The Section 546(a) Statute of Limitations:It May Start Running Sooner Than You Think in Chapter 7 Cases

by Henry M. Karwowski

Under Section 546(a) of the United States Bankruptcy Code, the deadline for filing actions under sections 544, 545, 547, 548, or 553 in a Chapter 7 case is the earlier of: (1) the later of two years after the entry of the order for relief, or one year after the appointment or election of the "first trustee" under Section 702 if such appointment occurred within the two-year period following the entry of the order for relief, or (2) the time at which the case is closed or dismissed.[1]

Numerous are the cases in which a court has interpreted Section 546(a) to mean that the limitations period for filing these actions in a Chapter 7 case begins to run on the date of the appointment of the permanent trustee.[2] Last December, however, in a case entitled *Avalanche Maritime, Ltd. v. Parekh (In re Parmetex, Inc.)*,[3] the United States Court of Appeals for the Ninth Circuit held that a Section 546(a) limitations period started to run on the date of the appointment of the interim trustee.[4]

While the Ninth Circuit, in reaching its determination, interpreted the pre-1994 version of Section 546, courts may apply the same analysis in cases involving the current version.[5] In fact, in *Parmetex*, the Ninth Circuit rejected the contention that adoption of the current version of Section 546 warranted a different result.[6]

The significance? In Chapter 7 cases, courts may now find that the Section 546(a) limitations period starts significantly sooner than practitioners have come to expect.

PROCEDURAL HISTORY/ARGUMENTS

In *Parmetex*, more than two years following the date of appointment of the interim trustee, unsecured creditors filed a complaint seeking to avoid allegedly fraudulent and preferential transfers by the debtor.[7] The defendants sought dismissal on the grounds that the creditors had failed to timely file the complaint pursuant to the pre-1994 version of Section 546(a).[8] That version provided, in relevant part, that certain avoidance actions could not be commenced after the earlier of two years after the appointment of a trustee under Section 702 or the time at which the case was closed or dismissed.[9]

The parties disagreed as to whether the expression "appointment of a trustee" in Section 546(a) refers to an interim trustee or a permanent trustee.[10] The defendants maintained that the expression refers to the "appointment" of an interim trustee under Section 701.[11] "If this is the case," the Ninth Circuit observed, "the Complaint was not timely filed because the interim trustee was appointed...more than two years before the Creditors filed suit."[12]

Meanwhile, the creditors argued that the expression refers to the "election" of a permanent trustee under Section 702(b).[13] According to the creditors, "§ 546 must refer to the qualification of a permanent trustee under § 702 because the statute explicitly references § 702."[14] The creditors also noted that a majority of lower courts had supported such an interpretation of Section 546(a).[15]

DECISION

The Ninth Circuit held that, despite lower courts holding to the contrary, the Section 546(a) statute of limitations started to run upon the appointment of the interim trustee under Section 701, and not upon the election of the permanent trustee under Section 702.[16] The court premised its holding upon two prior decisions — *Ford v. Union Bank (In re San Joaquin Roast Beef)*,[17] and *Upgrade Corp. v. Gov't Technology Servs., Inc. (In re Softwaire Centre Int'l, Inc.)*.[18]

In *San Joaquin*, the Ninth Circuit had held that, in a case converted from Chapter 11 to Chapter 7, the appointment of the first trustee, *i.e.*, the Chapter 11 trustee, triggers the Section 546(a) statute of limitations.[19] After relying on San Joaquin, the Ninth Circuit found that the interim trustee qualified as the "first trustee" in *Parmetex*.[20] In *Softwaire Center*, the Ninth Circuit had held that a debtor in possession constitutes "the functional

equivalent of an appointed trustee," and hence, that the Section 546(a) statute of limitations applies to debtors in possession as well as to trustees.[21] Applying that reasoning in *Parmetex*, the Ninth Circuit found that an interim trustee appointed under Section 701 constitutes the "functional equivalent" of a permanent trustee elected under Section 702.[22] It declared that "[t]his is so because the Bankruptcy Code does not require the permanent trustee to do anything different than that which he had already been doing as the interim trustee."[23] "Indeed," it added, "all Chapter 7 trustees, including the interim trustee, have the same rights, powers, and duties, including the power to assert claims governed by § 546(a)(1)."[24]

Therefore, the Ninth Circuit found that, because the interim trustee qualified as the first trustee, and because an interim trustee is the "functional equivalent" of a permanent trustee, the Section 546(a) statute of limitations started to run on the date of the appointment of the interim trustee.[25] Accordingly, it concluded that the creditors' action was barred.[26]

The Ninth Circuit rejected the contention that such a holding would "read" language — specifically, "§ 702" — out of the statute.[27] The Ninth Circuit observed that, although it does refer to Section 702 and not to Section 701, Section 546(a) also specifically refers to the "appointment" of trustees.[28] Only Section 701 addresses the "appointment" of Chapter 7 trustees.[29] Thus, the Ninth Circuit reasoned that adoption of a contrary holding would also read language — "appointed under" — out of the statute.[30] "Given that either interpretation would read language out of this unclear statute," it concluded, "we have simply discerned the most logical reading of § 546(a) that is consistent with our prior decisions in *San Joaquin Roast Beef* and *Softwaire Centre*."[31]

Finally, the Ninth Circuit rejected the contention that "the 1994 amendments to the Bankruptcy Code support a contrary interpretation of Section 546 because those amendments add the phrase 'or election' to the statute."[32] Finding that the amended statute fails to resolve the prior ambiguity, the Ninth Circuit asserted:

> [a]lthough the added phrase "or election," could suggest that the unamended § 546(a) applies to only the permanent trustee, the statute also now contains the phrase "first trustee." The added "first trustee" language suggests that the statute of limitations should be applied to the interim trustee because the interim trustee is the "first trustee." These contradictory changes do not help clear up the confusion present in the unamended version of § 546(a).[33]

RELEVANCE/CONCLUSION

Although the Ninth Circuit interpreted the pre-1994 version of Section 546(a), and even though its comments concerning the current version of Section 546(a) constitute *dicta*, courts may find the Ninth Circuit's determination applicable in cases involving the revised version of Section 546(a). First, because the word "appointment" remains in the current version of Section 546(a), courts analyzing the current version may adopt the Ninth Circuit's finding that the word refers to the appointment of an interim trustee under Section 701.[34] Second, notwithstanding the change in Section 546(a), all Chapter 7 trustees still possess the same powers. Hence, courts may also adopt the Ninth Circuit's finding that an interim trustee constitutes the functional equivalent of a permanent trustee.[35] Third, as the Ninth Circuit recognized, the phrase "first trustee" in the current version of Section 546(a) could be interpreted to signify that the limitations period in a Chapter 7 case must start upon the appointment of the interim trustee, the "first trustee."[36] Finally, *Parmetex* is the first case in which a United States Court of Appeals has addressed the issue of when the Section 546(a) statute of limitations starts to run in a Chapter 7 case.[37] Hence, courts are likely to accord some modicum of deference to the analysis in *Parmetex*.

Accordingly, counsel for trustees, debtors, creditors' committees, and creditors seeking to assert avoidance claims, as well as parties defending such claims, are advised to heed this case. ■

ENDNOTES

1. U.S.C. § 546(a) (2000).
2. *See, e.g., Taylor v. Hosseinpour-Esfahani (In re Hosseinpour-Esfahani)*, 198 B.R. 574, 578 n.5 (B.A.P. 9th Cir. 1996); *Mendelsohn v. Sequa Fin. Corp. (In re Frank Santora Equip. Corp.)*, 231 B.R. 486, 492 (E.D.N.Y. 1999); *Damir v. Trans-Pacific Nat'l Bank (In re Kong)*, 196 B.R. 167, 170 (N.D. Cal. 1996); *Hirsch v. Union Trust Co. (In re Colonial Realty Co.)*, 229 B.R. 567, 572 (Bankr. D. Conn. 1999); *Huennekens v. Greene (In re Dove)*, 199 B.R. 342, 347 (Bankr. E.D. Va. 1996); *Seals v. Abedi (In re Fort Worth Campbell & Assoc.)*, 182 B.R. 748, 750 (Bankr. N.D. Tex. 1995); *Field v. Montgomery County, Md. (In re Anton Motors, Inc.)*, 177 B.R. 58, 60-61 (Bankr. D. Md. 1995); *Styler v. Conoco, Inc. (In re Peterson Distrib.)*, 176 B.R. 584, 590 (Bankr. D. Utah 1995). *But see Clark Oil and Trading Co. v. Haberbush (In re Sahuaro Petroleum & Asphalt Co.)*, 170 B.R. 689, 693-94 (C.D. Cal. 1994), *aff'd*, 89 F.3d 846 (9th Cir), *cert. denied*, 519 U.S. 992 (1996).
3. 199 F3d 1029 (9th Cir. 1999),
4. The United States Trustee must appoint the interim trustee promptly after entry of the order for relief. *See* 11 U.S.C. § 701(a) (2000). Unless the creditors elect a trustee, the interim

trustee becomes the permanent trustee at the meeting of creditors. *See* 11 U.S.C. §§ 702, 341 (2000).

5. *See Parmetex*, 199 F.3d at 1031.
6. *See id.* at 1034.
7. *See id.* at 1030.
8. *See id.*
9. *See* 11 U.S.C. § 546(a) (1994).
10. *See Parmetex*, 199 F.3d at 1031.
11. *See id.* at 1031-32 (citing § 701(a)(1) ("[T]he United States trustee shall appoint one disinterested person...to serve as interim trustee in the case.")).
12. *See id.* at 1032.
13. *See id. (citing* § 702(b) ("[C]reditors may elect one person to serve as trustee in the case.").
14. *See id.*
15. *See id.*
16. *See id.* at 1033.
17. F.3d 1413 (9th Cir. 1993).
18. 994 F.2d 682 (9th Cir. 1993).
19. *See id. (citing San Joaquin*, 7 F.3d at 1416).
20. *See id.*
21. *See id. (quoting and citing Softwaire Center*, 994 F.2d at 683-84).
22. *See id.*
23. *See id.*
24. *See id.*
25. *See id.*
26. *See id.*
27. *See id.*
28. *See id.*
29. *See id.*
30. *See id.*
31. *See id.*
32. *See id.* at 1034.
33. *See id.*
34. *See* 11 U.S.C. § 546(a) (2000); *Parmetex*, 994 F.2d at 1033.
35. *See Softwaire Center*, 994 F.2d at 683-84. Again, in *Parmetex*, the Ninth Circuit based its finding that an interim trustee constitutes the functional equivalent of a permanent trustee on its decision in *Softwaire Centre*, in which it had held that a debtor in possession constitutes the functional equivalent of an appointed trustee. *See Parmetex*, 13 F.3d at 1033. The United States Court of Appeals for the Third Circuit adopted the Ninth Circuit's reasoning in *Softwaire Centre*. *See Constr. Management Servs., Inc. v. Mfrs. Hanover Trust Co. (In re Coastal Group, Inc.)*, 13 F.3d 81, 82 (3d Cir. 1994) ("[W]e agree with our sister courts of appeals that the limitations period in § 546(a)(1) applies to debtors-in-possession."). Thus, the Third Circuit would likely endorse the Ninth Circuit's finding in *Parmetex*. Indeed, the current version of § 546(a) now requires that applicable avoidance actions be commenced within two years of the entry of the order for relief in the event a trustee has not been appointed. *See* 11 U.S.C. § 546(a) (2000). Therefore, one can argue that Congress, in enacting the current version, implicitly adopted the holding in *Softwaire Center* that a debtor in possession constitutes the functional equivalent of an appointed trustee.
36. *See Parmetex*, 994 F.2d at 1034.
37. In *Maurice Sporting Goods, Inc. v. Maxway Corp. (In re Maxway Corp.)*, 27 F.3d 980, 984 (4th Cir. 1994), the United States Court of Appeals for the Fourth Circuit asserted, in *dicta*, that § 546(a) limitations period does not start in a Chapter 7 case until the selection of a permanent trustee.

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From the Editors

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has reviewed a myriad of proposed, pending and adopted legislation. We urge you to heed his request to volunteer to work on the section's Legislative Committee, or, at the very least, express your view to the committee on upcoming legislation.

For those of you who attended the Judges' Roundtable at this spring's Bench/Bar Conference, you heard Judge Novalyn Winfield opine that she would not be distressed if the then-pending bankruptcy reform legislation was not enacted. In her Perspective From the Bench article, she has expanded her comments on the proposed bankruptcy legislation and has reviewed the historical antecedents of the current Bankruptcy Code. Whether or when Congress will succeed in reforming the code, Judge Winfield's article has put back into perspective the concept of debt repayment as an underlying premise to debt relief.

Please take note that the Bankruptcy Inn of Court has commenced soliciting new students for next year's session. Positions are currently available for students, barristers and masters. Please see Bruce Buechler's update for more information.

I would be remiss if I didn't express my heartfelt gratitude to our assistant editor, Joseph J. DiPasquale, for his Herculean efforts in getting this newsletter to press. He has reminded and prodded, in a style reminiscent of the young Dan Stolz, contributors to submit articles on a timely basis. We are thrilled with the success he has had in obtaining contributing articles from younger bankruptcy practitioners, and applaud his continuing efforts.

On a final note, this edition contains the first message from Simon Kimmelman as the new chair of the Bankruptcy Law Section.

As many of you are aware, Simon was the original co-editor of this newsletter, and only resigned as such when his other responsibilities (including, among others, his being an officer of this section and chair of the Lawyers Advisory Committee) prevented him from devoting additional time to the newsletter. We are thrilled that Simon, once again, is submitting articles for the newsletter, and enthusiastically welcome him as the new chair of our section. ■