Relation-Back Doctrine Applied in Adversary Actions

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Two recent bankruptcy cases decided on the same day by the same judge dealt with motions to amend the complaints in preference actions. Both cases illustrate the court's application of the relation-back doctrine, with differing results. Along the way, the court addressed the requirements for proper service and equitable tolling of the statute of limitations.

In *Bernstein v. Evergreen Line (In re Berkline/Benchcraft Holdings LLC)*, Adv. No. 13-50947 (MFW) (Del. Bankr. Aug. 6, 2013), the defendant, Evergreen Line, sought to dismiss the amended complaint filed by the plan administrator, Robert S. Bernstein, for defective service and as time-barred by the applicable statute of limitations. During the preference period, the debtors made payments to or for the benefit of Evergreen Line. Bernstein filed a complaint to recover the payments as preferential transfers pursuant to Sections 547 and 550 of the Bankruptcy Code against Evergreen Shipping Agency and served its registered agent in Texas with the summons and complaint. In a telephone call with Evergreen Shipping's counsel, Bernstein learned that Evergreen Shipping was the U.S. agent for Evergreen Line, who was the party that had dealt with the debtors. Bernstein also learned that there was an error on the schedule of transfer payments in the original complaint so that the amount claimed was understated.

Bernstein filed an amended complaint, changing the name of the defendant to "Evergreen Line" and correcting the error in the amount of the transfers, and served the amended complaint with a new summons on Evergreen Line in care of its registered agent in Texas. However, the registered agent refused the complaint. Bernstein reviewed Evergreen Line's website and found that Evergreen Shipping was listed as the U.S. agent

for Evergreen Line, so he served the amended complaint on Evergreen Line in care of Evergreen Shipping at its address in New Jersey. Evergreen Line then moved to dismiss the amended complaint as time-barred by the statute of limitations and for improper service under the Bankruptcy Rules.

The amended complaint had been filed more than two years after the petition date, after the statute of limitations for such actions had run under Section 546 of the Bankruptcy Code. Bernstein argued that the amendment related back to the original complaint and was therefore timely. Where an amendment changes the party or the naming of the party against whom a claim is asserted, the amendment relates back to the date of the original pleading if three conditions are met: the amendment asserts a claim arising out of the same transaction or occurrence in the original pleading; the party to be brought in by amendment received such notice of the action within the time for service of the original complaint (120 days) that it will not be prejudiced in defending on the merits; and, within the same period, the party knew or should have known that the action would have been brought against it but for a mistake concerning the proper party's identity.

The court found that the first condition was satisfied, since the original and amended complaints sought the avoidance of the same transfers. Only the amount of one of the transfers had been corrected. Bernstein argued that the second condition was also satisfied because Evergreen Line received both actual and constructive notice within the time for service of the original complaint, since Evergreen Line probably received notice of the action when counsel for Evergreen Shipping notified Bernstein that Evergreen Line was the contract principal but, in any event, by the time counsel for Evergreen Line requested an extension of the deadline to answer the amended complaint (after the attempted service on the registered agent in Texas but before service on Evergreen Shipping in New Jersey). The court found that Evergreen Line had received adequate notice of the action and would not be prejudiced in defending the amended complaint.

The court also found that the third condition was satisfied. It found sufficient facts showing that Evergreen Line should have known that it would be sued, including the similarity in corporate names, the fact that Evergreen Shipping was the U.S. agent for Evergreen Line, and the plain language of the complaint.

The question of the adequacy of service raised different issues. The amended complaint was served by mail to Evergreen Line in care of Evergreen Shipping at the latter's address. Evergreen Line argued that the service was improper because the amended complaint was mailed to Evergreen Shipping without addressing it to the attention of an officer or other individual at Evergreen Shipping as required by Bankruptcy Rule 7004(b)(3) ("when serving a corporation, partnership or association, a complaint must be mailed 'to the attention of an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process'").

Bernstein argued that service was proper because it was made in care of Evergreen Line's agent at the correct address. The address was listed under the "offices and agents" tab on Evergreen Line's website, which did not identify any particular individual on whom service should be made.

The court agreed with Evergreen Line. Service on the corporate agent without directing the mailing to an officer or appropriate individual at the corporation was insufficient under Bankruptcy Rule 7004(b)(3). The only exception to the requirement of service on an individual is when a defendant expressly designates that service be made on a corporate representative. By mailing the amended complaint to the corporate agent without directing it to the attention of an individual, Bernstein failed to satisfy the requirement of the rule. Still, the court was willing to grant Bernstein more time to serve the amended complaint. The court found that Bernstein's efforts demonstrated substantial diligence and a good-faith effort to effectuate proper service, even though it was technically improper, and therefore good cause existed for granting an extension pursuant to Federal Civil Procedure Rule 4(m), as incorporated by Bankruptcy Rule 7004.

In *Burtch v. Opus LLC (In re Opus East LLC)*, Adv. No. 11-52423 (MFW) (Del. Bankr. Aug. 6, 2013), the plaintiff Chapter 7 trustee, Jeoffrey L. Burtch, sought leave to amend his complaint for a third time to add seven counts to avoid and recover allegedly preferential and fraudulent transfers from defendants who had not been named in the earlier complaints. The new defendants opposed the motion in part on the ground that the amendment was futile because it was added after the applicable statute of limitations had expired and did not relate back to the original complaint. The new defendants argued that the new allegations had no factual nexus to the original complaint because they relied on an entirely different set of facts and transactions. Burtch argued that language in the original complaint generally seeking recovery of all transfers satisfied the relating-back requirement. The court disagreed. The transfers that the proposed third amended complaint sought to avoid were not described in the original complaint, which identified by amount, transferor and transferee (none of whom included the new defendants) the transfers to be avoided. None of those transfers included the transfers sought to be added in the amended complaint. The court found that the new claims in the third amended complaint did not relate back to any of the claims in the original complaint.

Burtch argued in the alternative that the statute of limitations had been equitably tolled. The new defendants argued that equitable tolling should not apply because the defendants had not concealed any information from Burtch regarding the new transfers and Burtch failed to perform his statutory obligation to investigate fully the financial affairs of the debtor. Burtch argued that the new defendants' conduct was irrelevant and that the debtor's negligent concealment of the transfers in its Statement of Financial Affairs (SOFA) permitted equitable tolling.

The court found that the doctrine of equitable tolling should apply. First, the debtor failed to list the transfers in the SOFA and this was sufficient evidence of the debtor's concealment of the transfers. Moreover, it was reasonable for Burtch to rely on the information provided by the debtor because there was no indication that the schedules were inaccurate. Second, Burtch sufficiently carried out his duty of due diligence. Burtch was not required to search for transfers that were not listed on the debtor's sworn schedules. He was entitled to rely on the information in the SOFA and should not be expected to reconstruct the debtor's financial affairs based "on a hunch" of possible concealment. Because the debtor concealed the transfers, Burtch could not reasonably have been expected to learn about the transfers until discovery began in the case and therefore the statute of limitations was equitably tolled. Although the amendment did not relate back to the original complaint, the statute of limitations was nevertheless equitably tolled and the proposed amendment was not futile and would be allowed.

These cases illustrate how the relation-back doctrine is applied in the bankruptcy court. They also suggest that the bankruptcy court is sensitive to the difficulty that a trustee faces in trying to reconstruct the debtor's affairs in order to assert claims on behalf of the estate in a timely manner. In both cases, the court accepted the trustee's argument that his conduct was reasonable and diligent despite the fact that in one case service was not properly made and in the other potentially avoidable transfers were not discovered until after the expiration of the statute of limitations. The fact that the trustees could defend their conduct as reasonable under the circumstances allowed the court to rule in their favor.