



Commercial Fraud Committee

ABI Committee News

In This Issue:

Volume 8, Number 2 / September 2011

- [Fraudulent-Transfer Litigants Beware: The Statutory Limitations and Reach-Back Periods May Be Broader than You Think](#)
- [Second Circuit Affirms Use of Net Investment Method to Determine Customer's Net Equity under SIPA](#)
- [Seize the Opportunity to Contribute to the Commercial Fraud Committee By Writing for the Newsletter](#)
- [ABI Launches Its New Search Engine - search.abi.org](#)
- [Educational Materials from Recent Conferences Can Now be Found on the New Materials Website](#)

Fraudulent-Transfer Litigants Beware: The Statutory Limitations and Reach-Back Periods May Be Broader than You Think

by [Richard Levy, Jr.](#)
Pryor Cashman LLP; New York

Bankruptcy litigators undoubtedly are familiar with the provisions of the Bankruptcy Code that establish the "limitations period" within which a trustee (including, for these purposes, a debtor in possession^[1]) must commence actions to avoid transfers as fraudulent conveyances, and the "reach-back period" within which pre-bankruptcy transfers by the debtor may be subject to avoidance under the Bankruptcy Code or incorporated state law remedies. Although these statutes seemingly establish bright-line boundaries for the commencement of avoidance proceedings and for determining the pre-petition period within which transactions may be subject to attack by an avoidance complaint, it is important for practitioners to recognize that neither of these time periods is necessarily as ironclad as statutory language might suggest. Counsel should be aware that the federal courts recognize several important rules that may allow a trustee to expand the limitations and reach-back periods in order to justify late-filed avoidance complaints and to sustain challenges to transfers that otherwise appear to be too remote in time to be subject to avoidance.^[2]

The Limitations Period for Bankruptcy Avoidance Actions

For purposes of avoidance litigation, § 546(a) of the Bankruptcy Code contains the

[Committee Officers](#)

[Upcoming Events](#)

[Contribute to the Newsletter](#)

[ABI World](#)

[Newsletter Archives](#)

bankruptcy statute of limitations for the commencement of avoidance complaints.^[3] It governs the pursuit of claims predicated on the specific avoidance provisions enumerated in the Bankruptcy Code, such as those governing challenges to preferences, fraudulent transfers and statutory liens,^[4] as well as claims for avoidance under state fraudulent-conveyance statutes incorporated into the trustee's arsenal through § 544(b).^[5] Section 546(a) provides that "an action or proceeding [under the avoidance provisions] *may not be commenced*" after the earlier of (1) the later of two years after entry of the order for relief, or one year after the appointment or election of the first trustee (if the appointment or election occurs within two years after entry of the order for relief), or (2) closure or dismissal of the bankruptcy case.^[6]

Although § 546(a) appears on its face to create a strict outer boundary for the commencement of avoidance actions, the courts repeatedly construe the statute as only a statute of limitations, not as a jurisdictional bar against later-filed avoidance actions.^[7] Thus, the benefit of the statute to a defendant may be tolled by agreement, waived by failing to plead it as a defense, or equitably tolled based on appropriate facts and circumstances.

The Reach-Back Periods for Avoidance of Fraudulent Transfers

The substantive avoidance statutes, in turn, specify the pre-bankruptcy time periods within which transfers made by a debtor may be subject to attack. Under the federal fraudulent-transfer statute in § 548 of the Bankruptcy Code, transfers made within the two years preceding the filing of the bankruptcy petition are subject to challenge as fraudulent transfers.^[8] The statute does not distinguish between actual fraudulent transfers and constructive fraudulent transfers.

Through the incorporation of state avoidance remedies under § 544(b) of the Bankruptcy Code, transactions that occurred within the particular state's limitations period—frequently longer than the federal reach-back period—are subject to attack by a trustee. Some state statutes draw important distinctions between the challenge periods applicable to actual and constructive fraudulent transfers. For example, under the model Uniform Fraudulent Transfer Act (UFTA), transfers are subject to challenge for a period of four years following the transaction, except that a transfer with actual intent to hinder, delay or defraud creditors may be challenged later so long as the action is commenced within one year after the transfer was, or reasonably could have been, discovered by the claimant.^[9] Some UFTA states departed from the model UFTA and enacted shorter or longer limitations periods.^[10] Other states follow the older Uniform Fraudulent Conveyance Act (UFCA)^[11] or their own individualized fraudulent-conveyance statutes.^[12]

Expansion of the Limitations and Reach-Back Periods Based on the Equitable-Tolling Doctrine

As indicated above, the federal courts construe the bankruptcy limitations period under § 546(a) to be subject to expansion by the doctrine of equitable tolling. For relief under state reach-back statutes available to a trustee, similarly the federal courts regularly conclude that a bankruptcy trustee may reach more remote transfers under the jurisprudential doctrine of equitable tolling under an express “discovery rule” where included in the state statutes, or (in some jurisdictions) a jurisprudential “discovery exception” for appropriate causes of action.^[13] In a leading formulation of the principle, a statute will not even begin to run until “the plaintiff either acquires actual knowledge of the facts that comprise his cause of action or should have acquired such knowledge through the exercise of reasonable diligence after being apprised of sufficient facts to put him on notice.”^[14]

All federal statutes of limitations are subject to equitable tolling.^[15] This means that the limitations period for avoidance actions under § 546(a) may be “extended” if the factual elements necessary to invoke the doctrine are present. Similarly, the reach-back periods, which establish the time period during which pre-bankruptcy transactions are subject to challenge, may be “expanded” under similar principles.^[16] For purposes of the extension of the limitations period and the expansion of the reach-back period, the equitable-tolling doctrine applies to three principal situations: (1) the plaintiff was prevented from commencing a timely suit on a claim because the underlying circumstances of the claim were affirmatively concealed by fraud, misrepresentation or other extraordinary circumstances beyond the plaintiff’s control (the “fraudulent concealment” prong of the doctrine);^[17] (2) even though the fraud was not intentionally or affirmatively concealed, the claim inherently was not discoverable within the applicable time period (the “self-concealing fraud” prong of the doctrine, also sometimes identified as the “discovery” exception);^[18] and (3) the entity to which the cause of action belonged was controlled by or dominated by wrongdoers that prevent timely assertion of the claim (the “adverse domination” prong).^[19]

Although the scope of inquiry may vary based on which prong of the doctrine is involved, the courts generally test the propriety of an action that otherwise appears to fall outside the applicable statutory period by assessing whether (1) a defendant concealed the claim from the plaintiff, (2) the plaintiff commenced the action within the prescribed limitations period measured from the time of discovery of the pertinent facts by the plaintiff or a party in privity with the plaintiff, and (3) the plaintiff’s ignorance of the claim did not result from a lack of due diligence.^[20]

Because equitable tolling is, inherently, fact-intensive, the determination of its applicability to a particular case is often better suited to adjudication on summary judgment or at trial, not on a motion to dismiss.^[21] A defendant who seeks to terminate an avoidance action as untimely, in turn, must preserve the affirmative defense of the statute of limitations by pleading it in an answer or by making a pre-answer motion addressing the issue (recognizing that because of its factual nature, the determination may require discovery and fact-based adjudication by summary judgment or evidentiary proceedings).^[22]

The trustee who seeks to invoke the principles of equitable tolling to justify a late-filed avoidance complaint must demonstrate the existence of facts, separate and apart from the alleged fraudulent transfer itself, to warrant application of the doctrine.^[23] The rule ordinarily operates only against a defendant who actively participated in the concealment of the claim.^[24]

Thus, even if the transfer at issue occurred before the facial range of the reach-back period, the court may entertain an avoidance claim that was not discovered or discoverable within the applicable statutory time period if, for example, the transferor's fraud was either (1) not discovered, or was not discoverable, with reasonable diligence by at least one unsecured creditor, or (2) was only discovered, and could only have been discovered with reasonable diligence, by at least one unsecured creditor within the applicable discovery period under state law.^[25]

Conclusion

Although a detailed examination of equitable tolling as applied to avoidance litigation is beyond the scope of this article, the preceding summary illustrates the significance of the doctrine. Bankruptcy practitioners should be alert to the possibility that an avoidance claim that appears to be untimely, because of either the passage of the limitations period under § 546(a) or the occurrence of the transfer before the applicable pre-petition reach-back period, may be viable under principles that permit enlargement of the time periods for equitable reasons.

1. See 11 U.S.C. § 1107(a) (with certain exceptions not applicable here, a debtor in possession has all rights of a trustee serving in a chapter 11 case).
2. For a further discussion of differences between the "limitations period" and the "reach-back periods" in bankruptcy litigation, see Weinstein, David R. and Hopenstand, Gil, "Reach Backs, Statutes of Limitation and Deadlines," *XXVII Am. Bankr. Inst. J.* 63 (No. 5, June 2007).
3. An adversary proceeding is commenced—and the statute of limitations is thereby

tolled—by the *filing* of a complaint with the court. Fed. R. Civ. P. 3 (made applicable in bankruptcy cases by Fed. R. Bankr. P. 7003).

4. See 11 U.S.C. §§ 547, 548 and 545.

5. See 11 U.S.C. § 544(b).

6. 11 U.S.C. § 546(a) (emphasis added).

7. See, e.g., *Myers v. Raynor (In re Raynor)*, 617 F.3d 1066 (8th Cir. 2010), *cert. denied*, 131 S.Ct. 945 (2011); *Pugh v. Brook (In re Pugh)*, 158 F.3d 530 (11th Cir. 1998). *But see Field v. Trust Estate of Rose Keipoikai (In re Maui Indus. Loan & Fin. Co.)*, 2011 WL 1750291, at *3 (Bankr. D. Haw. May 4, 2011) (“Congress wrote the two-year period in Sec. 546(a) as a fixed period. The text does not support an inference that Congress intended to permit discretionary extension of the time period.”).

8. See 11 U.S.C. § 548(a)(1). Although the reach-back period for fraudulent transfers under § 548 is measured from the date of commencement of the bankruptcy case, it is important to recognize that the statute of limitations under § 546(a) for commencement of an avoidance action runs from the entry of the order for relief. See 11 U.S.C. § 546(a). Thus, unlike a voluntary case under chapter 7 or 11 where the petition operates as the order for relief, in an involuntary case where there is typically some delay between the petition date and the entry of an order for relief, the time to file avoidance complaints may well extend beyond the second anniversary of the filing of the involuntary petition. For purposes of avoidance under state law, bankruptcy trustees typically argue that the reach-back period is counted back from the petition date in the bankruptcy case. Defendants, however, may argue that the state law avoidance period must be measured “forward” from the date of the transfer to determine the timeliness of the complaint under the state limitations period, positing that the action is untimely if the state statute has run before the trustee files the complaint. If the state law period is a substantive element of the state law remedy, for which the state limitations period could be tolled only by the filing of a complaint (absent other equitable circumstances, as explained below) and not by the filing of a petition to commence a bankruptcy case, then the defendant could argue that an action may be barred, even if filed within the bankruptcy limitations period under § 546(a), if the state law period has already expired. Thus far, however, the federal courts have been unsympathetic to that contention, holding instead that if the trustee’s claim under state law was viable as of the petition date, then it remains viable under § 544(b) of the Bankruptcy Code so long as the avoidance complaint is filed within the two-year limitations period in § 546(a), even if the state statute technically would run at an earlier time during that period. See,

e.g., *Sears Petroleum & Trans. Co. v. Burgess Constr. Servs. Inc.*, 417 F.Supp.2d 212 (D. Mass. 2006); *Picard v. Chais (In re Bernard L. Madoff Inv. Secs. LLC)*, 445 B.R. 206, 229-32 (Bankr. S.D.N.Y. 2011).

9. Unif. Fraudulent Transfer Act § 9, 7A U.L.A. 645 (1985) (promulgated 1984). See, *e.g.*, Cal. Civ. Code § 3439.9; Ind. Code § 32-18-2-19; Tex. Code § 24.010. The statute also provides a five-year look-back period for a transfer to an insider of the debtor on account of an antecedent debt where the debtor was insolvent at the time of the transfer and the insider-transferee had reason to believe that the debtor was insolvent. Unif. Fraudulent Transfer Act §§ 5(b), 9, 7A U.L.A. 645 (1985) (promulgated 1984).

10. See, *e.g.*, Ala. Code § 8-9A-9 (10 years for actual fraudulent transfers of real property, six years for actual fraudulent transfers of personal property, or one year after transfer was or reasonably could have been discovered by the claimant), Ark. Code Ann. tit. 4, §§ 4-59-209(a)-(b) (three years for actual and constructive fraudulent transfers) and Maine Rev. Stat. tit. 14, § 3580 (six years for actual fraudulent transfers, or one year after transfer was or reasonably could have been discovered by the claimant).

11. Unif. Fraudulent Conveyance Act, 7A U.L.A. 181 (1978) (promulgated 1918).

12. For example, New York follows the UFCA (N.Y. Debt. & Cred. L. art. 10, §§ 270-281) and applies the limitations period for actions based on fraud to fraudulent conveyance claims (N.Y. Civ. Prac. L. & R. § 213(8)) (limitations period for fraud is the greater of six years from accrual of the cause of action or two years after the claimant discovered or reasonably could have discovered the fraud). Many states have different limitations periods for actions in fraud and actions for liability created by statute. In the realm of fraudulent transfers under the UFCA where, unlike the UFTA, there is no specific limitations period, the characterization of the claim as a fraud claim or a statutory liability claim may determine which limitations period controls the timeliness of the action. In most states, as in New York, claims for common law fraud are subject to a "discovery rule," which extends the accrual of the claim beyond the enumerated period until the later time when the claim was, or should have been, discovered. In contrast, statutory claims for fraud and other causes of action may be governed by limitations periods that are not subject to expansion by the discovery rule. See *Orr v. Kinderhill Corp.*, 991 F.2d 31 (2d Cir. 1993) (New York's six-year statute of limitations for fraud actions (N.Y. Civ. Prac. L. & R. § 213(8)), not three-year statute of limitations for causes of action created by statute (*id.*, § 214(2)), applied to determine timeliness of fraudulent-conveyance action). Thus, for example, in the avoidance litigation arising from the "Ponzi" scheme in the *Pettors* bankruptcy cases, certain defendants recently filed motions in

the bankruptcy court to determine whether the trustee's claims under the UFTA to avoid transfers that occurred in 2000 are time-barred as "statutory fraud claims" subject to Minnesota's six-year limitations period (Minn. Stat. § 541.05(2)), which is not tolled by a discovery rule and which expired nearly 18 months before the petition date. The trustee, in contrast, asserts that his claims are "common law fraud claims" subject to a separate limitations statute that includes a discovery exception (*id.* § 541.05(6)) and that the claims were not (and could not have been) discovered because of fraudulent concealment. See General Electric Capital Corp.'s Motion to Dismiss, *Kelley v. General Elec. Cap. Corp. (In re Petters Co.)*, Adv. No. 10-4418 (Bankr. D. Minn. filed Feb. 18, 2011 (ECF No. 11)).

13. The precise formulation and requirements of the equitable-tolling doctrine may vary by jurisdiction. Counsel, of course, should carefully review the law in the relevant federal district to determine the scope of these principles and the circumstances to which they apply.

14. *City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 461 (2d Cir. 1974).

15. *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946) (equitable tolling "is read into every federal statute of limitations"); *Bailey v. Glover*, 88 U.S. (21 Wall) 342, 349-50 (1874).

16. See, e.g., *IBT Int'l Inc. v. Northern (In re IBT Int'l Admin Servs. Inc.)*, 408 F.3d 689 (11th Cir. 2005); *Jobin v. Boryla (In re M&L Bus. Mach. Co.)*, 75 F.3d 586 (10th Cir. 1996); *The Mediators Inc. v. Manney (In re The Mediators Inc.)*, 190 B.R. 515 (S.D.N.Y. 1995), *aff'd on other grounds*, 105 F.3d 822 (2d Cir. 1997).

17. See *Bailey* 88 U.S. (21 Wall) at 349-50; *IBT Int'l*, 408 F.3d at 701; *Barr v. Charterhouse Group Int'l Inc. (In re Everfresh Beverages Inc.)*, 238 B.R. 558, 577 (S.D.N.Y. 1999). *Mediators* 190 B.R. at 525.

18. See *Holmberg*, 327 U.S. at 397; *IBT Int'l*, 408 F.3d at 701; *Mediators*, 190 B.R. at 525.

19. See, e.g., *Freeland v. Enodis Corp.*, 540 F.3d 721, 741 (7th Cir. 2008); *Armstrong v. McAlpin*, 699 F.2d 79, 87 (2d Cir. 1983); *Everfresh Beverages*, 238 B.R. at 577; *Kaliner v. Load Rite Trailers Inc. (In re Sverica Acq'n Corp.)*, 179 B.R. 457 (Bankr. E.D. Pa. 1995) (trustee's allegations of control of the corporate debtor by defendants was sufficient to withstand motion to dismiss on ground that alleged fraudulent transfers occurred outside the Pennsylvania reach-back period applicable to the claim).

20. See, e.g., *IBT Int'l*, 408 F.3d at 702; *Ernst & Young v. Matsumoto (In re United*

Mgmt. Inc., 14 F.3d 1380 (9th Cir. 1994); *Mediators*, 190 B.R. at 524-25 (citing *State of N.Y. v. Hendrickson Bros. Inc.*, 840 F.2d 1065, 1083 (2d Cir.), cert. denied, 488 U.S. 848 (1988)); *Official Comm. of Unsecured Creditors v. Pardee (In re Stanwich Fin. Servs. Corp.)*, 291 B.R. 25 (Bankr. D. Conn. 2003); *Metzeler v. Bouchard Transp. Co. (In re Uni-Petrol Geselleschaft fuer Mineraloelprodukte m.b.H)*, 66 B.R. 977, 981 (Bankr. S.D.N.Y. 1986). In the case of “adverse domination,” the time to sue ordinarily will begin to run “when the wrongdoers lose control of the entity.” *Freedland*, 540 F.3d at 741 (quoting *Resolution Trust Corp. v. O’Bear, Overholser, Smith & Huffer*, 840 F.Supp. 1270, 1284 (N.D. Ind. 1993)).

21. See, e.g., *Everfresh*, 238 B.R. at 577.

22. See *Young v. United States*, 535 U.S. 34, 50-51 (2002) (applying equitable tolling to expand the three-year look-back period for certain tax claims under 11 U.S.C. § 507(a)(8)(A); “limitations periods are customarily subject to ‘equitable tolling’ unless tolling would be inconsistent with the text of the relevant statute”; equitable tolling is consistent with the fundamental goals of bankruptcy law).

23. See, e.g., *Silverman v. United Talmudical Acad. Torah Vyirah Inc. (In re Allou Distribs. Inc.)*, 446 B.R. 32, 68 (Bankr. E.D.N.Y. 2011) (granting summary judgment dismissing the complaint where, among other things, the trustee failed “to identify sufficient facts [supporting the application of equitable tolling] that are distinct from the alleged facts in support of the underlying fraud, or that support [the defendant’s] active concealment of the fraud”).

24. See, e.g., *Mediators*, 190 B.R. at 525 (holding that concealment of claim by shareholder of one defendant did not operate to toll the limitations period against another defendant that was not shown to have been involved in the concealment) (citing *Griffin v. McNiff*, 744 F.Supp. 1237 (S.D.N.Y. 1990), *aff’d mem.*, 996 F.2d 303 (2d Cir. 1993)).

25. See, e.g., *Chais*, 445 B.R. at 233 (applying two-year discovery rule under New York law to trustee’s avoidance claims arising from Madoff “Ponzi” scheme to justify expansion of reach-back period to dates preceding the state’s six-year statute of limitations for common law fraud).

