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SEVENTH CIRCUIT HOLDS THAT BANKRUPTCY TRUSTEE'S "STRONG-ARM" POWERS ARE NOT STRONG ENOUGH FOR THE IRS

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INTRODUCTION

In the 2014 case *In re Equipment Acquisition Resources, Inc.*,¹ the U.S. Court of Appeals for the Seventh Circuit became the first federal circuit court to hold that bankruptcy trustees cannot use the "strong-arm" powers of 11 U.S.C.A. 544(b)² to avoid a fraudulent transfer where the transferee is the federal government.³ More specifically, the Seventh Circuit held that the doctrine of sovereign immunity makes it impossible for the trustee to satisfy the requirements of Section 544(b) in actions against a federal government entity.⁴ This holding is counterintuitive, because another provision of the Bankruptcy Code, Section 106(a)(1), abrogates federal sovereign immunity as to Section 544.⁵ The interplay of these two Code⁶ sections is nuanced, and the

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¹ *In re Equip. Acquisition Res., Inc.*, 742 F.3d 743 (7th Cir. 2014).

² 11 U.S.C.A. § 544(b) (West 2014).

³ *Equip. Acquisition Res.*, 742 F.3d at 746.

⁴ *Id.*

⁵ 11 U.S.C.A. § 106.

Seventh Circuit’s opinion creates some tension between the two provisions.

Equipment Acquisition Resources is important, not just because it is controversial, but also because it goes to the heart of how courts construe statutes. The Seventh Circuit’s opinion in *Equipment Acquisition Resources* and the opinions of prior courts on the same issue demonstrate what courts value when construing statutes, and how those values promote or obstruct bankruptcy policy. Additionally, the Seventh Circuit’s discussion of sovereign immunity is instructive as to how courts view the relationship between individuals and the government. Even so, the Seventh Circuit’s approach and its ultimate holding are vulnerable to criticism on several grounds.

In its opinion, the Seventh Circuit stated that it was simply interpreting Sections 544(b) and 106(a) according to their plain meaning.⁷ However, this approach fails to acknowledge that there are other legitimate interpretations of the provisions’ supposedly plain meaning, as every court to have confronted this issue prior to *Equipment Acquisition Resources* has disagreed with the Seventh Circuit. Also, the Seventh Circuit’s holding renders Section 106(a)—the section waiving sovereign immunity—partially meaningless. If, as the Seventh Circuit held, 544(b) cannot avoid transfers to federal government entities with sovereign immunity, then why did Congress decide to abrogate sovereign immunity with regard to all of Section 544? Further, the policy grounds on which the Seventh Circuit’s decision rests are hollow and speculative, and contrary to traditional bankruptcy objectives. The court’s decision should therefore be overruled, and not followed in other circuits.

Part I of this article begins by briefly discussing the source of the bankruptcy trustee’s strong-arm powers in the Bankruptcy Code. Part II examines the factual and procedural background of *Equipment Acquisition Resources*. Part III then analyzes the Seventh Circuit’s opinion in *Equipment Acquisition Resources* alongside the other

⁶ Unless otherwise stated, all references to the “Code” or to a “Section” refer to the Bankruptcy Code contained in Title 11 of the United States Code.

⁷ *Equip. Acquisition Res.*, 742 F.3d at 747.

district court cases that have addressed the same issue. Part IV assesses the strength of the Seventh Circuit's reasoning, and argues that other courts should not follow the Seventh Circuit's holding.

I. BACKGROUND

Understanding the holding of *Equipment Acquisition Resources* requires some background knowledge, including a familiarity with the legal doctrines and Bankruptcy Code provisions that form the framework of the case. This first Part briefly explains the law on the central issue in *Equipment Acquisition Resources*, and then discusses the holdings of other courts that have addressed the same question.

A. Bankruptcy Code Provisions

1. Section 544(b): The Strong-Arm Powers

Section 544(b) of the Bankruptcy Code, commonly referred to as the source of the "strong-arm" powers,⁸ is one of the most important tools in the bankruptcy trustee's tool-belt. Broadly speaking, this section gives the trustee the power to avoid a fraudulent transfer by the debtor, if the transfer would be voidable by one of the debtor's creditors under state law.⁹ In other words, Section 544(b) empowers the trustee by allowing him or her to exercise the rights that creditors of the debtor have under state fraudulent transfer law.¹⁰ After avoidance, the trustee can then claw back, or recover, the transferred assets for the benefit of the bankruptcy estate and the debtor's creditors.¹¹

⁸ See, e.g., *Leibowitz v. Parkway Bank & Trust Co. (In re Image Worldwide, Ltd.)*, 139 F.3d 574, 576-77 (7th Cir. 1998); *In re Munford, Inc.*, 98 F.3d 604, 609 (11th Cir. 1996) ("Section 544(b) is commonly referred to as the 'strong arm' clause.").

⁹ 5 COLLIER ON BANKRUPTCY ¶ 544.06(2) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014).

¹⁰ *Id.*

¹¹ 11 U.S.C.A. § 550(a).

Turning first to the language of Section 544(b)(1), the provision states, in relevant part, that “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”¹² The “applicable law” referred to in 544(b)(1) is non-bankruptcy, state law.¹³ And most often, the state statute the trustee invokes is some form of the Uniform Fraudulent Transfer Act (“UFTA”), which has been adopted by the legislatures of 43 states.¹⁴ In sum, 544(b)(1) effectively “allows the trustee to use the applicable state’s law of fraudulent conveyances to set aside obligations incurred by the bankrupt.”¹⁵

There are some important limitations on the trustee’s ability to invoke state fraudulent transfer law through Section 544(b). First, the trustee’s rights are no greater than those of a creditor acting under state law.¹⁶ It is often said that the trustee steps into the shoes of the creditor. Courts have explained this limitation as follows:

It is well established that the effect of this section is to clothe the trustee with no new or additional right in the premises over that possessed by a creditor, but simply puts him in the shoes of the latter, and subject to the same limitations and disabilities that would have beset the creditor in the prosecution of the action on his own behalf; and the rights of the parties are to be determined, not by any provision of the Bankruptcy Act, but by the applicable principles of the common law, or the laws of the state in which the right of action

¹² *Id.* § 544(b).

¹³ *See, e.g.,* *Kittay v. Korf (In re Palermo)*, 739 F.3d 99, 101-02 (2d Cir. 2014); *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198, 1201 (9th Cir. 2005); *In re Valley Mortgage, Inc.*, No. 10–19101–SBB, 2013 WL 5314369, at *1 (Bankr. D. Colo. 2013) (“Generally, ‘applicable law’ is interpreted to include state law causes of action”).

¹⁴ 5 COLLIER ON BANKRUPTCY ¶ 544.06(2).

¹⁵ *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 202 (7th Cir. 1988).

¹⁶ 5 COLLIER ON BANKRUPTCY ¶ 544.06(3).

may arise. In other words, the Bankruptcy Act merely permits the trustee to assert the rights which the creditor could assert but for the pendency of the bankruptcy proceedings, and if, for any reason arising under the laws of the state, the action could not be maintained by the creditor, the same disability will bar the trustee.¹⁷

Because the trustee can only act to the extent that a creditor of the debtor could act under state law, bankruptcy courts look to state law in defining the properties and limits of the trustee's strong-arm powers.¹⁸ Accordingly, in Section 544(b) avoidance actions, the court focuses on the creditor's powers under state law, and not the Bankruptcy Code alone.¹⁹

Another important limitation on the trustee's strong-arm powers is the requirement that some creditor actually exist who could bring a claim under the state's fraudulent transfer law.²⁰ This "actual creditor" requirement is derived from the language of 544(b). The trustee or debtor in possession must plead the existence of a creditor who could

¹⁷ *Davis v. Willey (In re Willey)* 263 F. 588, 589 (N.D. Cal. 1920). The *Davis* court was actually describing the statute that preceded Section 544, because the present Bankruptcy Code did not exist in 1920. Nonetheless, the predecessor to Section 544 was functionally equivalent to the current version.

¹⁸ *See, e.g., In re Archdiocese of Milwaukee*, 483 B.R. 855, 862-63 (Bankr. E.D. Wis. 2012) ("The trustee's rights under § 544(b) are limited to the 'rights of an existing unsecured creditor because § 544(b) rights are completely derivative of those of an actual unsecured creditor.' Further, the trustee will be able to attack the transfer only to the extent a creditor with an allowable claim can avoid the transfer under applicable state law.") (internal citations omitted); *In re Fleming Packaging Corp.*, No. 03-82408, 2007 WL 1021884, at *9 (Bankr. C.D. Ill. 2007) ("When bringing an avoidance action under Section 544(b) . . . the extent of the trustee's rights is determined entirely by state law.").

¹⁹ *See supra* note 18 and accompanying text.

²⁰ 5 COLLIER ON BANKRUPTCY ¶ 544.06(1) ("If there are no creditors against whom the transfer is voidable under the applicable law, the trustee is powerless to act under section 544(b)(1).").

have avoided the transfer at issue.²¹ That creditor must have been in existence when the purported fraudulent transfer took place and on the date of the bankruptcy filing.²² The creditor's claim against the debtor also must be one which would be allowed in bankruptcy.²³ Courts and commentators sometimes refer to this creditor as the "golden creditor," because it is a lynchpin of Section 544(b) analysis.²⁴ However, courts generally do not require the trustee to specifically name or rely on one particular creditor.²⁵ As discussed below, the actual creditor requirement was central to the court's decision in *Equipment Acquisition Resources*.²⁶

2. Reach-back Period

In addition to Section 544, there is another primary means for avoiding fraudulent transfers under the Bankruptcy Code: Section 548.²⁷ Whereas Section 544 is the source of the trustee's *state law* avoidance powers, Section 548 is the source of the trustee's *bankruptcy law* fraudulent transfer avoidance powers. Section 548 mirrors state fraudulent transfer law, bringing the Bankruptcy Code into agreement with state law.²⁸

However, sections 544 and 548 differ in at least one important way. Section 548 has a shorter, two-year reach-back period; in other words, the trustee may only avoid transfers "made or incurred on or

²¹ *Leibowitz v. Parkway Bank & Trust Co. (In re Image Worldwide, Ltd.)*, 139 F.3d 574, 577 (7th Cir. 1998); *In re Leonard*, 125 F.3d 543, 544 (7th Cir. 1997).

²² 5 COLLIER ON BANKRUPTCY ¶ 544.06(1).

²³ *Id.* The law as to allowance of claims is outside the scope of this article, but it is sufficient to note that allowance is an additional requirement to establish standing under Section 544(b).

²⁴ *See, e.g., Faulkner v. Kornman (In re The Heritage Org., L.L.C.)*, 413 B.R. 438, 459 (Bankr. N.D. Tex. 2009); *Turner v. Phoenix Fin., LLC (In re Imageset, Inc.)*, 299 B.R. 709, 715 (Bankr. D. Me. 2003).

²⁵ 5 COLLIER ON BANKRUPTCY ¶ 544.06(1).

²⁶ *See infra*, Part III.A.

²⁷ 11 U.S.C.A. § 548 (West 2014).

²⁸ 5 COLLIER ON BANKRUPTCY ¶ 548.01.

within 2 years before the date of the filing of the petition.”²⁹

Conversely, state fraudulent transfer law, namely the UFTA, has a four-year reach-back period.³⁰ Therefore, the Section 544 strong-arm powers are an essential tool for avoidance because they give the trustee access to the longer reach-back period under state law, and the ability to avoid transfers that the trustee otherwise could not avoid under Section 548 of the Bankruptcy Code alone.³¹

3. Section 106(a): The Bankruptcy Code’s Abrogation of Sovereign Immunity

Sovereign immunity is a primordial common law doctrine which bars suit against sovereign entities.³² Immunity from suit is an attribute that is “inherent in the nature of sovereignty”³³ Thus, the states and federal government are “not to be amenable to the suit of an individual without [their] consent.”³⁴ The American legal system

²⁹ § 548(a)(1).

³⁰ UNIF. FRAUDULENT TRANSFER ACT § 9 (“A [claim for relief] [cause of action] with respect to a fraudulent transfer or obligation under this [Act] is extinguished unless action is brought: (a) under Section 4(a)(1), *within 4 years after the transfer was made or the obligation was incurred* or, if later, within one year after the transfer or obligation was or could reasonably have been discovered by the claimant; (b) under Section 4(a)(2) or 5(a), *within 4 years after the transfer was made or the obligation was incurred*” (emphasis added)).

³¹ See, e.g., *In re Dolata*, 306 B.R. 97, 115 (W.D. Penn. 2007) (comparing Section 548(a)(1) with Pennsylvania’s fraudulent transfer statute and noting that they are “expressly distinguishable” in that “transfers that may be subject to attack under § 548(a)(1) are limited to those that are made within one year [now two years] of the date of a debtor’s bankruptcy petition filing, whereas a transfer generally remains assailable under [Pennsylvania’s statute] provided that an avoidance action is brought thereunder within four years of such transfer”) (internal citations omitted).

³² See *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 69 (1999); Charles Alan Wright, et al., 14 FED. PRAC. & PROC. JURIS. § 3654 (3d ed.) (“It now is well settled by numerous judicial precedents—although for a century the rule was stated only in dicta—that the United States may not be sued without its consent.”)

³³ *Hans v. Louisiana*, 134 U.S. 1, 13 (1890).

³⁴ *Id.*

inherited this principle from English common law at the time of the nation's founding.³⁵ The United States Supreme Court has observed that “[w]hen the Constitution was ratified, it was well established in English law that the Crown could not be sued without consent in its courts.”³⁶ At present, the prevailing view on the Supreme Court is that the framers understood and accepted sovereign immunity, and that it is implicit in the framework of the Constitution.³⁷

Sovereign immunity operates to deprive a court of subject matter jurisdiction over the suit unless the sovereign consents to be sued.³⁸ Generally, only Congress can consent to, waive, or abrogate the federal government's sovereign immunity.³⁹ Where Congress abrogates sovereign immunity through a legislative act, it must do so explicitly and unequivocally.⁴⁰ Waivers are strictly construed, and any ambiguity as to the waiver is construed in favor of the sovereign.⁴¹

In the past, the states and the federal government invoked sovereign immunity as a bar against actions brought by debtors and

³⁵ Alden v. Maine, 527 U.S. 706, 715-16 (1999) (“Although the American people had rejected other aspects of English political theory, the doctrine that a sovereign could not be sued without its consent was universal in the States when the Constitution was drafted and ratified.” (citing *Chisholm v. Georgia*, 2 Dall. 419, 437-46 (1793) (Iredell, J., Dissenting))).

³⁶ *Id.*

³⁷ *Id.*

³⁸ Charles Alan Wright, et al., 14 FED. PRAC. & PROC. JURIS. § 3654 (3d ed.) (“The natural consequence of the sovereign immunity principle is that the absence of consent by the United States is a fundamental defect that deprives the district court of subject matter jurisdiction.”).

³⁹ 2 COLLIER ON BANKRUPTCY ¶ 106.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014) (“[F]ederal and state governmental bodies enjoy sovereign immunity from suit except when their immunity has been abrogated by Congress, waived by some action taken by the governmental body or eliminated by a specific provision of the Constitution itself.”); *U.S. v. Nordic Vill., Inc.*, 503 U.S. 30, 33-34 (1992).

⁴⁰ *Nordic Vill.*, 503 U.S. at 33-34.

⁴¹ *Id.* at 34 (“the Government's consent to be sued ‘must be construed strictly in favor of the sovereign, and not enlarge[d] . . . beyond what the language requires’”) (internal quotation marks and citations omitted).

trustees.⁴² However, the Bankruptcy Code now contains an explicit abrogation of sovereign immunity in Section 106.⁴³ This section went into effect with the Bankruptcy Reform Act of 1994, which amended Section 106 to its current form.⁴⁴ Section 106 now explicitly enumerates each section of the Bankruptcy Code for which the abrogation applies.⁴⁵ Section 106(a)(1) states, in relevant part, “Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to . . . [s]ection[] . . . 544 of this title.”⁴⁶ Section 106(a)(2) gives courts the power to “hear and determine any issue arising with respect to the application of such section[] to governmental units.”⁴⁷ The phrase “governmental unit” is a defined term under the Code, broadly including all federal, state, and local government entities.⁴⁸ And Section 106(a)(3) provides that “[t]he court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages.”⁴⁹

According to the House Reports and legislative history for Section 106,⁵⁰ Congress enacted Section 106 because the statute that preceded

⁴² 2 COLLIER ON BANKRUPTCY ¶ 106.01.

⁴³ 11 U.S.C.A. 106(a) (West 2014).

⁴⁴ Pub.L. No. 103–394, § 113, 108 Stat. 4106 (1994).

⁴⁵ § 106(a).

⁴⁶ *Id.*

⁴⁷ *Id.* § 106(a)(2).

⁴⁸ *Id.* § 101(27) (“The term ‘governmental unit’ means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.”).

⁴⁹ *Id.* § 106(a)(3).

⁵⁰ H.R. Rep. No. 595, 95th Cong., 1st Sess. 317 (1977), reprinted in App. Pt. 4(d)(i); S. Rep. No. 989, 95th Cong., 2d Sess. 29-30 (1978).

it failed to unambiguously abrogate sovereign immunity.⁵¹ In *Hoffman v. Connecticut Department of Income Maintenance* and *United States v. Nordic Village, Inc.*, the Supreme Court held that Section 106's predecessor failed to successfully abrogate sovereign immunity, because its language was not sufficiently explicit.⁵² However, following the 1994 amendments, there is now no disagreement; Section 106 unambiguously abrogates sovereign immunity as to the Code sections listed in 106(a).⁵³

B. Prior Court Decisions Addressing the Issue

While the Seventh Circuit was the first federal circuit court of appeals to consider the issue of whether a trustee can use Section 544(b) to avoid fraudulent transfers to the federal government,⁵⁴ it was not the first court to do so. A number of district courts have also passed on the issue. *In re C.F. Foods, L.P.*⁵⁵ is the first and one of the most frequently cited of such cases. In *C.F. Foods*, two partners formed a Pennsylvania limited partnership for the purpose of engaging in business as a candy wholesaler.⁵⁶ The partners solicited investments, promising returns of eighteen to thirty percent.⁵⁷ In reality, the business was a vehicle for fraud. In 1988 the business reported that it had \$140 million in sales even though it actually had

⁵¹ WILLIAM L. NORTON, NORTON BANKRUPTCY LAW & PRACTICE § 14:4 (3d ed.) (“The Committee Report points out that the amendment was intended to overrule both *Hoffman v. Connecticut Dept. of Income Maintenance* and *U.S. v. Nordic Village Inc.*”); 2 COLLIER ON BANKRUPTCY ¶ 106.

⁵² See *Hoffman v. Connecticut Dept. of Income Maint.*, 492 U.S. 96 (1989); *U.S. v. Nordic Vill., Inc.*, 503 U.S. 30 (1992).

⁵³ See *supra* note 51.

⁵⁴ *In re Equip. Acquisition Res., Inc.*, 742 F.3d 743, 748 (7th Cir. 2014) (“This is an issue of first impression for any circuit court of appeals.”).

⁵⁵ *Liebersohn v. IRS (In re C.F. Foods, L.P.)*, 265 B.R. 71 (Bankr. E.D. Penn. 2001).

⁵⁶ *Id.* at 74.

⁵⁷ *Id.*

only \$5 million in revenue.⁵⁸ In order to perpetuate and cover up the fraud, the partners recorded fake transactions and sales figures.⁵⁹ Based on the reported sales figures, the partners incurred federal personal income tax liability, and they used partnership assets to cover this liability.⁶⁰ Between 1996 and 1998, the partnership made nine payments to the IRS for the partners' benefit, totaling \$3,190,259.38.⁶¹

In May of 1999, C.F. Foods entered involuntary Chapter 7 bankruptcy.⁶² The bankruptcy trustee subsequently filed an adversary proceeding against the IRS, seeking to recover the tax payments as fraudulent transfers.⁶³ The trustee asserted that the transfers were fraudulent under Pennsylvania's Uniform Fraudulent Transfer Act,⁶⁴ which the trustee invoked through Section 544(b).⁶⁵ In response, the IRS took the position that it was immune from the avoidance claim due to sovereign immunity.⁶⁶ The IRS argued that outside of bankruptcy, unsecured creditors would be barred by sovereign immunity from asserting state law avoidance claims against the federal government; and because the trustee steps into the shoes of a state law creditor, the trustee should be similarly barred from bringing a claim under Section 544 and Pennsylvania's fraudulent transfer act.⁶⁷ Put differently, the IRS contended that Congress had not made the necessary explicit waiver of sovereign immunity as to any state fraudulent transfer statutes—Section 106(a) only applied to the Bankruptcy Code and not state law, and as a result, the trustee should be barred from asserting the avoidance claim.⁶⁸

⁵⁸ *Id.* at 75.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* at 75 n.4.

⁶² *Id.* at 73.

⁶³ *Id.* at 74.

⁶⁴ 12 PA. CONS. STAT. ANN. § 5101, *et seq.* (West 2014).

⁶⁵ *C.F. Foods*, 265 B.R. at 77.

⁶⁶ *Id.* at 81.

⁶⁷ *Id.* at 82-83.

⁶⁸ *Id.*

Although the court thought there was some “allure” to the IRS’s argument, it ultimately held in favor of the trustee.⁶⁹ After examining the legislative history of Section 106, the court found that Congress had unequivocally asserted its power to abrogate the federal government’s sovereign immunity from actions brought under Section 544.⁷⁰ This abrogation also covered state law causes of action subsumed by Section 544(b).⁷¹ The Court reasoned that “[b]y including § 544 in the list of Bankruptcy Code sections set forth in § 106(a), Congress knowingly included state law causes of action within the category of suits to which a sovereign immunity defense could no longer be asserted.”⁷² This reading of 106(a) was correct, said the court, in light of the statute’s “unambiguous language.”⁷³ The court conceded that its decision resulted in some incongruity by giving the trustee greater rights in bankruptcy than a creditor would have outside of bankruptcy.⁷⁴ But, as the court observed, this result was consistent with the broad rights possessed by the trustee by virtue of Section 544.⁷⁵ Further, the court also justified its decision on policy grounds, noting that any recovery of assets for the bankruptcy estate benefits all of the debtor’s creditors as a whole.⁷⁶

In addition to *C.F. Foods*, several other district courts have considered this issue prior to *Equipment Acquisition Resources*, and each court’s decision falls in line with the *C.F. Foods* holding. For example, *In re Custom Contractors, LLC* also involved a trustee’s

⁶⁹ *Id.* at 86.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.* at 85.

⁷³ *Id.* at 86.

⁷⁴ *Id.* at 85-86.

⁷⁵ *Id.*

⁷⁶ *Id.* (“even if there was any ambiguity to § 106(a)—and I find that there is none—other considerations still weigh heavily against the result sought by the IRS. Any recovery by the bankruptcy trustee will benefit *all* of the debtor’s creditors, including the IRS.”).

complaint to avoid and recover transfers from the debtor to the IRS.⁷⁷ The complaint alleged that the debtor, a limited liability company, had transferred \$199,956.25 to the IRS on behalf of one of its principals.⁷⁸ The company made the transfer to satisfy the principal's personal income tax liability at a time when he was struggling to pay his own bills, even though the company owed the principal no money.⁷⁹

The bankruptcy trustee in *Custom Contractors* sought to avoid the transfers through Section 544(b)(1) and the Florida Uniform Fraudulent Transfer Act (FUFTA).⁸⁰ The IRS then moved to dismiss, raising the same argument that it had in *C.F. Foods*—that the trustee could not avoid the transfers because no creditor outside of bankruptcy could bring a state law claim against the IRS under the FUFTA due to sovereign immunity.⁸¹ The court again rejected the IRS's argument.⁸² Citing to *C.F. Foods*, the court held that the "unambiguous language of § 106" abrogated the federal government's sovereign immunity as to state fraudulent transfer laws invoked pursuant to the trustee's strong-arm powers.⁸³ The court reasoned that a contrary reading of the statute "requir[ing] a trustee to demonstrate that the United States has waived sovereign immunity in every instance the trustee seeks to rely on state law for the purpose of § 544 would render the general abrogation of sovereign immunity under § 106 almost meaningless."⁸⁴

Another case following the lead of *C.F. Foods* and *Custom Contractors* is *In re DBSI, Inc.*⁸⁵ As in the cases discussed above, the bankruptcy trustee brought a Section 544(b) claim to avoid and

⁷⁷ Menotte v. U.S. (*In re Custom Contractors, LLC*), 439 B.R. 544, 545 (Bankr. S.D. Fla. 2010).

⁷⁸ *Id.* at 545-46.

⁷⁹ *Id.*

⁸⁰ *Id.* at 546; FLA. STAT. ANN. 726.105, *et seq.* (West 2014).

⁸¹ *Custom Contractors*, 439 B.R. at 546-47.

⁸² *Id.* at 549.

⁸³ *Id.* at 548-49.

⁸⁴ *Id.* at 549 (emphasis added).

⁸⁵ Zazzali v. Swenson (*In re DBSI, Inc.*), No. 10-54649(PJW), 2011 WL 607442 (Bankr. D. Del. 2011).

recover transfers that the debtor made to the IRS on behalf of the company's insiders, and the IRS moved to dismiss the claim on sovereign immunity grounds.⁸⁶ Here again, the IRS emphasized the actual creditor requirement of Section 544(b), and argued that a creditor could not bring an avoidance action against the IRS because Congress had not explicitly waived sovereign immunity as to the state's fraudulent transfer statute.⁸⁷

Again, the court sided with the trustee, citing approvingly to *C.F. Foods* and *Custom Contractors* and finding their reasoning persuasive.⁸⁸ The court looked at the interaction between Sections 106 and 544, and found that “[i]nterpreting § 106(a)(1) to include an abrogation of the applicable nonbankruptcy causes of action available to a trustee under § 544(b)(1) comports with the purpose and use of that provision.”⁸⁹ The court underscored two reasons that formed the basis of its holding. First, there is a “long history of empowering bankruptcy trustees to bring certain state law causes of action,” and Congress would have been aware of this history when it enacted Section 106 and abrogated sovereign immunity as to Section 544.⁹⁰ It follows, therefore, that when Congress enacted Section 106 it intended to abrogate sovereign immunity as to state law avoidance actions brought under Section 544.⁹¹

Second, the court found that the IRS's reading of Section 106 was problematic because it “would render § 106 practically meaningless.”⁹² The court explained:

[According to the IRS], Congress' abrogation of sovereign immunity as to § 544 is only one part of the equation . . . [T]here must also be a waiver or abrogation of sovereign

⁸⁶ *Id.* at *1.

⁸⁷ *Id.* at *3.

⁸⁸ *Id.* at *4.

⁸⁹ *Id.* at *5.

⁹⁰ *Id.* at *4.

⁹¹ *Id.* at *5.

⁹² *Id.*

immunity with respect to the particular “applicable law” However, neither [this state’s] legislature nor any state would have authority to abrogate the sovereign immunity of the United States as a defense to a creditor claim under the state’s version of the Uniform Fraudulent Transfer Act or otherwise. Thus, the IRS’ argument would apparently render meaningless Congress’ abrogation of sovereign immunity as to § 544.⁹³

Put differently, accepting the IRS’s argument would mean introducing a second hurdle of sovereign immunity, requiring another act of abrogation or waiver in addition to Section 106.⁹⁴ The court reasoned that this outcome was undesirable, because it would render Section 106 ineffective as to Section 544(b) without some extra act abrogating sovereign immunity for state laws.⁹⁵

The line of cases that began with *C.F. Foods* continued unbroken through the end of 2013 with *In re Valley Mortgage, Inc.*⁹⁶ In *Valley Mortgage*, the debtor was a corporation used to perpetrate a massive Ponzi scheme.⁹⁷ Between 2005 and 2007, the debtor’s president and majority owner wrote eight checks totaling \$161,341.40 to the U.S. treasury to cover his personal income taxes.⁹⁸ After the Ponzi scheme came to light, the corporation went into receivership and filed for bankruptcy.⁹⁹ Once in bankruptcy, the debtor in possession sought to avoid the checks to the IRS as fraudulent transfers.¹⁰⁰ Because the last

⁹³ *Id.* (quoting *Sharp v. U.S. (In re SK Foods, L.P.)*, No. 09–29162–D–11, 2010 WL 6431702, at *2 (Bankr. E.D. Cal. 2010) (unreported)).

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *VMI Liquidating Trust Dated December 16, 2011 v. U.S. ex rel. IRS (In re Valley Mortgage, Inc.)*, No. 10–19101–SBB, 2013 WL 5314369, at *1 (Bankr. D. Colo. 2013).

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.* at *2 (“Here, the Debtor filed for bankruptcy on April 19, 2010. The last transfer in question to the Defendant occurred in July of 2007. Thus, all of the

of the transfers occurred in 2007, more than two years prior to bankruptcy, Section 544(b) was the only viable means for avoidance.¹⁰¹ The debtor therefore invoked the Colorado Uniform Fraudulent Transfer Act¹⁰² and sought to avoid the transfers as actually and constructively fraudulent.¹⁰³

The IRS raised a sovereign immunity defense,¹⁰⁴ and once again the court rejected it.¹⁰⁵ The court held that the waiver of sovereign immunity in Section 106(a) applied to Section 544(b) “regardless of whether the application of 544(b)(1) is predicated on a state law cause of action”¹⁰⁶ In construing Sections 106 and 544 together, the court reasoned that it would be improper to exclude 544(b) from Congress’ waiver of sovereign immunity as to all of Section 544:

Congress chose to explicitly waive sovereign immunity with respect to the entirety of section 544. . . . If Congress intended to retain a sovereign immunity defense to actions brought under section 544(b)(1), Congress certainly could have done so. This Court refuses to read into section 106(a) an exclusion to the waiver of sovereign immunity which Congress did not specifically provide. To do so would be

alleged fraudulent transfers to the Defendant occurred more than two years prior to the Debtor's bankruptcy petition and are therefore outside of [Section 548's] statute of limitations.”).

¹⁰¹ *Id.* at *4 (“[I]n order for the Debtor to assert a timely claim to recover alleged fraudulent transfers, it must rely on [the state fraudulent transfer law’s] longer statute of limitations because the limitations period in section 548 of the Code has expired.”).

¹⁰² COLO. REV. STAT. ANN. § 38-8-101, *et seq.* (West 2014).

¹⁰³ *Valley Mortgage*, 2013 WL 5314369, at *4.

¹⁰⁴ *Id.* (“the [IRS] argues that if sovereign immunity prohibits an unsecured creditor from bringing a non-bankruptcy state law claim against the Defendant, then sovereign immunity similarly prohibits a trustee who steps into the shoes of an unsecured creditor from bringing the same non-bankruptcy state law claim”).

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

improper and result in a judicially created amendment to an otherwise clear and unambiguous statute.¹⁰⁷

The Court also noted that its decision was in line with “numerous other courts” that had also held that the waiver of sovereign immunity in Section 106 extended to state law causes of action brought via Section 544.¹⁰⁸

The cases discussed above are representative of an unbroken chain of court decisions from *C.F. Foods* in 2001 through *Valley Mortgage* in 2013. These cases illustrate the persuasive legal arguments and reasoning that motivated the court in each case to follow the lead of the *C.F. Foods* position. *C.F. Foods*, *Valley Mortgage*, and all the cases decided in between are consistent, and the courts’ opinions are cogent. In each case, the court relied on classic techniques of statutory interpretation, starting with language of the statutes,¹⁰⁹ and construing it in a way that harmonized with Congress’ intent and the Bankruptcy Code as a whole. Nonetheless, the Seventh Circuit found reason to part ways with this line of cases.

II. CASE BACKGROUND

Before discussing the Seventh Circuit’s opinion in *Equipment Acquisition Resources* in Part III below, this Part provides the factual and procedural background underlying the court’s decision. This Part begins by setting forth the facts that led up to the suit, followed by a

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* Interestingly, one of the decisions the court cited to was the U.S. District Court for the Northern District of Illinois’s opinion in *United States v. Equipment Acquisition Resources, Inc.* (*In re Equip. Acquisition Res., Inc.*), 485 B.R. 586 (N.D. Ill. 2013), *rev’d*, *In re Equip. Acquisition Res., Inc.*, 742 F.3d 743 (7th Cir. 2014), which was reported prior to the appeal of that case to the U.S. Court of Appeals for the Seventh Circuit. At the time of *Valley Mortgage*, the Northern District’s decision had not yet been reversed, and it fell in line with *C.F. Foods* and its progeny.

¹⁰⁹ *See generally* U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241 (1989) (“The task of resolving the dispute over the meaning of [a statute] begins where all such inquiries must begin: with the language of the statute itself.”).

brief discussion of the case's disposition in the bankruptcy court and district court prior to appeal to the Seventh Circuit.

A. Factual & Procedural Background

The debtor who initiated the bankruptcy proceedings was a corporation named Equipment Acquisition Resources, Inc. (EAR).¹¹⁰ EAR was organized as an S-corporation¹¹¹ under the laws of Illinois, and engaged in the business of semiconductor manufacturing equipment sales and servicing.¹¹² In the years leading up to bankruptcy, EAR, through its officers and agents, engaged in what would later be described in pleadings as a “massive fraud.”¹¹³ EAR allegedly sold equipment at inflated prices, then leased the equipment back, misrepresented the value of the equipment, and pledged the same pieces of equipment to multiple creditors in order to obtain loans.¹¹⁴

After the fraud was exposed, EAR's shareholders elected one person to act as the sole director of EAR's board and simultaneously serve as the company's chief restructuring officer.¹¹⁵ The restructuring officer filed for Chapter 11 bankruptcy on October 23, 2009.¹¹⁶ Post-filing, the restructuring officer conducted an investigation and

¹¹⁰ *In re Equip. Acquisition Res., Inc.*, 742 F.3d 743, 744-45 (7th Cir. 2014).

¹¹¹ Because EAR was organized as an S-corp., corporate income passed through to the owners who then reported that income on their individual tax returns. *Id.* (“Subchapter S corporations do not pay taxes on corporate income; instead, the tax liability is passed through to the corporation's shareholders.”); *see generally* MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 496 (8th ed. 2000) (“Under *flow-through* taxation, a firm is not subject to taxation. Instead, all of the firm's income and expenses, and gains and losses, are taxable directly to the firm's owners. Distributions are not taxed.”).

¹¹² *Equip. Acquisition Res., Inc. v. U.S. (In re Equip. Acquisition Res., Inc.)*, 451 B.R. 454, 457 (Bankr. N.D. Ill. 2011), *rev'd*, *In re Equip. Acquisition Res., Inc.*, 742 F.3d 743 (7th Cir. 2014).

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

discovered that, during the lead-up to bankruptcy, between October 15, 2007 and December 3, 2008, EAR made nine transfers to the IRS totaling \$4,737,261.36.¹¹⁷ EAR had apparently made these payments on behalf of its shareholders in order to cover the shareholders' income tax liability, which they incurred as a result of their receipt of corporate profits.¹¹⁸

Now in bankruptcy, EAR, acting as debtor in possession, sought to avoid the payments as constructively fraudulent transfers and recover the funds.¹¹⁹ On January 20, 2010, EAR initiated an adversary proceeding with the filing of a complaint against the United States.¹²⁰ EAR subsequently amended its complaint to also include the shareholders as defendants.¹²¹ Of the nine tax payments, eight occurred within a two-year period prior to the filing of the bankruptcy petition.¹²² EAR sought to avoid these pursuant to the bankruptcy avoidance powers in Section 548.¹²³ As to these payments, EAR and the IRS eventually reached a settlement, under which the IRS agreed to disgorge the payments.¹²⁴ The ninth payment, however, was the real

¹¹⁷ *Id.*

¹¹⁸ When companies offer to pay their principals' income taxes as an additional form of compensation,

“the IRS finds itself in the position of defendant in a fraudulent transfer action. If an S corporation, which ordinarily owes no income taxes, pays the income taxes for its shareholders, the S corporation arguably receives no value for this payment. If at the time of such payments, the S corporation was insolvent, undercapitalized, or knew it will incur debts beyond its ability to pay when such debts come due, and the S corporation ends up in bankruptcy, the payments may be challenged as constructive fraudulent transfers, both under the Bankruptcy Code and under state law”

Alec P. Ostrow, *Taxes and Transfers and Trusts*, 2014 NORTON ANN. SURV. BANKR. L. 2 (2014).

¹¹⁹ *Equip. Acquisition Res.*, 451 B.R. at 457.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.* at 458.

source of contention between the parties. This payment had occurred more than two years prior to bankruptcy. So, EAR could only avoid the transfer through Section 544(b), which gave EAR access to state fraudulent transfer law, here the Illinois Uniform Fraudulent Transfer Act,¹²⁵ and that law's longer reach-back period.¹²⁶

The IRS filed its answer on January 13, 2011 and raised ten defenses.¹²⁷ In response to EAR's Section 544(b) claim, the IRS raised the defense of sovereign immunity, taking the familiar position that an actual creditor bringing a claim outside of bankruptcy would not be able to avoid a transfer to the IRS using the Illinois Uniform Fraudulent Transfer Act, and therefore neither could EAR.¹²⁸

B. Disposition in the Lower Courts

The bankruptcy court described the issue as hinging on the interplay between Sections 544 and 106, and undertook a thorough statutory interpretation inquiry, examining the language of Section 106.¹²⁹ In construing the statute, the court acknowledged that it was not the first court to confront this issue.¹³⁰ Indeed, the opinion quotes heavily from the courts' decisions in *C.F. Foods* and *Custom Contractors*, and cites to their progeny, such as *DBSI* among others.¹³¹ Ultimately, the bankruptcy court found that "[t]he plain language of § 106(a)(1) is clear, precise, unambiguous, and straightforward," and that "when it abrogated sovereign immunity as to § 544 causes of action, Congress intended to include those state law causes of action available under § 544(b)(1)."¹³² Accordingly, the court denied the

¹²⁵ 744 ILL. COMP. STAT. ANN. 160/5(a)(2) (West 2014).

¹²⁶ *Equip. Acquisition Res.*, 451 B.R. at 461.

¹²⁷ *Id.* at 457.

¹²⁸ *Id.* at 458.

¹²⁹ *Id.* at 461-63.

¹³⁰ *Id.* at 463.

¹³¹ *Id.* at 463-65.

¹³² *Id.* at 468.

IRS's motion to dismiss, and ordered the United States to pay back a portion of the fraudulently transferred funds.¹³³

The IRS appealed to the U.S. District Court for the Northern District of Illinois, arguing that the bankruptcy court erred and that the district court should vacate the order requiring the United States to return the funds.¹³⁴ The district court framed the issue as whether the limits of Section 544(b) prevented avoidance notwithstanding the abrogation of sovereign immunity in Section 106.¹³⁵ In siding with EAR and affirming the bankruptcy court's holding, the district court broadly held that "106(a)(1) simply eliminates the obstacle [of sovereign immunity] wherever it appears 'with respect to' § 544."¹³⁶ Like prior courts, the Northern District court held that the IRS's sovereign immunity defense failed when put up against the "plain language of §§ 106(a)(1) and 544(b)(1)."¹³⁷

III. DISCUSSION OF THE SEVENTH CIRCUIT'S OPINION IN *EQUIPMENT ACQUISITION RESOURCES*

Although *Equipment Acquisition Resources* was a case of first impression for the Seventh Circuit, the court did not consider the case on a blank slate. As shown in Part I, there was already a significant body of case law when the case reached the Seventh Circuit.¹³⁸ This Part examines how the Seventh Circuit interpreted Sections 106 and 544 and decided *Equipment Acquisition Resources* in light of the existing case law.

¹³³ *Id.*

¹³⁴ U.S. v. Equip. Acquisition Res., Inc. (*In re* Equip. Acquisition Res., Inc.), 485 B.R. 586, 591 (N.D. Ill. 2013), *rev'd*, *In re* Equip. Acquisition Res., Inc., 742 F.3d 743 (7th Cir. 2014).

¹³⁵ *Id.* at 592.

¹³⁶ *Id.* at 593.

¹³⁷ *Id.*

¹³⁸ *See supra*, Part I.B.

A. Seventh Circuit's Decision

Judge Flaum authored the Seventh Circuit's opinion.¹³⁹ The opinion begins by examining the nature of Section 544 avoidance actions, and focusing on the provision's limits.¹⁴⁰ The court emphasized that the trustee's strong-arm powers are circumscribed by the confines of state law and the actual creditor requirement.¹⁴¹ First, the court stated the legal standard for the "actual shoes" restriction, reinforcing that the bankruptcy trustee's strong-arm powers are "derivative of state law," and the trustee can only do in bankruptcy "what a creditor would have been able to do outside of bankruptcy."¹⁴² Second, the court called attention to the actual creditor requirement: "If there are no creditors against whom the transfer is voidable under the applicable law, the trustee is powerless to act under section 544(b)(1)."¹⁴³ Since these two restrictions exist simultaneously, said the court, "if the actual creditor could not succeed for any reason . . . then the trustee is similarly barred and cannot avoid the transfer."¹⁴⁴

The Seventh Circuit's opinion then proceeded to the substantive merits of EAR's claim, and it is here that the court parted ways with the lower courts and prior case law. The court reasoned that EAR's claim failed due to the limits inherent in Section 544 itself, *despite* 106(a)'s explicit abrogation of sovereign immunity.¹⁴⁵ More specifically, the court held that EAR could not even satisfy the actual creditor requirement of Section 544(b), which "by its very terms, requires EAR to show that a creditor exists who could use a state's 'applicable law' to recover the payment from the IRS."¹⁴⁶ The court

¹³⁹ *In re Equip. Acquisition Res., Inc.*, 742 F.3d 743, 744 (7th Cir. 2014).

¹⁴⁰ *Id.* at 746.

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.* (quoting 5 COLLIER ON BANKRUPTCY ¶ 544.06[1] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014)).

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 747.

¹⁴⁶ *Id.*

found that “there is no question that no [such] creditor exists in this case . . . [A]n unsecured creditor would have been barred [by sovereign immunity] from bringing an Illinois fraudulent-transfer action against the IRS outside of bankruptcy.”¹⁴⁷ An argument that focuses on Section 106(a) instead of 544 “misses the point,” said the court.¹⁴⁸ Rather, “[n]othing in § 106(a)(1) gives the trustee greater rights to avoid transfers than the unsecured creditor would have under state law. By concluding that § 106(a)(1) did just that, the courts below erred.”¹⁴⁹ In short, the court rested its decision not on whether Congress had successfully abrogated sovereign immunity in Section 106(a), but on the “unambiguous language” of § 544(b).¹⁵⁰

The court further stated that EAR would fail to satisfy the actual creditor requirement of Section 544(b) for other reasons, even if there were no sovereign immunity questions.¹⁵¹ The court reasoned that certain clauses of the U.S. Constitution pose other significant obstacles to recovering money from the federal government.¹⁵² Specifically, the Appropriations Clause in Article I Section 9 states that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law”¹⁵³ Courts have read this clause to “mean[] simply that no money can be paid out of the Treasury unless it has been appropriated by an act of Congress.”¹⁵⁴ Therefore, the court stated, sovereign immunity issues notwithstanding, this clause would prevent a creditor from using a state law to recover money from the federal government; absent an act of Congress, the recovery payment would violate the Appropriations Clause.¹⁵⁵ Similarly, the court held

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 748.

¹⁵⁰ *Id.* at 749.

¹⁵¹ *Id.* at 747-48.

¹⁵² *Id.* at 748.

¹⁵³ U.S. CONST. art. I, § 9, cl. 7.

¹⁵⁴ *Office of Pers. Mgmt. v. Richmond*, 496 U.S. 414, 424 (1990).

¹⁵⁵ *Equip. Acquisition Res.*, 742 F.3d at 748 (“states cannot enforce their laws so as to retrieve money from the federal coffers . . .”).

that the Supremacy Clause is yet another barrier.¹⁵⁶ Under this clause, the Constitution and federal law is “the supreme law of the land,” and the states may not tax the federal government or empower their citizens to recover federal taxes.¹⁵⁷ For these reasons, said the Seventh Circuit, it would be unconstitutional for a state law creditor to recover tax payments from the federal government.¹⁵⁸

The Seventh Circuit also justified its decision on policy grounds.¹⁵⁹ The court speculated that allowing recovery against the IRS might make federal agencies more vulnerable to state-law-based recovery actions.¹⁶⁰ State legislatures could loosen the requirements for avoidance under state law, which would allow recovery against the IRS in various unforeseen situations.¹⁶¹ This result would be contrary to the IRS’s interest in financial stability.¹⁶² Additionally, the court observed that in cases where there is ambiguity as to whether Congress intended to waive sovereign immunity, the ambiguity should

¹⁵⁶ The Supremacy Clause of Article IV states:

“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”

U.S. CONST. art. VI, cl. 2.

¹⁵⁷ See *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819) (“[S]tates have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by congress to carry into execution the powers vested in the general government.”).

¹⁵⁸ *Equip. Acquisition Res.*, 742 F.3d at 748.

¹⁵⁹ *Id.* at 750.

¹⁶⁰ *Id.*

¹⁶¹ *Id.* (“state legislatures could relax the criteria for what constitutes a fraudulent transfer, rendering federal tax revenue even more vulnerable to unexpected recovery actions.”).

¹⁶² *Id.* (quoting *United States v. Clintwood Elkhorn Mining Co.*, 553 U.S. 1, 12 (2008)).

be construed in favor of the sovereign.¹⁶³ In other words, “when it comes to sovereign immunity ties go to the government.”¹⁶⁴

For these reasons, the Seventh Circuit found that EAR could not satisfy the actual creditor requirement of Section 544(b).¹⁶⁵ And as a consequence of the court’s holding, there is no state law creditor that can possibly satisfy the Section 544(b) actual creditor requirement in cases where the federal government is the transferee. Simply put, there are no shoes into which the trustee or debtor in possession can step.

B. The Seventh Circuit’s Response to C.F. Foods

In its opinion, the Seventh Circuit also addressed *C.F. Foods* and its progeny, acknowledging that its decision “diverge[d] from all of the bankruptcy and district courts to consider the issue in the context of the federal government.”¹⁶⁶ The Seventh Circuit stated that those prior cases erred by focusing too heavily on Section 106 and neglecting the actual creditor requirement of 544(b).¹⁶⁷

The court also responded to some of the individual points relied on in prior opinions. For example, recall that *C.F. Foods* and other courts reasoned that disallowing avoidance would render 106(a) meaningless as to Section 544(b).¹⁶⁸ The Seventh Circuit disagreed, stating that Section 106(a) would still be applicable to 544(a), even if inapplicable to 544(b).¹⁶⁹ Unlike Section 544(b), 544(a) has no actual creditor requirement; so a court considering a Section 544(a) claim would not be concerned with whether an actual creditor could avoid a transfer or would otherwise be barred by sovereign immunity.¹⁷⁰ The court’s position here draws some support from the fact that all the

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 750-51.

¹⁶⁶ *Id.* at 748.

¹⁶⁷ *Id.* at 748-49.

¹⁶⁸ *See supra* Part I.B.

¹⁶⁹ *Equip. Acquisition Res.*, 742 F.3d at 749.

¹⁷⁰ *Id.*; compare 11 U.S.C.A. § 544(b) (West 2014) with § 544(a).

sections named in 106(a) are referenced generally, according to their section number, without any sign as to whether abrogation is limited to particular lettered subsections.¹⁷¹ It would be strange, the court reasoned, to expect Congress to specify that 106(a) applies only to 544(a) and not 544(b), when none of the other sections listed in 106(a) are that specific.¹⁷² It is therefore at least possible that Congress intended to abrogate sovereign immunity only as to Section 544(a) and not all of Section 544.¹⁷³

Nevertheless, the Seventh Circuit surmised that, after its holding, there would still be situations where the abrogation in 106(a) would apply to 544(b).¹⁷⁴ Specifically, the waiver of sovereign immunity might be meaningful in cases where the trustee seeks to recover a tax payment from the debtor to a state or local governmental unit.¹⁷⁵ In that situation, if the state waived or abrogated its own sovereign immunity to suits in state court, then 544(b) would allow the trustee to bring an avoidance claim against the state in bankruptcy court as well.¹⁷⁶

The court rejected prior courts' reliance on Congress' intent and the legislative history.¹⁷⁷ History and intent cannot overcome the "unambiguous language" of Section 544, said the Seventh Circuit.¹⁷⁸ The Seventh Circuit also questioned the *C.F. Foods* court's reading of the legislative history. The House Report showed that Congress

¹⁷¹ *Equip. Acquisition Res.*, 742 F.3d at 749 ("All of the fifty-nine provisions listed in § 106(a)(1) cite to a Code provision generally, without listing particular subsections. Yet, as the United States correctly points out, many of the listed provisions have subsections that do not implicate sovereign immunity. We believe the better conclusion is that Congress simply listed undivided Code sections if any part of that section included something for which sovereign immunity should be waived.").

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

amended Section 106 to make it more clear and unambiguous.¹⁷⁹ But, according to the Seventh Circuit, assuring that the Bankruptcy Code successfully abrogates sovereign immunity is a separate question, unrelated to the issue of whether the trustee can satisfy the actual creditor requirement in Section 544(b).¹⁸⁰

IV. ARGUMENT

As compared to the outcome in *Equipment Acquisition Resources*, the holdings in *C.F. Foods* and its progeny are better at reconciling the Bankruptcy Code, promoting bankruptcy policy, and honoring Congress' intent underlying Section 106. Accordingly, I argue that *Equipment Acquisition Resources* should be overruled and other courts should not look to it for guidance.

The Seventh Circuit's faith in the supposed plain and unambiguous meaning of Section 544 is misplaced. Many of the other courts that considered this same issue prior to *Equipment Acquisition Resources* also purported to rely on the plain meaning of Sections 544 and 106.¹⁸¹ Therefore, it is possible, if not likely, for different courts to reach opposite outcomes while professing to interpret a law's plain meaning and merely apply it to the facts.¹⁸² As one court remarked,

¹⁷⁹ *Id.* at 750.

¹⁸⁰ *Id.*

¹⁸¹ See *supra* Part I.B.

¹⁸² For other cases questioning the value of a plain meaning approach in situations where there is disagreement over a statute's interpretation, see, for example, *In re Philadelphia Newspapers, LLC*, 422 B.R. 553, 565 (Bankr. E.D. Penn. 2010) (observing that "five bankruptcy courts have now addressed th[is] issue and they are sharply divided. In four decisions courts have expressly based their ruling on the 'plain meaning' of the text of [this Rule] but have evenly split on that 'plain meaning.'"); *In re Turner*, 384 B.R. 537, 540 (Bankr. S.D. Ind. 2008), *rev'd*, 574 F.3d 349 (7th Cir. 2009) ("Bankruptcy courts have reached conflicting conclusions as to the 'plain meaning' of § 707(b)(2)(A)(iii)."); *In re Curry*, 362 B.R. 394, 397 (Bankr. N.D. Ill. 2007) ("[I]t is difficult to see how recognition that [the statute] 'is susceptible to conflicting interpretations,' can nonetheless lead to a conclusion that any ultimate interpretation is 'supported by the plain meaning . . .'" (internal citations omitted)).

“like beauty, clarity is often in the eye of the beholder.”¹⁸³ The problem here is in the Seventh’s Circuit’s heavy reliance on the plain meaning approach at the expense of other sources of meaning. If a statute’s meaning is actually patent, then a single outcome would be inevitable. Instead, where judges reach different and conflicting interpretations, the only conclusion is that the meaning is not actually plain.

In *Equipment Acquisition Resources*, the interaction between Sections 544 and 106 is not plain. The Seventh Circuit focused on the actual creditor requirement of Section 544(b), and found that a creditor would be barred by sovereign immunity from avoiding a transfer to the government notwithstanding Section 106.¹⁸⁴ Conversely, *C.F. Foods* and others reasoned that even if a creditor acting under state law would be barred by sovereign immunity, that bar disappears in the world of bankruptcy.¹⁸⁵ The answer to this issue is not simple, and courts may need to look beyond the statute’s language to other sources of meaning, such as the statute’s purpose and Congress’ intent. It is too facile for a court to imply that a solution is clear or obvious when qualified judges acting in good faith come to different conclusions.

Heavy reliance on a statute’s language may also cause judges to give short shrift to Congress’ intent and a statute’s purpose. As to Section 106, the legislative history and House Reports show that Congress specifically amended the statute to more explicitly and unambiguously abrogate sovereign immunity after two Supreme Court cases held that Section 106’s predecessor did not successfully abrogate sovereign immunity.¹⁸⁶ The legislative history thus shows that Congress was careful to ensure that Section 106 successfully abrogated sovereign immunity as to the enumerated sections. Further, as the *C.F. Foods* court observed, the fact that Congress decided to

¹⁸³ *Price v. Delaware State Police Federal Credit Union U.S. Trustee (In re Price)*, 370 F.3d 362, 368 (3d Cir. 2004) (observing that “notwithstanding their perception of a plain meaning, [] courts have arrived at polar opposite results”).

¹⁸⁴ See *supra* notes 139, 145-150 and accompanying text.

¹⁸⁵ See *supra* notes 55, 70-75 and accompanying text.

¹⁸⁶ See *supra* notes 50-52 and accompanying text.

include Section 544 in subsection 106(a)(1) strongly suggests that Congress knew that it was including the strong-arm powers in the scope of the waiver. But because the Seventh Circuit focused more on the actual creditor requirement of Section 544, its holding ignores the significance of this legislative history.

The Seventh Circuit's approach also has the undesirable effect of creating disharmony in the Bankruptcy Code. The court's holding renders Section 106(a) practically superfluous and inapplicable as to Section 544(b)—a critical source of the trustee's power to avoid fraudulent transfers. Courts should avoid interpretations of statutes that create "surplusage."¹⁸⁷ As to this argument, the Seventh Circuit countered that 544(b) still has some application in cases involving transfers to state governments that have waived their own sovereign immunity.¹⁸⁸ This point of view is plausible because 106(a) applies to any "governmental unit," including state and local governments.¹⁸⁹ However, this interpretation creates an absurd result when the transferee is the federal government. As the court in *DBSI* pointed out, only Congress can waive the federal government's sovereign immunity; thus the Seventh Circuit's holding will require Congress to take the additional step of waiving sovereign immunity as to actions brought under each individual state's fraudulent transfer act.¹⁹⁰

Equipment Acquisition Resources should be overruled for policy reasons as well. The Seventh Circuit noted that its holding furthered the policy of ensuring the IRS's financial stability, because states might amend their fraudulent transfer statutes to make it too easy to

¹⁸⁷ See, e.g., *U.S. v. Hernandez*, 79 F.3d 584, 596 (7th Cir. 1996) ("[W]e recognize the time-honored rule that we are to avoid, if possible, a construction of a statute that renders any term surplusage."); *Washington Market Co. v. Hoffman*, 101 U.S. 112, 115-16 (1879) ("It is a cardinal rule of statutory construction that significance and effect shall, if possible, be accorded to every word. . . . 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.' This rule has been repeated innumerable times.").

¹⁸⁸ See *supra* notes 171, 174-176 and accompanying text.

¹⁸⁹ 11 U.S.C.A. § 106(a)(1) (West 2014).

¹⁹⁰ See *supra* notes 85, 92-95 and accompanying text.

avoid transfers to the IRS.¹⁹¹ However, at present this justification is entirely based on speculation. There is no indication that this is likely to happen, especially since most states have adopted the UFTA at the recommendation of the model act's drafters.¹⁹²

Further, there is a strong bankruptcy policy in favor of promoting what is best for the debtor's creditors as a whole, and ensuring that there is equity among them.¹⁹³ Yet the Seventh Circuit's holding favors one of a debtor's creditors—the IRS—over all others. The cases in this article demonstrate that business-owners' personal tax liability can be substantial when profits are large. However, the Seventh Circuit's holding removes those assets from the bankruptcy estate and thus from the pot of money which is eventually distributed to the debtor's creditors. Therefore, this holding is contrary to the two bankruptcy policies of maximizing the debtor's estate and ensuring equity among creditors. For these reasons, courts should not follow *Equipment Acquisition Resources* and should instead adopt the reasoning of *C.F. Foods* and its progeny.

CONCLUSION

When the federal government becomes a target for avoidance, a conflict arises between Sections 106(a) and 544(b) of the Bankruptcy Code. Various courts, including the Seventh Circuit, have attempted to resolve this tension by relying on the Code provisions' plain meaning. However, the differing court decisions on this issue demonstrate that the meaning of these statutes is not plain, and a resolution is not obvious. As such, this article asserts that courts should be willing to look to other sources of meaning, such as Congress's intent and

¹⁹¹ See *supra* notes 158, 160-162.

¹⁹² See *supra* note 14 and accompanying text.

¹⁹³ See, e.g., *Graham v. Huntington Nat'l Bank (In re Medcorp, Inc.)*, 472 B.R. 444, 450 (Bankr. N.D. Ohio 2012) ("The policy rationale of [avoidance] is to maximize the estate assets available to a debtor's general body of unsecured creditors"); *First Union Nat'l Bank v. Gibbons (In re Matter of Princeton-N.Y. Investors, Inc.)*, 219 B.R. 55, 65-66 (Bankr. D.N.J. 1998) (discussing the bankruptcy goal for "the Trustee to maximize the bankruptcy estate for creditors' benefit").

traditional bankruptcy policy. Following this approach, courts should hold that sovereign immunity is abrogated as to state law causes of action brought by the trustee under Section 544(b). This outcome better harmonizes the Bankruptcy Code, promotes bankruptcy policy, and honors Congress's intent while staying within the boundaries of the statutes' language.