preferable to the approach applied in *Vaughan*. Applying a plain-meaning analysis to the facts in *Kipnis*, the court concluded that the meaning of Section 544(b) is clear and does not limit the type of creditor from which a trustee can choose to derive rights. Moreover, because the court determined that its interpretation of the statute was not “absurd,” the court did not deem it necessary to expand its inquiry beyond the express language of Section 544(b) to consider legislative intent or policy concerns.¹²

The court agreed with *Kaiser* that *Vaughan's nullum tempus* argument was misplaced. Because Section 544(b) is a derivative statute, the *Kipnis* court wrote, “the focus is not on whether the trustee is performing a public or private function, but rather, the focus is on whether the IRS, the creditor from whom the trustee is deriving her rights, would have been performing that public function if the IRS had pursued the avoidance actions.”

However, the court agreed with *Vaughan* on one point—if applied in other cases, the court's ruling could result in a 10-year look-back period in many cases. By contrast, the court in *Kaiser* found this argument to be a “logical fallacy” because the issue had then appeared in very few cases, despite the fact that Section 544(b) had been enacted more than 35 years prior to the court's ruling. According to the *Kipnis* court, because the IRS is a creditor in a significant number of cases, the paucity of decisions addressing the issue can more likely be attributed to the fact that trustees and DIPs have not realized that this “weapon is in their arsenal.”

OUTLOOK

Although perhaps surprising to some observers, *Kipnis* does not break new ground on the power of a bankruptcy trustee or DIP to bring avoidance actions under Section 544(b) of the Bankruptcy Code. Still, the court's endorsement of the majority approach on the availability of a longer look-back period in cases in which the IRS is a creditor is notable. If followed by other courts, the

¹² *Kipnis*, 555 B.R. at 882 (citing *Lamie v. United States Trustee*, 540 U.S. 526, 534, 157 L. Ed. 2d 1024 (2004) (“It is well established that ‘when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.’”)).

approach could significantly augment estate avoidance action recoveries.

Furthermore, the IRS is not the only triggering creditor under Section 544(b) with a longer look-back period. Other governmental entities may also provide that additional tool to a trustee or DIP.¹³

¹³ See, e.g., *Alberts v. HCA Inc. (In re Greater Se. Cmty. Hosp. Corp. I)*, 365 B.R. 293, 304 (Bankr. D.D.C. 2006) (the trustee of a liquidating trust created by a Chapter 11 plan could step into the shoes of the IRS as well as the Department of Health and Human Services (six year statute of limitations for actions to collect Medicare overpayments under 28 U.S.C. § 2415) for the purpose of bringing an avoidance action under Section 544(b) and the Illinois UFTA); *G-I Holdings, Inc.*, 313 B.R. at 636 (the asbestos claimants' committee in a Chapter 11 case could step into the shoes of the New Jersey Department of Environmental Protection (10-year statute of limitations for enforcement action) for purposes of Section 544(b)).