

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:)	In Proceedings
)	Under Chapter 7
DONALD and SHIRLEY MEDLEY,)	
)	No. BK 93-40675
Debtor(s).)	
)	
CHARLES JONES, TRUSTEE,)	
)	
Plaintiff(s),)	
)	
vs.)	No. ADV 95-4058
)	
DELZELL MEDLEY, DONALD MEDLEY and)	
SHIRLEY MEDLEY,)	
)	
Defendant(s).)	

OPINION

On August 7, 1995, the trustee filed a complaint under 11 U.S.C. § 544(b) to avoid the alleged fraudulent transfer of corporate stock from the debtors, Donald and Shirley Medley, to Delzell Medley, Donald Medley's mother. The defendants filed a motion to dismiss, asserting that the transfer of stock took place on October 14, 1990, more than four years before the trustee's complaint was filed. The defendants contend the trustee's action is untimely under either the state statute of limitations incorporated in the trustee's § 544(b) action or the federal statute of limitations of 11 U.S.C. § 546(a), which precludes commencement of a § 544 action after a bankruptcy case is closed. See 11 U.S.C. § 546(a)(2). The trustee responds that his complaint is timely under § 546(a) because, although the debtors' bankruptcy case was closed prior to the filing of the present action, it was not "properly closed" since it was necessary to reopen the case to allow the trustee to fully administer the debtors' estate.

It is undisputed that the transfer in question occurred on October 14, 1990, when the debtors conveyed their 100% ownership of stock in Vacations Clearing House, Inc., to Delzell Medley. On September 1, 1993, the debtors filed their Chapter 7 bankruptcy petition, at which time the Chapter 7 trustee was appointed. The trustee filed a "no asset" report on October 4, 1993, and, on December 29, 1993, the debtors' bankruptcy case was closed. Subsequently, the debtors sought and obtained leave to reopen their bankruptcy case on two separate occasions, first, in January 1994 to file a dischargeability action and, then, in April 1994 to file a reaffirmation agreement.

On July 18, 1995, the trustee filed a motion to reopen the debtors' bankruptcy case to administer newly discovered assets and, further, withdrew his "no asset" report for the purpose of investigating a prepetition transfer of interests by the debtors. The trustee's motion was granted and, on August 7, 1995, the trustee filed the present complaint under § 544(b) to avoid the debtors' prepetition transfer of corporate stock to Delzell Medley. The trustee's complaint, based on state law fraudulent conveyance provisions, alleged that the debtors conveyed the subject property, having a value in excess of \$50,000, with the actual intent to defraud creditors (Count I) or for inadequate consideration with the reasonable belief that such transfer would render them insolvent (Count II). See 740 ILCS 160/5(a)(1) and (a)(2).¹

¹ Section 5 of Illinois' Uniform Fraudulent Transfer Act ("UFTA") provides in pertinent part:

(a) A transfer made . . . by a debtor is fraudulent as

DISCUSSION

Section 544(b) allows the Chapter 7 trustee to pursue, on behalf of unsecured creditors, state law remedies that would have been available to such creditors outside bankruptcy.² In these cases, a kind of dual statute of limitations applies. If the state statute of limitations has run at the time the bankruptcy petition is filed, the trustee, who is subject to the same limitations and disabilities as the creditor whose remedy he seeks to enforce, is likewise prevented by that statute from pursuing the action. If, on the other hand, the creditor whose cause of action the trustee is pursuing still had time to bring the action when the bankruptcy petition was filed, the trustee gains the benefit of the federal statute of limitations of § 546(a), and the time for bringing the trustee's § 544(b) action is extended by

to a creditor . . . if the debtor made the transfer . . .
(1) with actual intent to hinder, delay, or defraud
any creditor of the debtor; or

(2) without receiving a reasonably equivalent
value in exchange for the transfer or obligation, and the
debtor:

. . .

(B) intended to incur, or believed or reasonably
should have believed that he would incur, debts beyond his ability to
pay as they became due.

740 ILCS 160/5(a) (1993).

² Section 544(b) provides:

(b) The trustee may avoid any transfer of an interest
of the debtor in property . . . that is voidable under
applicable law by a creditor holding an unsecured claim that
is allowable under section 502 of this title

See 11 U.S.C. § 544(b).

that statute. See In re Dry Wall Supply, Inc., 111 B.R. 933, 936 (D. Colo. 1990); In re Martin, 142 B.R. 260, 265-66 (Bankr. N.D. Ill. 1992); In re Topcor, Inc., 132 B.R. 119, 123-24 (Bankr. N.D. Tex. 1991); In re Mahoney, Trocki & Assocs., Inc., 111 B.R. 914, 918 (Bankr. S.D. Cal. 1990). In this case, the state law period for bringing the actions alleged in the trustee's complaint was four years from the time the transfer was made or, with respect to Count I, within one year after the transfer was or could have been discovered. See 740 ILCS 160/10(a) and (b).³ This limitations period had not run when the debtors' bankruptcy case was filed in September 1993, as the debtors' petition was filed within four years after the alleged fraudulent transfer was made on October 14, 1990. Upon the filing of the debtors' bankruptcy petition, § 546(a) became applicable to determine the appropriate time for filing the trustee's action under § 544(b). Thus, while the state statute of limitations had expired at the time the trustee's complaint was filed in August 1995, the trustee's action was not untimely if it was filed within the time set forth in § 546(a).

³ Section 10 of Illinois' UFTA provides:

A cause of action with respect to a fraudulent transfer . . . under this Act is extinguished unless action is brought:

(a) under [section 5(a)(1)], within 4 years after the transfer was made . . . or, if later, within one year after the transfer . . . was or could reasonably have been discovered by the claimant;

(b) under [section 5(a)(2)], within 4 years after the transfer was made

740 ILCS 160/10 (1993).

Section 546(a), in effect at the time the debtors' case was commenced, provides that the time for bringing an action under § 544 is "the earlier of--

- (1) [2 years after appointment of the trustee] or
- (2) the time the case is closed or dismissed.

11 U.S.C. § 546(a) (1993) (emphasis added).⁴ The trustee here was appointed on September 1, 1993, the day the debtors' bankruptcy petition was filed. Under § 546(a)(1), the trustee had two years or until September 1, 1995, to file his § 544(b) action, which was met by the filing of his complaint on August 7, 1995, prior to the expiration of the two-year period. However, under § 546(a)(2), the trustee was required to file his complaint before the bankruptcy case was closed. The defendants contend that since the case was closed on December 29, 1993, after the trustee filed his "no asset" report, the trustee was thereafter precluded from bringing this § 544(b) action, even though he sought and obtained the reopening of the debtors' case and filed his complaint within the two-year period.

The defendants' argument raises a question of what is meant by the

⁴ Section 546(a)(1) was amended by the Bankruptcy Reform Act of 1994 to provide that the two-year period runs from the time of entry of the order for relief or appointment of the trustee, whichever is later. See Pub.L. 103-394, § 216, 108 Stat. 4106, 4126-27. Since the debtors' case was commenced prior to the Reform Act's effective date of October 22, 1994, it is governed by the former version of § 546(a)(1). See Pub. L. 103-394, § 702; Gleichman Sumner Co. v. King, Weiser, Edelman & Bazar, 69 F.3d 799 (7th Cir. 1995). In this case, there would be no difference under either the former or present version of § 546(a)(1), as the trustee was appointed on September 1, 1993, the same day the order for relief was entered. Moreover, § 546(a)(2), the provision here at issue, was left unchanged by the Reform Act legislation.

"time a case is closed" in § 546(a)(2). While the defendants would read § 546(a)(2) as barring any action filed after a case is initially closed, this interpretation fails to consider the effect of reopening a closed case to administer newly discovered assets. Section 350 of the Code provides that a case shall be closed "after an estate is fully administered" and further allows for the reopening of a closed case "to administer assets." 11 U.S.C. § 350. Courts construing this provision have held that when a trustee has not fully administered a debtor's estate due, for example, to the debtor's failure to disclose assets in his petition, the case cannot be said to have been properly "closed" for purposes of § 350. In re Petty, 93 B.R. 208, 211-212 (Bankr. 9th Cir. 1988); see In re Schroeder, 173 B.R. 93, 94-95 (Bankr. D. Md. 1994), rev'd on other grounds, 182 B.R. 723 (D. Md. 1995). Courts have similarly determined that when a case is reopened to allow the trustee to pursue assets through a § 544(b) action, the trustee's action should not be barred merely because the estate was closed under the mistaken assumption it had been fully administered. Petty, at 212 (citing Bilafsky v. Abraham, 67 N.E. 318, 319 (Mass. 1903); White v. Boston, 104 B.R. 951, 955 (S.D. Ind. 1989); In re Stanke, 41 B.R. 379, 381 (Bankr. W.D. Mo. 1984); see In re Herzig, 96 B.R. 264, 266 (Bankr. 9th Cir. 1989). Rather, to the extent previously undisclosed assets remain to be recovered by the trustee, the case would not have been "properly and finally closed" prior to that time within meaning of § 350 and § 546(a)(2). Petty, at 212; Stanke, at 381.

The defendants cite no authority supporting their position that a trustee's action is barred under § 546(a)(2) even after a case is

reopened under § 350 to administer newly discovered assets. Rather, while acknowledging the body of case law interpreting "closed" as meaning "properly and finally closed," the defendants assert that the present case is distinguishable on its facts since it was closed and reopened on three separate occasions prior to the filing of the trustee's § 544(b) action. The Court finds no merit in this distinction since the case was twice reopened on the debtors' own motion to allow them to file a reaffirmation agreement and a dischargeability complaint. It can hardly be argued that the debtors' reopening of the case somehow prejudiced the trustee from later seeking to reopen to pursue the present action.

The defendants further assert that to construe "closing of a case" so broadly as to allow any reopening of a bankruptcy case to revive the substantive rights of the trustee effectively renders § 546(a) meaningless as a statute of repose providing respite from litigation. However, it is not every motion to reopen that justifies setting aside the bar of § 545(a)(2) to allow the bringing of an avoidance action by the trustee. In construing a predecessor statute of § 546(a)(2), the court in Kinder v. Scharff, 231 U.S. 517 (1913), refused to allow a trustee's suit upon reopening when, "during the pendency of the original proceeding the trustee suspected the alleged fraud, made some inquiries, but dropped the matter because he thought it was not worthwhile" 231 U.S. at 520. The Kinder court ruled that where the trustee was "chargeable with knowledge of the fraud" prior to closing of the case, the court would not "remove the bar of the statute" merely because the trustee later changed his mind. Id. at

521.

As in Kinder, this Court would limit setting aside the bar of § 546(a)(2) to those instances in which a bankruptcy case was closed prematurely without the trustee's actual or constructive knowledge that assets remained to be administered. It is the function of statutes of limitation such as § 546(a) to give certainty to proceedings and discourage stale claims. See In re McGoldrick, 117 B.R. 554, 558 (Bankr. C.D. Cal. 1990). They are not designed, however, to reward fraudulent behavior or safeguard the acts of those who successfully conceal their wrongful behavior. Id. In this case, there is no allegation the trustee knew or had reason to suspect the alleged fraud before the case was closed in December 1993. The transfer was not disclosed in the debtors' bankruptcy petition, and it was only "fortuitously" through the course of litigation in another bankruptcy case involving Donald Medley that the matter came to the trustee's attention. See Rpt. of Proc., Mot. to Dismiss, Adv. No. 95-4058, Oct. 3, 1995. Under these circumstances, the Court finds that the debtors' case was not "properly closed" in December 1993, and the trustee is, therefore, not precluded from bringing the present action under § 544(b).

For the reasons stated, the Court will deny the defendants' motion to dismiss the trustee's complaint.

SEE WRITTEN ORDER.

ENTERED: DECEMBER 14, 1995

/s/ KENNETH J. MEYERS
U.S. BANKRUPTCY JUDGE