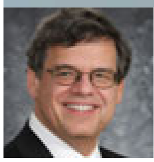
DELAWARE BUSINESS COURT INSIDER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Bankruptcy Court Holds Equitable Tolling Doesn't Apply to Look-Back Period

Barry M. Klayman and Mark E. Felger
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Section 548 of the Bankruptcy Code allows a trustee in bankruptcy to avoid certain "fraudulent transfers" of the debtor's property if they occurred within two years before the date of the bankruptcy filing. In *Industrial Enterprises of America Inc. v. Burtis*, Bankruptcy Court Judge Brendan Shannon answers the question, "May § 548's two-year 'look back' period be equitably tolled, allowing transfers that occurred outside of that window to be avoided under § 548?" The court holds that it cannot, and in the process rejects case law to the contrary not only from other jurisdictions but also from Shannon's own prior inconsistent decisions.

The facts of the case were not complicated. Almost two years after Industrial Enterprises of America Inc. filed for Chapter 11, it filed an adversary proceeding against defendants Susan and Matthew Collyer asserting state-law claims as well as claims under Sections 544, 548 and 550 of the Bankruptcy Code to recover property allegedly transferred from the company to the defendants in the years before its bankruptcy.

The Collyers moved to dismiss the action for failure to state a claim. The court dismissed IEAM's § 548 claim because, according to the allegations in the complaint, the challenged transfers had occurred several months outside of the two-year look-back period and therefore § 548 did not apply, regardless of when IEAM learned of the transfers or the allegedly "nefarious circumstances" surrounding them. The court subsequently acknowledged that, although not explicitly stated, the court's holding meant that the § 548 look-back period could not be equitably tolled. The doctrine of equitable tolling permits a plaintiff to sue after the statutory time period has expired if the plaintiff has been prevented from doing so because of inequitable circumstances such as conduct by the defendant to mislead or hide the facts from the plaintiff.

The court's initial decision in favor of the Collyers conflicted with its rulings in other adversary proceedings by IEAM in which the court had allowed the debtor's § 548 look-back claims to survive motions to dismiss on the theory that the two-year look-back period could be equitably tolled. Citing those cases and cases from other jurisdictions, IEAM moved for reconsideration of the court's decision dismissing the § 548 claim against the Collyers. IEAM argued, not surprisingly, that the court should reverse itself and state a rule consistent with its prior orders that the doctrine of equitable tolling may apply to § 548 claims. In so doing, IEAM noted that equitable tolling has often been applied by bankruptcy courts to allow a claim to be filed outside of the applicable statute of limitations where some action on the part of the defendant caused the plaintiff to be unaware that it had a claim, as it argued the Collyers did in the case before the court.

After holding that the motion for reconsideration allowed the court to resolve its "incongruent rulings," the court affirmed its prior ruling that the doctrine of equitable tolling does not apply to claims under § 548. The court agreed with IEAM that statutes of limitations are customarily equitably tolled to avoid technical forfeitures that would unfairly avoid a trial on the merits, but held that the two-year look-back period was not a statute of limitations; instead, the look-back period is a substantive element of a § 548 claim intended to restrict the trustee's broad power to pursue fraudulent transfers.

As the court explained, statutes of limitations are rules of procedure that regulate "secondary conduct" - the filing of a lawsuit - and not "primary conduct" - the actions that give rise to the lawsuit. A statute of limitations begins running when a cause of action accrues and requires a litigant to file a claim within a certain time in the future. Unlike a statute of limitations, § 548 creates a cause of action for the trustee based on a transfer of a debtor's interest in property, but does not regulate how far into the future the trustee may bring that claim. Section 548 looks back from when the cause of action accrued (the petition date) to see if transfers occurred within the previous two years. The look-back provision does not refer to any act, such as filing a complaint, that is within the trustee's control, but to the universe of transfers that are avoidable under § 548. It is a substantive element of the claim and not a procedural requirement.

The court declined to follow the case law from other jurisdictions that appeared to permit equitable tolling of § 548's look-back period. It also acknowledged its previous "discordant holdings" and "[c]lad in sackcloth and ashes ... extend[ed] its apologies to the parties for the delay and additional burden imposed on account of its inconsistent rulings." In holding that the doctrine of equitable tolling did not apply to § 548's two-year look-back period, the court brought its prior inconsistent rulings into alignment and resolved an issue that no other published decision in this district has squarely decided.

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