

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO**
Bankruptcy Judge Elizabeth E. Brown

In re:

LAKEVIEW DEVELOPMENT
CORPORATION,

Debtor.

Bankruptcy Case No. 14-16938 EEB

Chapter 7

JOLI A. LOFSTEDT, chapter 7 trustee,

Plaintiff,

v.

UBS FINANCIAL SERVICES, INC., as
custodian for the benefit of David M.
Summers IRA and
DAVID M. SUMMERS IRA,

Defendants.

Adversary Proceeding No. 16-1197 EEB

ORDER GRANTING DEFENDANT’S MOTION TO DISMISS

THIS MATTER is before the Court on a Motion to Dismiss, filed by the Defendant David M. Summers IRA (the “Defendant” or the “Summers IRA”). The Trustee brought this action against the Defendant and the custodian of the IRA to recover allegedly preferential payments on a promissory note. The Defendant does not deny receipt of these payments but its Motion raises several bases for dismissal. The Court will only address two of these grounds. First, the Defendant asserts that it is not a proper party to this action because it is not a legal entity separate from its owner, Mr. David M. Summers. Therefore, the Defendant argues that the Trustee should have sued Mr. Summers instead. Second, even if the Trustee were to substitute Mr. Summers as the defendant, the Defendant contends she would not be able to prevail because Mr. Summers received a discharge in his individual bankruptcy case, barring any pre-bankruptcy claims against him, including preference claims. Both issues raise questions of first impression in this district.

I. BACKGROUND

A. Lakeview's Bankruptcy

Lakeview Development Corporation ("Lakeview") acquired vacant land near Loveland, Colorado with plans to develop it into a residential subdivision. Mr. Summers, its President and largest shareholder, spearheaded this effort. But during the development phase, Lakeview ran into financial difficulties. Mr. Summers filed a chapter 11 petition on its behalf on May 20, 2014.

As a debtor in possession, Lakeview encountered strong resistance from its creditors. The court¹ held numerous contested hearings on motions to sell property, motions to assume brokerage listing agreements, motions for stay relief, Lakeview's plan and disclosure statement, motions for protective orders, motions to extend the exclusive period, motions to obtain post-petition financing, motions to change the composition of the unsecured creditors' committee, and more. With mounting administrative expenses and Lakeview's inability to confirm a plan, the committee filed a motion for the appointment of a chapter 11 trustee. Although Lakeview opposed this motion, the court granted it and, in due course, the Trustee received her appointment as Lakeview's chapter 11 trustee. Thereafter, both Lakeview and the Trustee attempted to confirm their separate reorganization plans, but with no success. Ultimately, secured creditors obtained stay relief to foreclose on the property. Then the U.S. Trustee moved for conversion, which this Court granted. The Trustee continues to represent this estate but now as its chapter 7 trustee.

In performing her duty to liquidate the estate's assets, the Trustee filed numerous adversary proceedings, including this one. In her complaint, she alleges that, on December 31, 2010, Lakeview executed a \$750,000 promissory note payable to UBS Financial Services ("UBS"), as custodian for the Summers IRA. She further alleges that, on August 1, 2013, less than one year prior to its bankruptcy, Lakeview made two \$75,000 interest payments (the "Transfers") on the note to UBS and/or the Summers IRA. The Trustee seeks to avoid and recover these Transfers under 11 U.S.C. §§ 547(b) and 550(a).²

B. Mr. Summers' Bankruptcy

Shortly after the Court converted Lakeview's chapter 11 case to chapter 7, and two days after the Trustee filed this adversary proceeding, Mr. Summers filed his own chapter 7 bankruptcy, Case No. 16-15359 TBM. He listed the Summers IRA, with a balance of \$503,701.99, as an asset in his schedules and claimed it as fully exempt

¹ This case was assigned to Judge Sidney B. Brooks until his retirement, whereupon the Clerk of Court reassigned the case to this judge on November 18, 2015.

² All references to "Code," "\$," or "section" shall refer to Title 11, United States Code, unless expressly stated otherwise.

under Colo. Rev. Stat. § 13-54-102(1)(s).³ Mr. Jeffrey Hill (“Mr. Hill”), the chapter 7 trustee of Mr. Summers’ estate, objected to this exemption to the extent the balance of the IRA included the two Transfers, totaling \$150,000. Mr. Hill asserted that the portion of the IRA attributable to the Transfers was “tainted by fraud.” After a trial before another division of this court, the court denied Mr. Hill’s objection to the IRA exemption. It found no evidence of actual fraud when Mr. Summers caused Lakeview to make the Transfers. While the Summers IRA may have received preferential treatment when it received the Transfers, the court found the underlying transaction was legitimate and Lakeview received consideration through a corresponding satisfaction of antecedent debt.

The Trustee in this case filed a proof of claim against Mr. Summers’ estate for \$586,878.49, for what she described as the “[v]alue of [a]voidable [t]ransfers under 11 U.S.C. 547 and 548.” Given the reference to § 548 and an obvious tie between the amount of this claim and what was then the likely balance of the Summers IRA, the Trustee apparently believed she had a basis for avoiding all transfers to the IRA under a fraudulent conveyance theory. But in her suit against the Summers IRA, she has abandoned this theory and sought only to recover the Transfers as preferential payments in the amount of \$150,000. And as it turned out, the amount of the Trustee’s claim against Mr. Summers’ estate became irrelevant. There were no unsecured, nonexempt assets in his estate and, therefore, Mr. Hill was unable to distribute any funds to unsecured creditors. Nevertheless, Mr. Summers received a chapter 7 discharge.

II. DISCUSSION

A. The IRA is Not a Separate Legal Entity

The Defendant asserts that it is not a separate legal entity and, therefore, it cannot be sued in this action. Surprisingly, there are few reported decisions addressing this question. *Wagner v. Lacy*, 2013 WL 12328852, at *3 (D.N.M. Nov. 18, 2013) (observing the dearth of case law on the issue). Of those that exist, almost all the courts agree with the Defendant and hold that an individual retirement account (“IRA”) is not a separate legal entity. But they reach this conclusion without providing a great deal of analysis. Nor does this Court hold out much hope of providing a satisfactory answer. That is because an IRA is somewhat of a fictional creature, existing only to provide its owner with certain tax attributes. When the IRA holds only funds or marketable securities, it seems obvious that it is merely an asset of the debtor and not a separate entity. But when it holds other types of property, whether personal property (here a promissory note) or real property, it seems that it ought to be considered a separate entity so that it has the power to sue and be sued when it comes to asserting rights in the property. But again, that is not the conclusion of most courts.

³ Section 13-54-102(1)(s) provides an exemption for all “funds held in or payable from any pension or retirement plan . . . including any individual retirement account, as defined in 26 U.S.C. sec. 408.” Colo. Rev. Stat. § 13-54-102(1)(s).

For example, in *SIPC v. Bernard L. Madoff Investment Securities, LLC*, 2019 WL 6245772 (Bankr. S.D.N.Y. Nov. 21, 2019), the court held that “an IRA is not a separate legal entity from its owner.” *Id.* at *27. It reached this conclusion in the context of a larger ruling regarding who was the initial transferee of fraudulently conveyed property. The individual defendant, who owned the IRA, argued the IRA’s custodian was the initial transferee. The court rejected this notion and found the custodian was a mere conduit. The owner of the IRA was the initial transferee, according to the court, because she, not the custodian, first acquired dominion and control over the transferred asset.

In *Wagner v. Eberhard (In re Vaughan Co. Realtors)*, 2014 WL 271632 (Bankr. D.N.M. Jan. 23, 2014), the defendant argued that, because the allegedly fraudulently transferred funds went to his IRA and not to him personally, he was only liable to the extent he received distributions from his IRA. The court rejected this reasoning as well, stating that “[a] self-directed IRA, like a savings account, is not a separate legal entity from its owner.” *Id.* at *3. The court also observed that funds deposited into an IRA are treated as income of the individual owner under § 101(10A) because the funds are available for the owner’s use. The court compared the owner’s control over the funds in the IRA to that of the owner of a self-settled revocable trust in that the owner can access the assets at any time. It concluded that the defendant had access to and control over the funds in his IRA from the date the funds were deposited. “For fraudulent transfer purposes, even if not for income tax or exemption purposes, the transfer of funds by a third party to an individual’s IRA has the same legal effect as if the funds were transferred directly to that individual.” *Id.*; see also *Regions Bank v. Kaplan*, 2017 WL 2868413 (M.D. Fla. April 10, 2017); *United States v. Bailey*, 2012 WL 569744, at *5 n.5 (W.D.N.C. Feb. 22, 2012) (in the context of a criminal forfeiture proceeding, the court ruled that “because an IRA is not a separate legal entity from its owner,” the individual IRA beneficiaries were the true owners of the subject stock certificates).

In *Brady v. Park*, 445 P.3d 395 (Utah 2019), the court had to decide whether it had appellate jurisdiction over an IRA when the IRA’s owner had filed a notice of appeal, but the custodian of the IRA had not. The court held that the IRA was “not a legal entity that is distinct from its owner. Rather, it is more akin to property such as a bank account.” *Id.* at 423. Because the court had jurisdiction over the owner of the IRA, it concluded that it had jurisdiction over all of his assets, including assets held in the IRA. *Id.*

In *Deem v. Baron*, 2016 WL 8230425 (D. Utah April 14, 2016), IRA owners sued on a promissory note and a loan agreement. They named the obligors and the IRA custodian as parties. The obligors moved to dismiss, claiming that the owners were not the real parties in interest. The court disagreed. It ruled that the IRA owners “are the true and real parties in interest on every contract which form [sic] the basis of this action and since they are the ones most knowledgeable of all the facts and circumstances surrounding those contracts, and since they are also the ones for whose benefit all of the transactions were performed, they are the appropriate parties to prosecute the case.” *Id.* at *2; see also *Vannest v. Sage, Rutty & Co., Inc.*, 960 F. Supp. 651 (W.D.N.Y. 1997) (IRA owners, not custodian, was the real party in interest with standing to bring securities fraud claims); *FBO David Sweet IRA v. Taylor*, 4 F. Supp. 3d 1282

(M.D. Ala. 2014) (IRA owner was the proper party to sue for breach of the IRA's contract with defendants).

The Court found only two cases in which a court ruled that an IRA, or its custodian, was the proper party. In *Pennsco Trust Co, Custodian FBO Jeffrey D. Hermann, IRA v. Delfierro*, 2017 WL 3454570 (W.D. Wash. Aug 11, 2017), the court rejected the argument that IRA owner was the real party in interest. Based on prior decisions deeming the IRA custodian the beneficial owner of the promissory note, it held that the IRA custodian was the proper party plaintiff in this judicial foreclosure action.

In *In Endeavour GP, LLC v. Endeavour Highrise, LP (In re Endeavour Highrise, LP)*, 432 B.R. 583, 660-65 (Bankr. S.D. Tex. 2010), the IRA owners argued that the IRA had no legal existence or capacity to be sued. But the court ruled that they had waived this argument when they had consented to the substitution of the IRAs for the custodians, whom the trustee had originally named as defendants. Alternatively, the court held that the proper parties to sue on a claim involving property held in an IRA are the IRA's custodian *and* the individual beneficiary, and that the agreed substitution order effectively brought those parties into the suit.

Rather than relying on any contrary caselaw authority, the Trustee argues that the IRA is a separate entity because it is a "trust." It is true that a trust is a separate legal entity. See Restatement (Third) of Trusts, § 2, cmt. a. (2003). But is a custodial IRA a trust? The Internal Revenue Code sends conflicting signals. In one place, it states that "[f]or purposes of this section, the term 'individual retirement account' means a trust created or organized in the United States for the exclusive benefit of an individual." 26 U.S.C. § 408(a). But later in the same statute, in a provision dealing specifically with custodial IRA accounts like the Summers IRA, it provides:

(h) Custodial Accounts. -- For purposes of this section, a custodial account shall be *treated as a trust* if the assets of such account are held by a bank . . . or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which he will administer the account will be consistent with the requirements of this section, and if the custodial account would, *except for the fact that it is not a trust*, constitute an individual retirement account described in subsection [408(a)].

26 U.S.C. § 408(h) (emphasis added). This later provision indicates that custodial IRAs are merely "treated" as trusts, but are not, in fact, trusts.

Several courts have reached this same conclusion. In some of the cases, the courts had to reach this issue in the context of deciding whether an IRA was an asset of the owner's bankruptcy estate or a trust excluded from property of the estate by § 541(c)(2). They held that the IRAs were not trusts, relying specifically on 26 U.S.C. § 408(h). See *Walsh v. Benson*, 2006 WL 2422557, *3-4 (W.D. Penn. Aug. 18, 2006); *In re Williams*, 290 B.R. 83, 87 (Bankr. E.D. Pa. 2003). In comparing the characteristics of a custodial IRA versus the requirements necessary for the creation of a trust, these

courts concluded that a custodial IRA is not a trust because the custodian is not denominated a trustee, there is no separation of the legal title from the beneficial interest in the property held in the IRA, and the IRA owner retains the authority to manage and control the investments in the IRA. See also Tara Twomey and Todd F. Maynes, *Protecting Nest Eggs and Other Retirement Benefits in Bankruptcy*, 90 Am. Bankr. L.J. 235, 239 (2016) [hereinafter “Protecting Nest Eggs”] (observing that “IRAs generally are not held in a trust for state-law purposes or exemption purposes, [therefore] they typically are not excluded from the estate pursuant to § 541(c)(2)”).

Courts have also determined that IRA custodians do not owe fiduciary duties to the IRA owners because IRAs are not trusts. For example, in *Hines v. FiServe, Inc.*, 2010 WL 1249838 (M.D. Fla. March 25, 2010), the court rejected the argument that the tax code imposed fiduciary duties on the custodians of plaintiffs’ IRAs, stating that 26 U.S.C. § 408(h) “recognizes that custodial IRAs, such as the Plaintiffs’ accounts here, are not trusts. They are only treated as trusts for tax deferral purposes.” *Id.* at *3; see also, *Lewis v. Del. Charter Guaranty & Trust Co.*, 2015 WL 1476403, *11 (E.D.N.Y. March 31, 2015); *Mandelbaum v. Fiserv, Inc.*, 787 F. Supp. 2d 1226, 1240-41 (D. Colo. 2011) (Colorado trust statutes do not govern duties of IRA custodian). But see *Neilson Bank v. Union Bank of Calif.*, 2003 WL 27374138 (C.D. Cal. Aug. 12, 2003) (stating that an IRA is a “form of trust” and must be sued through its trustee or beneficiary, but recognizing that an IRA is not a separate legal entity from its owner for purposes of analyzing whether proposed class counsel had conflict of interest).

These cases and Internal Revenue Code at 26 U.S.C. § 408(h) demonstrate that IRAs are nothing more than a tax deferral savings account or device. Congress created IRAs in 1974 to give employees not covered by employer-sponsored retirement plans a tax-advantaged way to save for retirement. *Protecting Nest Eggs*, 90 Am. Bankr. L.J. at 239; Patricia E. Killey, *Hidden in Plain View: The Pension Shield Against Creditors*, 74 Ind. L.J. 355, 358 n. 6 (1998). The owner of an IRA may withdraw the entire balance of the IRA account at any time, subject to applicable tax penalties. *Rousey v. Jacoway*, 544 U.S. 320, 327 (2005). These penalties are the main distinguishing factor between IRAs and a typical savings account. By imposing penalties to deter early withdrawal, Congress was fostering the intended purpose of the account – to provide income for an individual in retirement. *Id.* at 331-21.

But they differ from a savings account in at least one important respect. An IRA may hold assets other than funds. In general, they may be invested in all types of assets, except life insurance contracts, certain endowment contracts, and collectibles, which 26 U.S.C. § 408(a)(3), (e)(5) and (m) specifically prohibit. See also *Ancira v. C.I.R.*, 119 T.C. 135 (2002) (funds from IRA invested in stock); *McGaugh v. C.I.R.*, 111 T.C.M. (CCH) 1116 (2016) (same). They are even permitted to hold title to real estate. *Dabney v. C.I.R.*, 107 T.C.M. (CCH) 1535 (2014).

Despite the fact that an IRA may hold title to real estate and other non-liquid assets, it is still just a tax-advantaged receptacle for a debtor’s assets. The nature of this asset is perhaps best illuminated by exemption law. The Supreme Court has recognized that the assets in a debtor’s IRA are property of the debtor’s bankruptcy

estate that may be exempted if the conditions of applicable state or federal exemption statutes are satisfied. *Clark v. Rameker*, 573 U.S. 122, 124 (2014); *Rousey v. Jacoway*, 544 U.S. at 322. These cases treat the assets in the IRA as assets owned by the bankrupt debtor directly. Section 522(b)(3)(C) allows a debtor to exempt “retirement funds to the extent that those funds are *in [an] . . . account* that is exempt from taxation. . . .” 11 U.S.C. § 522(b)(3)(C) (emphasis added). And, under Colorado law, a debtor may exempt “*funds [] held in or payable from any pension or retirement plan . . . including . . . any individual retirement account*, as defined in 26 U.S.C. sec. 408.” Colo. Rev. Stat. § 13-54-102(1)(s).(emphasis added). By way of comparison, when a debtor holds an interest in a separate entity, such as a corporation or an LLC, the debtor’s equity interest is listed as an asset, but the assets owned by the separate entity are not included in the debtor’s schedules. See also *Gordon v. Wadsworth (In re Gordon)*, 791 F.3d 1182, 1185-86 (10th Cir. 2015).

Moreover, absent an exemption, state law allows a judgment creditor to directly garnish funds or attach other assets held by a judgment debtor’s IRA. *In re Damast*, 136 B.R. 11, 19-20 (Bankr. D.N.H. 1991). It does not require a separate judgment against the IRA, as if the IRA were a separate entity. In *In re Vogel*, 78 B.R. 192 (Bankr. N.D. Ill. 1987), the chapter 7 trustee objected to a debtor’s claim of exemption in an IRA and a Keough account, arguing that the debtor had not satisfied the state law requirements for the exemption of retirement accounts. The debtor countered that he was not claiming the retirement account exemption, but rather the life insurance exemption because the only assets in these accounts were life insurance policies. Despite the fact that the IRA and Keough plan held the policies, the court agreed with the debtor. It said that the policies were personal property owned by the debtor based on its conclusion that “[n]either the IRA nor the Keough plan is a separate entity. The property in both accounts remains the [d]ebtor’s property.” *Id.* at 194.

Similarly, in *Maniatis, IRA v. IMH Special Asset NT 161, LLC*, Case No. 2:14-CV-0085 HRH, Docket No. 15 (D. Ariz. March 20, 2014), in a suit between a debtor and his judgment creditors, the court ruled that the debtor could not exempt his IRAs under Arizona’s exemption statute because they were not tax-exempt. Unhappy with this result, the debtor caused the IRAs to file suit in federal court for a declaration that they were tax-exempt and to enjoin the judgment creditors from reaching the property held in the IRAs. The creditors argued that the Rooker-Feldman doctrine barred the IRAs’ claims in federal court because the IRAs were seeking to overturn the state court’s ruling on the exemption question. The IRAs argued that Rooker-Feldman did not apply because they were not parties to the state court suit. The court agreed with the creditors that the IRAs could not be “parties” to the state court action because they “are not legal entities but rather are property.” *Maniatis*, slip op. at 8-9. But then it held that, “[b]ecause [the IRAs] are property owned by Maniatis, and Maniatis is a judgment debtor, [the IRAs] were always part of the state court action and subject to that court’s rulings.” *Id.* at 9. Therefore, the court concluded that the Rooker-Feldman doctrine barred the federal claims.

Based on many of these precedents as well as tax and exemption laws, this Court as well holds that a custodial IRA is not a separate legal entity. It is only a

receptacle for a person's assets. It is a receptacle that enjoys certain tax attributes and is subject to certain tax penalties. But the assets held in the receptacle remain the assets of the individual owner. That is why the individual lists and exempts the assets in his bankruptcy schedules. And that is why, in any suit involving these assets, the individual owner is the real party in interest. Thus, the Defendant is not a proper defendant in this case. Any claims against it must be dismissed.

In any suit that involves the assets of a custodial IRA, it is also proper to name the custodian as a defendant for two reasons. Naming the custodian helps to ensure that the real owner will be apprised of the suit. It also places the custodian on notice that the assets held in the custodial IRA are subject to the court's jurisdiction. Thus, UBS Financial Services, Inc. is a proper defendant in this action. If the Court were not dismissing this action, UBS would be subject to the Court's further rulings regarding the assets of the Summers IRA.

B. The Trustee's Preference Claim Against David Summers Was Discharged

Next the Court turns to the question of whether the Trustee may substitute her claims against the IRA for claims against Mr. Summers. Mr. Summers asserts that the bankruptcy discharge he received in his personal bankruptcy case prevents the Trustee from suing him. In fact, the Trustee's claims predate his individual bankruptcy filing and, thus, are prepetition claims. The Trustee even filed a proof of claim against his estate based on her avoidance claims to recover the Transfers.

But there is a complicating factor. Section 524(a)(2) provides that a bankruptcy discharge "operates as an injunction against the commencement or continuation of an action . . . to collect, recover or offset any such debt as a *personal liability of the debtor*, whether or not such discharge of such debt is waived[.]" 11 U.S.C. § 524(a)(2) (emphasis added). As such, a bankruptcy discharge "extinguishes only one mode of enforcing a claim – namely, an action against the debtor *in personam* – while leaving intact another – namely, an action against the debtor *in rem*." *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991). The Trustee argues that her claim to recover the Transfers is an *in rem* claim only. She merely seeks the return of the specific property transferred, not a money judgment against Summers for the "value" of the property transferred.

Black's Law Dictionary defines an "*in personam*" claim as an action "brought against a person rather than property" and an "*in rem*" action as one "involving or determining the status of a thing, and therefore the rights of persons generally with respect to that thing." *In Personam, In Rem, Black's Law Dictionary* 862 (9th ed. 2009). The Supreme Court has explained that the difference between *in rem* and *in personam* actions as follows:

If a court's jurisdiction is based on its authority over the defendant's person, the action and judgment are denominated "in personam" and can impose a personal obligation on the defendant in favor of the plaintiff. If

jurisdiction is based on the court's power over property within its territory, the action is called "in rem" or "quasi in rem." The effect of a judgment in such a case is limited to the property that supports jurisdiction and does not impose a personal liability on the property owner, since he is not before the court. [T]he owner is affected only "indirectly" by an in rem judgment adverse to his interest in the property subject to the court's disposition.

Shaffer v. Heitner, 433 U.S. 186, 199 (1977).

It described the distinction this way in an earlier case:

A judgment in personam imposes a personal liability or obligation on one person in favor of another. A judgment in rem affects the interests of all persons in designated property. A judgment quasi in rem affects the interests of particular persons in designated property. The latter is of two types. In one the plaintiff is seeking to secure a pre-existing claim in the subject property and to extinguish or establish the nonexistence of similar interests of particular persons. In the other the plaintiff seeks to apply what he concedes to be the property of the defendant to the satisfaction of a claim against him.

Hanson v. Denckla, 357 U.S. 235, n.12 (1958).

In applying these definitions, courts have generally ruled that a discharge in bankruptcy does not by itself avoid, invalidate, or otherwise affect a creditor's lien against property of the debtor or the debtor's bankruptcy estate. Thus, once the automatic stay has expired, the creditor is free to enforce its claim, but only against the property subject to its lien. See, e.g., *Johnson v. Home State Bank*, 501 U.S. at 82; *Hall v. JP Morgan Chase Bank (In re Hall)*, 559 B.R. 456 (Bankr. W.D. Va. 2016) (creditor's suit to reform its defective deed of trust on the debtor's property was an *in rem* claim to enforce a prepetition equitable lien); *Olague v. Martinez (In re Martinez)*, 2011 WL 6934474 (9th Cir. BAP Oct. 11, 2011) (a quiet title claim in which the plaintiff sought a declaration that the release of his lien on the debtor's property was unauthorized was an *in rem* action); *Johnson v. Williams (In re Williams)*, 490 B.R. 236 (Bankr. W.D. Kan. 2013) (creditor was free to record and enforce unavoided mortgage on debtor's property after discharge). At one end of the spectrum, these cases present clear examples of the distinction between *in rem* and *in personam* actions.

But when a trustee sues to avoid a transfer, the line between *in rem* and *in personam* becomes blurred. Is an action to recover specific property from a transferee an *in rem* action? There are few reported cases that address this specific issue. The Court could locate only four such cases, all involving fraudulent rather than preferential transfers, and the results were evenly split.

In *Millbury National Bank v. Palumbo (In re Palumbo)*, 353 B.R. 37 (Bankr. D. Mass. 2006), the bankruptcy court ruled that a fraudulent transfer recovery claim was an

in rem action and, therefore, the claim had not been discharged by the transferee's bankruptcy. In that case, the chapter 7 trustee of the husband's bankruptcy estate sued to set aside the fraudulent transfer of the husband's residence to his wife, who had received a chapter 7 discharge in a separate case she filed shortly after the transfer. The court said the fact that the wife had not been named as a defendant, "does not bar the action to the extent the adversary proceeding only seeks to restore to the estate property that, if the allegations are proven, rightfully belongs to [the husband's] estate." *Id.* at 42. In *In re Antonious*, 373 B.R. 400 (Bankr. E.D. Pa. 2007), the court cited *Palumbo* with approval, noting without any additional discussion or analysis, that depending on the nature of relief sought and the timing of the transfer, a fraudulent transfer suit may not violate the transferee's discharge.

In *Parker v. Handy (In re Handy)*, 624 F.3d 19 (1st Cir. 2010), the court came to the opposite conclusion. In this case, a creditor claimed that its debtor, the husband, had fraudulently transferred funds to his wife and that she had used the funds to purchase a home. The creditor sued her in state court under the Uniform Fraudulent Transfer Act. Before the suit had progressed to judgment, the wife filed bankruptcy. After she received her discharge, the creditor moved for relief from stay to continue its fraudulent transfer suit in state court. The creditor sought money damages and the imposition of a constructive trust on the home. The First Circuit held that the creditor's claim for money damages was an *in personam* claim that had been discharged, that the creditor's request for the "remedial device" of a constructive trust did not convert his *in personam* claim to an *in rem* claim, and that the creditor had no other viable *in rem* remedy. *Id.* at 22.

The court in *Rountree v. Nunnery (In re Rountree)*, 448 B.R. 389 (Bankr. E.D. Va. 2011) employed similar reasoning. It concluded that, despite the fact that the unsecured creditors requested *in rem* relief in the form of avoidance of the debtor's transfer of real property, the action was in the nature of an *in personam* proceeding. It, therefore, held the claim had been discharged.

The Supreme Court has discussed whether an avoidance claim is *in rem* or *in personam* in order to determine whether sovereign immunity barred the avoidance claim against a governmental entity. In the most recent of the three cases in which it has considered the question, *Central Virginia Community College v. Katz*, 546 U.S. 356, (2006), the court observed that the determination or declaration that a transfer is preferential under § 547 is separate from the recovery of the property transferred, and that a "court order mandating turnover of the property, although ancillary to and in furtherance of the court's *in rem* jurisdiction, might itself involve *in personam* process." *Id.* at 371-72. Unfortunately, the court concluded it did not need to decide whether the recovery of preferentially transferred property is an *in rem* or *in personam* claim. But in a footnote, it acknowledged that the proper characterization of such actions is not clear and may depend on whether the trustee seeks the return of the "value" of the preference or return of the "actual property transferred." *Id.* at 372 n.10.

In *dicta* in another sovereign immunity case, *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 454 (2004), the Supreme Court strongly implied that the

recovery of a preferential transfer requires a court to exercise *in personam* jurisdiction over the transferee. In that case, the court distinguished the dischargeability determination in a § 523(a)(8) adversary proceeding from the recovery of property in a preference action, noting that in determining whether the debtor's student loan was discharged, the bankruptcy court did not attempt to adjudicate any claims outside its *in rem* jurisdiction, and that "[t]he case before us is thus unlike an adversary proceeding by the bankruptcy trustee seeking to recover property in the hands of the State on the grounds that the transfer was a voidable preference." *Id.* at 454.

The last of the Supreme Court's sovereign immunity cases is *United States v. Nordic Village Inc.*, 503 U.S. 30 (1992). In that case, a bankruptcy trustee sued to avoid a debtor's unauthorized postpetition transfer under § 549(a) and to recover the transfer from the Internal Revenue Service under § 550(a). The court noted that the trustee sought recovery of a sum of money rather than "particular dollars," thus he "did not invoke and the Bankruptcy Court did not purport to exercise, *in rem* jurisdiction." *Nordic Village*, 403 U.S. at 38. However, the court also distinguished the case of *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), in which the court upheld a bankruptcy court's order directing the IRS to turn over tangible property of the debtor it had seized prepetition. The court observed that the preference recovery suit in *Nordic Village* was "quite different from a suit for the return of tangible property in which the debtor retained ownership." *Nordic Village*, 403 U.S. at 39.

Since the Supreme Court defined the limits of the bankruptcy courts' constitutional jurisdiction in *Stern v. Marshall*, 564 U.S. 462 (2011), bankruptcy courts have struggled to determine whether preference recovery is an *in rem* or *in personam* claim. But they have done so in the context of deciding whether they have jurisdiction to enter a final judgment against a creditor that has not filed a proof of claim. Again, the cases are split, although it appears that most courts hold that preference recovery actions are *in rem* for jurisdictional purposes. For example, in *West v. Freedom Medical, Inc. (In re Apex Long Term Acute Care—Katy, LP)*, 465 B.R. 452 (Bankr. S.D. Tex. 2011), the court said that, "§ 547 declarations are an exercise of the Bankruptcy Court's *in rem* authority. Although it is a closer call, we also conclude that a § 550(a) recovery of a declared § 547 preference is an appropriate exercise of the Bankruptcy Court's ancillary authority under *Katz*." *Id.* at 468. The *Apex* court reasoned that the recovery of preferences is closely tied to the Code's overarching purpose of ensuring equitable distribution among creditors. *Id.* at 463-67. And it viewed the *Katz* opinion as suggesting that "amounts that are preferentially transferred were always really part of the bankruptcy estate." *Id.* at 463.

However, the court in *Penson Financial Services, Inc. v. O'Connell (In re Arbc Capital Management, Inc.)*, 479 B.R. 254 (S.D.N.Y. 2012) reasoned that, where a preference defendant has not filed a proof of claim, the action to recover a preferential transfer more closely resembles an action to augment the bankruptcy estate than an action related to the distribution of the bankruptcy *res*, noting that the Supreme Court has held that, if a party has not filed a claim against the bankruptcy estate, "the trustee can recover allegedly preferential transfers only by filing what amounts to a legal action

to recover a monetary transfer” and the defendant is entitled to a jury trial. *Id.* at 266 (quoting *Langenkamp v. Culp*, 498 U.S. 42, 45 (1990)).

Determining whether the Trustee’s claim to avoid the Transfers is an *in rem* action is a close question. The Supreme Court’s sovereign immunity cases do not provide clear guidance. Nor do the cases analyzing the extent of the bankruptcy court’s constitutional authority. *Nordic Village* plainly indicates that a trustee pursuing a money judgment for the value of a preferential transfer is seeking *in personam* relief, but *Nordic Village* and *Katz* suggest that the result may be different if a trustee seeks the return of particular property. Where the property preferentially transferred is cash, as it is here, the distinction seems to elevate form over substance. The dissent in *Katz* criticized the majority opinion’s claim that the trustee sought the return of the actual “property transferred” rather than the “value” of the preference, stating that “where, as here, the property in question is money, there is no practical distinction between these two options.” *Katz*, 546 U.S. at 392-93 (Thomas, J. dissenting); see also *Koken v. Viad Corp.*, 307 F. Supp. 2d 650, 656 (E.D. Penn. 2004) (rejecting argument that a suit to recover a preferential payment invoked *in rem* jurisdiction, noting that the plaintiff, if successful, would not receive the “same check or dollar bills, transferred,” rather, the funds plaintiff sought, “unlike an identifiable piece of property” were fungible).

Absent a binding precedent to the contrary, this Court concludes that the recovery of preferentially transferred funds is an *in personam* claim. It is unlike the *in rem* claim in *Johnson v. Home State Bank* and similar cases where the claims involve the enforcement of liens or disputes regarding ownership interests in property, which clearly survive a bankruptcy discharge. It is unlike the *in rem* or *quasi in rem* claims described in *Hansen v. Denckla*. And it is distinguishable from a debtor’s claim for turnover of property in which he retains an ownership interest, such as the claim in *Whiting Pools*. Here, permitting the Trustee to recover the Transfers from Mr. Summers would be tantamount to entering a monetary judgment against him.

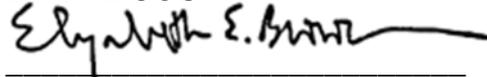
Thus, the Court concludes that the Trustee’s claim is *in personam* in nature. Therefore, it would violate Mr. Summers’ bankruptcy discharge if the Court were to allow the Trustee to substitute Mr. Summers as a defendant. Since amending the Trustee’s complaint to add Mr. Summers would be futile, it is proper to merely dismiss this action.

III. CONCLUSION

For the foregoing reasons, the Court hereby ORDERS that the Defendant’s Motion to Dismiss is GRANTED and the Trustee’s Complaint is DISMISSED with prejudice.

DATED this 25th day of March, 2020.

BY THE COURT:



Elizabeth E. Brown, Bankruptcy Judge