COMMERCIAL LAW & BANKRUPTCY SECTION NEWSLETTER

IDAHO STATE BAR - NOVEMBER 2017

THE CHALLENGE OF GETTING PAID FOR CHAPTER 7 REPRESENTATIONS

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IN RE GRIMMETT: AN INTRODUCTION

By: Bob Faucher, Holland & Hart LLP

The academics tell us that "almost all bankruptcy attorneys require people filing under chapter 7 to pay attorneys' fees in full before filing the case."[1] But that's simply not true in Idaho. In September 2017, excluding pro se cases, 70% of individual chapter 7 debtors paid their attorney in full before filing. In 30% of the cases, on the other hand, the attorney was expecting his or her client to make post-petition payments for legal services necessary to the prosecution of the chapter 7 case.[2] In the vast majority of those cases, significantly less than one-half of the fee was paid prepetition. And in 38% of the cases involving post-petition payments, the debtor paid nothing prepetition. The "no money down" chapter 7 has arrived in Idaho.

It could be that cases involving post-petition fee payments and "no money down" cases are increasing. In an admittedly random sampling, the September 2017 data was compared to September 2014 data. In the earlier month, excluding pro se cases, 25% of the individual chapter 7 cases involved a debtor on the hook for making post-petition fee payments. And only 7% of those cases were "no money down" cases.

All of the foregoing data were drawn from the Rule 2016(b) disclosures the debtor's attorney filed in the cases.

We know that a debtor's prepetition obligation to pay attorney's fees post-petition is dischargeable. *Hessinger & Assocs. v. U.S. Trustee (In re Biggar)*, 110 F.3d 685, 688 (9th Cir. 1997). Accordingly, how can it be that the Rule 2016(b) disclosures evidence that a substantial number of Idaho attorneys structure representations that obligate the client to pay attorney's fees post-petition?

Generally speaking, the attorneys in such situations in our circuit are relying on *Gordon v. Hines (In re Hines)*, 147 F.3d 1185 (9th Cir. 1998). Matt Christensen in his article below discusses *Hines* in detail. In short, the Ninth Circuit in *Hines* seems to hold that claims of the chapter 7 debtor's attorney for services provided post-petition are not subject to the automatic stay, and are not dischargeable, even if the services were provided pursuant to prepetition agreement. The panel in *Hines* called the attorney's rights to collect those fees a "doctrine of necessity."

There is a fascinating and pitched legal battle ongoing in Idaho on these and related questions. The important related issues include, among other things, "unbundling" and conflicts of interest between attorney and client. Matt and Kelly McConnell's articles below address *In re Grimmett*, 2017 WL 2437231 (Bankr. D. Idaho June 5, 2017). *Grimmett* constitutes Judge Pappas's take on one attorney's practice of seeking to collect, aggressively, the majority of his chapter 7 attorney's fees post-petition. As Matt and Kelly's analyses reveal, that attorney did not fare well before the Idaho bankruptcy court.

The attorney, however, is not giving up. The battle has moved to the sixth floor of our courthouse, where the attorney will see if Judge Lodge considers the attorney's reliance on *Hines* to have more merit than did Judge Pappas. *Weekes Law, PLLC v. Geiger*, Case No. 17-cv-00266-EJL, U.S. District Court, Idaho. The appellate briefing is completed, and makes for compelling reading. The appellant's briefs are full-throated, certainly. Attorneys from the Department of Justice in Washington, D.C. apparently drafted the United States Trustee's brief.

Notwithstanding the fundamental nature of the questions at issue, and the fact that the Bankruptcy Code is coming up on its 40th anniversary, the issues are live and tremendously significant. Matt and Kelly's articles below will hopefully help Idaho's attorneys structure their client representations to the mutual benefit of the prospective chapter 7 debtor and the attorney, and in compliance with all legal requirements.

ENDNOTES

[1] P. Foohey, R.M Lawless, K. Porter & D. Thorne, "No Money Down" Bankruptcy, 90 S. Cal. L.R. 1055, 1066 (2017).

[2] The average total fee for the cases in which the debtor was paying the entire fee prepetition was $1,050. The average total fee for the cases in which the debtor was paying some or all of the fee post-petition was $1,750.

IN RE GRIMMETT: UNBUNDLING VS. NON-PAYMENT AND DISCHARGEABILITY

By: Matthew T. Christensen, Angstman Johnson, PLLC

Both the 9th Circuit Court of Appeals and the 9th Circuit Bankruptcy Appellate Panel have authorized "unbundling" of services in certain circumstances.[i] The Idaho Rules of Professional Conduct also allow unbundling in similar circumstances. *In re Grimmett* is the latest decision from the Idaho Bankruptcy Court to deal with the issue of unbundling.[ii] Moreover, the Idaho court is not yet done voicing its opinions on the issue.

Facts of *In re Grimmett*

Grimmett involved a Chapter 7 debtor who, similar to many other Chapter 7 debtors, was unable to procure enough funds to pay her Chapter 7 attorney (the "Attorney") in full prior to the filing of the petition. In that case, the Attorney and Grimmett agreed on a Chapter 7 Agreement and Promissory Note that split the services to be provided by the Attorrney into both pre- and post-petition services. Under the Agreement, pre-petition services consisted of initial consultations, analysis of Grimmett's financial situation and exemption planning, review of Grimmett's questionnaire, and preparation and filing of the petition, SSN statement, Certificate of Credit Counseling and an application to pay the filing fee in installments. Everything else to be performed by the Attorney was considered either post-petition services, or additional services.

In conjunction with the Agreement, Grimmett agreed to pay the Attorney $2,000. $500 of this amount was allocated to pre-petition services and had to be paid pre-petition, with regular monthly post-petition payments to begin within 21 days after the initial petition was filed, with the balance owed to be paid within 12 months of the petition date. The Agreement provided for automatic debit withdrawals for the post-petition payments, collection activity by the Attorney in the event of non-payment of the post-petition payments, and an acknowledgement that the Attorney may "factor" the post-petition payment stream with a company called "BK Billing". After Grimmett made one post-petition payment, she was unable to continue making the required payments, and the Attorney began an increasingly-escalated attempt to collect the post-petition amounts owed. These attempts included threats to withdraw from the representation (which may have the effect of dismissing the bankruptcy case).

After receiving several notices, Grimmett sent a letter to the Court describing the situation, which the Court lodged in the docket. The United States Trustee then filed a motion to require the Attorney to disgorge all fees it had been paid, as well as for other sanctions.

In re Grimmett decision

After reciting the facts, the Court recognized the IRPC requirement of getting informed consent by the client prior to unbundling services. However, the Court declined to address the specific ethics-based issue, choosing instead to address unbundling under applicable bankruptcy rules and precedent. The Court first recited the oft-quoted list of "normal, ordinary and fundamental aspects" of a Chapter 7 case which attorneys should be prepared to perform.

> These include the proper filing of all required schedules, statements and disclosures; preparation and filing of necessary amendments to the same; attendance at the § 341 meeting; turnover of assets to the trustee, and cooperation with the trustee; compliance with the tax

> turnover and other orders of the Court; performance of the duties imposed by § 521(a)(1), (3) and (4); counseling in regard to § 521(a)(2) and the reaffirmation, redemption, surrender or retention of consumer goods securing obligations to creditors, and assisting the debtor in accomplishing those aims; and responding to issues that arise in the basic milieu of the bankruptcy case, such as violations of stay and stay relief requests, objections to exemptions and avoidance of liens impairing exemptions, and the like.[iii]

The Court characterized the Agreement as an attempt to unbundle the post-petition representation, in violation of both the spirit and letter of Castorena. *See* n. 3, *supra*.

The Court then turned to the US Trustee's argument that, by attempting to collect the post-petition fees, the Attorney was violating either the bankruptcy stay or bankruptcy discharge (depending on the timing of the entry of discharge). Here, the Court had to grapple with Ninth Circuit precedent, *In re Hines*.[iv] Hines involved a converted Chapter 13 case. The Debtor began the Chapter 13 case with one attorney, then later hired a different attorney (Gordon) to convert the case to Chapter 7. The Debtor then reverted back to the original attorney. Gordon and the debtor had a split fee arrangement that required the bulk of his fees be paid after conversion to Chapter 7. The Debtor new attorney argued that Gordon's efforts to collect the post-conversion fee after his termination was a violation of the bankruptcy stay.

In reviewing and applying the *Hines* decision, the Court ruled that the pre-petition agreement to pay fees both pre- and post-petition was "discharged in bankruptcy, period, and [the Attorney in *Grimmett*] cannot enforce that contract obligation post-petition." The Court then turned to *Hines'* secondary topic – whether the Attorney could recover post-petition fees under a quantum meruit theory. The Court found that the *Grimmett* Attorney presented insufficient evidence to establish the value of the services that were provided, and therefore quantum meruit was not a valid argument.

True unbundling of services vs. *Grimmett*

While the Court in *Grimmet* concluded that the Attorney improperly unbundled the pre- and post-petition services, in reality this is not what the Agreement did.[v] While the Agreement did apportion the services into pre- and post-petition time periods, the Agreement simply required Grimmett to pay for all services to be performed by the Attorney. This is, of course, similar to nearly every fee arrangement between an attorney and client, and is not unique to Chapter 7 debtor practice.

In other words, the attorney and client are agreeing that the attorney's work will not be done for free – the client must pay for those services. While *Castorena* laudably lists the essential functions of a debtor's attorney, there is nothing in that decision that requires an attorney to perform the normal, fundamental and ordinary aspects of representation for free – the client is always expected to pay for those services. Unlike a "typical" unbundling case, involving a discrete aspect of the case which is not included in the flat fee (i.e., nondischargeability or other adversary proceedings), here there was no unbundling (with the exception of those things identified in endnote v). The Attorney agreed to provide essential services to Grimmett in exchange for Grimmett's agreement to pay a flat fee for those services. The

agreement simply apportioned a portion of the flat fee to prepetition services, and a different portion to post-petition services.

Pre-petition agreements to pay post-petition fees are not discharged and are proper

Hines dealt with a pre-filing agreement to pay certain portions of the debtor's attorney fee post-filing, which the debtor in fact did.[vi] The debtor then terminated that attorney (Gordon), and reverted back to her original attorney. That attorney then sought stay-violation sanctions against Gordon. The Ninth Circuit recognized the quandary it faced:

> [T]he very administration of the bankruptcy system requires that attorneys for Chapter 7 debtors must have a legally enforceable right for their postpetition services that were contracted for before filing of the petition. If the absence of such a right were to become the law, it does not require much thought to recognize that the entire system would suffer a massive breakdown. In our view the required recognition of such a right, essentially a doctrine of necessity, is best implemented by a holding that all claims for lawyers' compensation stemming from such postpetition services actually provided to the debtor really do not fall within the automatic stay provisions of Section 362(a)(6) or the discharge provisions of Section 727. [vii]

Secondarily, the Ninth Circuit also recognized that the attorney's post-petition claim may not even arise until services are provided post-petition, which takes it out of the pre-petition claim arena.[viii] In *Hines*, however, the Ninth Circuit recognized that the attorney had been terminated – consequently the pre-petition agreement no longer existed and could no longer form the basis for the attorney's claim for fees. For that reason, the Ninth Circuit then turned to the quantum meruit argument and allowed fees pursuant to that argument. Notably, the Ninth Circuit did not deny Gordon's claim for post-petition fees because the pre-petition agreement had been discharged – it was denied because the pre-petition agreement had been terminated by the debtor firing Gordon.

Hines' essential holding—that enforcement of a pre-petition agreement to pay post-petition fees was not a violation of the stay or discharge injunction—explicitly recognizes that the obligation is not discharged in a bankruptcy proceeding. This holding has been subsequently reaffirmed by the Ninth Circuit in a later decision.[ix]

The Court in *Grimmett* appears to interpret *Hines* as determining that a discharge disallows all claims for fees related to a pre-petition fee agreement.[x] However, that interpretation extends *Hines* beyond its scope. *Hines* explicitly recognized that claims for post-petition fees were not discharged; only claims for pre-petition fees incurred. *Sanchez* later affirmed this essential holding. The Attorney in *Grimmett* has appealed the Court's decision, partly on this basis.

Conclusion[xi]

Undoubtedly, debtors' counsel should read *In re Grimmett* as a voice of warning. Whether the Court correctly interpreted *In re Hines* or not, there were a myriad of problems with the representation of Grimmett. However, debtors' counsel should

read the *Grimmett* decision as a roadmap of the potential pitfalls of pursuing that model of representation, and adjust their practice to avoid those problems.

ENDNOTES

[i] *See, e.g., Gordon v. Hines (In re Hines)*, 157 F.3d 1185 (9th Cir., 1998); *Tedocco v. DeLuca (In re Seare),* 515 B.R. 599 (9th Cir. BAP, 2014).

[ii] The *In re Grimmett* decision also dealt with some other deficiencies by the Attorney, including confusion regarding the required Rule 2016(b) statements regarding the Attorney's fees, as well as whether the Attorney had obtained "wet signatures" from Grimmett prior to filing the petition, statements and schedules. This article (and the remaining newsletter articles) are limited to the unbundling issue addressed by the Court.

[iii] *In re Castorena*, 270 B.R. 504, 530 (Bankr. D. Idaho, 2001).

[iv] *Gordon v. Hines (In re Hines),* 147 F.3d 1185 (9th Cir., 1998).

[v] In full acknowledgement, the Agreement did separate out "reaffirmation agreements, adversary actions and contested motions ... [including, but not limited to] motions to turnover property, motions for relief from stay...". As *Castorena* opined, these topics are "normal, fundamental and ordinary" aspects of a bankruptcy case, for which counsel agrees to represent the debtor. As outlined in *Castorena*, these sorts of issues cannot be properly unbundled without full, complete and informed consent of the debtor – which undoubtedly did not occur in this case. The unbundling of these services from the post-petition services was improper.

[vi] While the agreement in *Hines* was created during the Chapter 13 portion of the case, and therefore might be considered a post-petition agreement, it is treated as a pre-petition agreement under the provisions of 11 U.S.C. § 348(d).

[vii] *Hines*, 147 F.3d at 1191.

[viii] As the Court recognized, *Hines* reaffirmed a previous Ninth Circuit case which had determined that claims for unpaid pre-petition services were discharged in the Chapter 7 bankruptcy. *See, e.g., Hessinger & Assocs. v. U.S. Trustee (In re Biggar)*, 110 F.3d 685 (9th Cir. 1997). However, *Hines* dealt with claims for post-petition services rendered, and therefore did not reach the issues dealt with in, or otherwise extend, *Biggar*.

[ix] *See, e.g., Sanchez v. Gordon (In re Sanchez)*, 241 F.3d 1148 (9th Cir. 2001).

[x] Grimmett's obligation to pay the Attorney the agreed-upon fee was discharged in bankruptcy, that the Attorney cannot enforce that pre-petition contract post-petition, and that the Attorney's only recourse for post-petition payments was to equity.

[xi] the aggressive collection tactics pursued by the Attorney, and recognized that it did not appear the Attorney in that matter had factored Grimmett's payments to BK Billing. A discussion here of the collection tactics is beyond the scope of the article, but it should be noted that there were no allegations that the Attorney failed to perform any of the essential functions necessary for Grimmett to gain a discharge. The issue of factoring is presently before the Bankruptcy Court in *In re Hirsch*, 17-40179-JDP.

IN RE GRIMMETT: LIMITATIONS ON LEGAL SERVICES MUST COMPLY WITH THE IDAHO RULES OF PROFESSIONAL CONDUCT

By: Kelly Greene McConnell, Givens Pursley LLP

This portion of the newsletter supports the decision of Judge Pappas in restricting the unbundling legal services between pre-petition and post-petition services. There is no doubt that the cost of hiring a lawyer puts legal services outside the reach of many people today. That situation is compounded in the bankruptcy courts where the parties are seeking relief from their financial distress. However, avoiding ethical rules enacted for the protection of debtors is not an acceptable solution to the problems of legal costs.

The *Grimmett* decision[i] illustrates a common problem in Chapter 7 bankruptcy cases. More particularly, Chapter 7 debtors frequently do not have the entire amount required to pay debtor's counsel in one pre-petition payment. Some lawyers will allow their Chapter 7 debtor clients to pay legal fees over time after the bankruptcy case has been initiated. And there is the rub. Under the Bankruptcy Code, unpaid legal fee obligations incurred before the case is commenced may be subject to discharge.[ii] Further, counsel could be prohibited from attempting to collect certain legal fees by the bankruptcy automatic stay and/or the discharge injunction.[iii]

Creativity abounds among lawyers trying to get paid.[iv] To avoid the collection traps for debtor's counsel in a Chapter 7 case, the *Grimmett* lawyer drafted a legal representation agreement that divided duties between those commenced pre-petition and those to be performed post-petition. The theory is that the representation agreement for post-petition services would not be subject to the referenced Bankruptcy Code provisions restricting the ability to collect. Dividing legal services in this way, however, constitutes a limitation of services under the Idaho Rules of Professional Conduct (IRPC). While the limitation of legal services is allowed under the IRPC, that allowance is itself limited.

The analysis here starts with our local bankruptcy rules which make the IRPC applicable to counsel appearing in Idaho bankruptcy cases.[v] This means that all attorneys must abide by the IRPC in Idaho bankruptcy cases. The IRPC allows for limitations on legal services, more colloquially known as unbundling, as follows:

> A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.[vi]

Therefore, limiting the scope of services requires that: (1) the limitation is reasonable; and (2) the client understands the limitation; and (3) the client consents.[vii] The *Grimmett* court essentially found that the division of pre-petition and post-petition legal services as attempted was not reasonable under the circumstances. In addition, the Court found that no evidence was presented that the Debtor understood the limitation of services which is required before consent can be given.[viii]

In support of its finding that the unbundling of legal services was not proper as a matter of bankruptcy law, the Court turned to the prior Idaho decision of *In re Castorena*.[ix] The *Castorena* Court found that an unbundling of legal services in bankruptcy must include certain core services to be reasonable under the circumstances.[x] Along these lines, the *Castorena* Court stated that the attorney must assist the debtor through the "normal, ordinary and fundamental aspects of the process."[xi] More to the point, if the legal service is necessary to effect the debtor's desire to obtain bankruptcy relief, then "the less likely exclusion [of the legal service] is appropriate."[xii]

The *Grimmett* engagement expressly divided out certain services as post-petition that are necessary for obtaining a Chapter 7 discharge. For example, under the engagement debtor's counsel could have withheld such critical services

as preparing and filing schedules, attending the meeting of creditors and "even communicating with the Debtor about directives from the Court or Trustee."[xiii] Dividing out critical functions to the bankruptcy process into services which could be denied for lack of paying legal fees is on its face unreasonable under the circumstances. Any engagement agreement that allows debtor's counsel to abandon the client after commencing the case by filing a bare-bones petition is unreasonable under the circumstances and should be considered a violation of the IRPC.

Further note should be taken with respect to the informed consent requirement. The *Grimmett* case apparently did not involve any evidence regarding the debtor's understanding of the engagement agreement which failed for unreasonableness alone. Because the *Grimmett* Court found that service unbundling was invalid under bankruptcy law, it did not make any finding related to informed consent. Regardless, the Court did state that it was doubtful that informed consent was obtained. In fact, it is doubtful that informed consent to this degree of unbundling would ever be obtained given the complexity of the legal issues.

Practitioners should pay particular attention to this point. Again, informed consent requires that the client understand all the implications resulting from unbundling. This means that the client needs to understand the requirements of the Bankruptcy Code (such as filing schedules) and the consequences for not having representation for certain matters (possible dismissal). Given the degree of complexity of the Bankruptcy Code itself, the debtor who understands the implications of unbundling will be extremely rare. The United States Trustee in *Grimmett* was interested in whether the debtor understood the nature of the bankruptcy process, so do not be surprised if you see further scrutiny on this point.[xiv]

Debtor's counsel is entitled to be paid for services rendered. The structure of the code and the financial weakness of debtors can make receiving payment a challenge. However, the solution is not to disregard the rules of professional conduct. The solution here, like so many other problems, is in the hands of the United States legislature. If you agree and would like to see change, consider becoming involved with an organization like the American Bankruptcy Institute to work on legislative change.[xv]

ENDNOTES

[i] *In re Grimmett*, 2017 WL 2437231 (Bkrtcy. D. Idaho, June 5, 2017); Case #16-01094 JDP, Dkt. #58.

[ii] 11 U.S.C. § 727(b).

[iii] 11 U.S.C. §§ 326(a)(6), 524(a).

[iv] The *Grimmett* case involved post-petition collection tactics were questionable at best and not addressed in this article.

[v] LBR 9010.1(g).

[vi] IRPC 1.2(c).

[vii] *Id.*

[viii] The Court however, did not base its ruling upon a violation of the IRPC, but rather found that the unbundling of services was invalid under bankruptcy law.

[ix] *In re Castorena*, 270 B.R. 504 (Bankr. D. Idaho 2001).

[x] *Id.* at 530.

[xi] *Id.*

[xii] *Id.*

[xiii] *Grimmett, supra,* at p.19.

[xiv] Motion for Entry of an Order Cancelling Agreements and Directing Weeks Law, PLLC, and Nolan Sorensen to Return Fees, Case #16-01094, Dkt. #29.

[xv] Snarky comment about the current U.S. Legislature, *omitted.*

TRUSTEE AVOIDANCE POWERS: UTILIZING "APPLICABLE LAW" TO BENEFIT FROM EXTENDED LOOK-BACK PERIODS

By: Chad R. Moody & Matthew T. Christensen,
Angstman Johnson, PLLC

A bankruptcy trustee is vested with special powers to avoid certain transfers made by a debtor to another party within a number of years prior to the commencement of the bankruptcy case.[1] Recently, the Bankruptcy Court for the District of Idaho ruled in *Hillen v. City of Many Trees, LLC (In re CVAH, Inc.)*,[2] the Trustee could "step into the shoes" of the Internal Revenue Service ("IRS") and utilize the transfer avoidance powers within both the Federal Debt Collection Procedures Act ("FDCPA")[3] and the Internal Revenue Code ("IRC").[4] *In re CVAH* is notable not only for its analysis of what constitutes "applicable law" under 11 U.S.C. § 544(b)(1), but also for how a trustee benefits from the rights of the IRS under the FDCPA and IRC, including availing himself or herself of extended look-back periods of up to ten years.

Background

Prior to filing for bankruptcy in May 2014, CVAH Inc. ("CVAH") failed to pay corporate income taxes for tax years 2009 through 2013. During the six years prior to filing bankruptcy, CVAH made numerous payments to various parties, not in satisfaction of any debt owed by CVAH, but for debts owed by others, including CVAH's owner and family. The Trustee filed approximately 50 adversary complaints seeking to avoid transfers CVAH made to the various third parties. Because these transfers did not satisfy obligations owed by CVAH, the Trustee alleged that these transfers could be avoided by CVAH's largest creditor, the IRS. Specifically, the Trustee sought to "step into the shoes" of the IRS and utilize the longer "look-back" periods under the FDCPA and IRC to recapture transfers made by CVAH to the defendants within the six years prior to CVAH filing its petition for bankruptcy. Certain defendants filed motions to dismiss, raising numerous arguments challenging the Trustee's ability to invoke the FDCPA or IRC as a basis to avoid the transfers under § 544(b)(1). The Court framed the issue as: "[u]nder § 544(b)(1), may a bankruptcy trustee employ the transfer avoidance provisions, including the extended reach-back periods, provided in either the FDCPA and IRC?"[5] In its decision ultimately denying defendants' motions, the Court conducted an extensive analysis of § 544(b)(1), the FDCPA, and the IRC, which other courts have since found instructive. [6]

"Applicable law" under § 544(b)(1)

The Court first considered the meaning of "applicable law" as used in § 544(b)(1) and whether it included the FDCPA and IRC. In addition to the fraudulent transfer avoidance provisions in § 548, a trustee, may also rely on § 544(b)(1) to avoid "any transfer of an interest of the debtor in property. . . that is voidable under *applicable law* by a creditor holding an unsecured claim." Under the rule a trustee "steps into the shoes" and assumes the rights of an unsecured creditor to recover transfers an actual creditor would have been able to recover but for the debtor filing for bankruptcy.[7] In examining this rule, the Court ultimately held that "applicable law" warranted a broad interpretation. The Court noted there was an absence of limiting language narrowing the meaning of "applicable law," save that the creditor into whose shoes the trustee steps must have an applicable claim and be able to avoid a transfer under the selected law.[8]

The Court found that its interpretation of § 544(b)(1) was consistent with the rule's purpose and Congress's intent as expressed in the plain language of the rule. Specifically, the Court reasoned that allowing a trustee to utilize all available "applicable law" furthered the underlying

purpose of § 544(b)(1)—to restore the bankruptcy estate to the financial condition it would have been in but for the fraudulent transfers. The Court also observed "had Congress intended to restrict the reach of 'applicable law' in § 544(b)(1), it would have done so expressly."[9] Accordingly, the Court held that, under the plain language of § 544(b)(1), the Trustee was permitted to step into the shoes of the IRS and invoke any applicable law available to the IRS, including the FDCPA and IRC, to avoid the CVAH transfers to defendants.[10]

The FDCPA and the Six-Year Look-Back Period

The Court next considered whether language in the FDCPA prohibited the Trustee from relying on it as "applicable law" for purposes of § 544(b)(1). The FDCPA provides the exclusive civil procedures for the United States to recover debts owed to the government and creates a cause of action for federal creditors to avoid constructively fraudulent transfers, pursuant to FDCPA § 3304.[11] Under § 3306(b), a federal creditor may avoid a constructively fraudulent transfer if such action is commenced within six years after the transfer was made.

Citing FDCPA § 3003(c)(1), the defendants argued the Trustee was prohibited from utilizing the six-year look-back period because to do so would impermissibly "modify" the operation of Title 11 the ("Code").[12] Noting a split of authority on this issue, the Court engaged in an extensive statutory analysis of the FDCPA. Disagreeing with the defendants and the one Court of Appeals decision on this issue, the Court reasoned there is no change to the operation of § 544(b)(1) or any other provision of the Code if the look-back period for avoidance of a fraudulent transfer stems from the FDCPA, rather than other laws. The Court also disagreed with defendants' contention that the FDCPA was intended for the sole benefit of the United States and could not be utilized by a bankruptcy trustee. The Court noted that the focus of the § 544(b)(1) inquiry is not on what actions a *trustee* may take, but what actions the *creditor* into whose shoes the trustee is stepping may take.

The IRC and the Ten-Year Look-Back Period

The Court then turned to whether the Trustee could rely on IRC as "applicable law" for purposes of § 544(b)(1). The Court explained that the IRC permits the IRS, under 26 U.S.C. § 6901, to collect taxes by assessing tax liability against a transferee of assets of a taxpayer who owes income tax. Citing to I.R.C. § 7402, the Court noted that rather than assessing a transferee, the IRS may also sue for relief and such action is subject to the ten-year limitation period in IRC § 6502. The Court ruled that the IRS (and thus, the Trustee), could rely on state law to avoid the transfers in question to satisfy CVAH's unpaid taxes.[13] The Court then noted that in pursuing those transfers the IRS would be immune from the state four-year extinguishment period for fraudulent transfers. Accordingly, the Court held that, although the Trustee was relying on state law to avoid the CVAH transfers, by standing in the shoes of IRS, the Trustee exercised the same sovereign immunity powers and would not be subject to the state's extinguishment period. The defendants also raised various arguments concerning the applicability of the restrictions IRS might have faced outside of bankruptcy, and whether those restrictions would apply to the Trustee in pursuing the transfers in question. Additionally, the defendants raised a number of policy-related arguments. The Court analyzed each of these issues, and dismissed them all in turn.

Other Related Issues

While not addressed in the CVAH decision, some additional issues are important when evaluating the Trustee's ability to pursue claims under § 544(b)(1). First, the ability to stand in the creditor's shoes depends on the creditor's claim

at the time the bankruptcy petition was filed. If that creditor was then later paid in full after the petition was filed (either through a confirmed plan, or through a third-party payment), that does not defeat the Trustee's ability to stand in that creditor's shoes in pursuing claims.[14] Second, the amount of a recoverable transfer is not limited by the amount of unsecured claims in a case. For instance, an avoidable transfer of $400,000 value would be fully recoverable, even if there were only $250,000 worth of allowed unsecured claims in a case.[15] Last, the amount of recoverable transfer is also not limited by the amount of the triggering creditor's claim. For instance, the same avoidable transfer of $400,000 value would be fully recoverable, even if the triggering creditor (i.e., the IRS) was only owed $2,000 on the petition date.[16]

Conclusion and Impact

Although a bankruptcy trustee has long held the ability to use § 544(b)(1) to avoid transfers, the extent of the trustee's avoiding powers under the statute had not been clearly explored. That has changed with recent court decisions, including the Court's decision *In re CVAH*. Going forward, so long as the federal government (and specifically the IRS) is a creditor, trustees possess a powerful weapon to avoid fraudulent transfers by debtors to other parties. By stepping into the shoes of the IRS and invoking the FDCPA and the IRC as "applicable law," a trustee benefits from the same rights enjoyed by the IRS, including the use of a lookback period of up to ten years, thereby subjecting the debtor's transactions to greater scrutiny.

ENDNOTES

1 *See* 11 U.S.C. §§ 544(b)(1) and 548.

2 *Hillen v. City of Many Trees, LLC (In re CVAH, Inc.)*, 570 B.R. 816 (Bankr. D. Idaho 2017).

3 28 U.S.C. § 3001 et seq.

4 U.S. Code Title 26.

5 *In re CVAH, Inc.*, *supra* note 2, at 10.

6 *See Arrowsmith v. Mallory (In re Health Diagnostic Lab., Inc.)*, 2017 Bankr. LEXIS 2230, at 57 (Bankr. E.D. Va. Aug. 9, 2017).

7 *In re CVAH, Inc.*, *supra* note 2, at 14 (emphasis added).

8 *Id.* at 17-18 (noting that the unsecured claim must be allowable under § 502, or disallowed under 502(e)).

9 *Id.* at 20 (*citing Patterson v. Shumate*, 504 U.S. 753, 758 (1992) (applying the Supreme Court's analysis and interpretation of the similar phrase "applicable nonbankruptcy law" as found in § 541(c)(2)).

10 *Id.* at 18-19.

11 *Id.* at 25 (*citing* 28 U.S.C. § 3001(a)(1) and *United States v. Gelb*, 783 F.Supp.748, 751 (E.D.N.Y. 1991)).

12 *Id.* at 27 (*citing* 28 U.S.C. § 3003(c)(1) ("This chapter shall not be construed to supersede or modify the operation of—[the Code]").)

13 *Id.* at 42-44 (*Citing* Idaho UFTA, Idaho Code §§ 55-913 and 55-914).

14 *See, e.g., Acequia, Inc. v. Clinton (In re Acequia, Inc.)*, 34 F.3d 800 (9th Cir. 1994).

15 *Id.*

16 *Id., see also Cadle Co. v. Mims (In re Moore)*, 608 F.3d 253 (5th Cir., 2010).