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Court Limits a 'Self-Settling Trust or Similar Device' to an Express Trust

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May 20, 2011

The Legal Intelligencer

In *In re Porco Inc.*, the Bankruptcy Court for the Southern District of Illinois in a March 30 opinion addressed an issue of apparent first impression: whether a resulting or constructive trust is a "self-settling trust or similar device" subject to the trustee's avoidance power under § 548(e). In holding that the "similar device" clause is limited to express trusts, the court significantly limited the scope of a trustee's power to avoid and recover transfers by or on behalf of a debtor to a related third party.

Background of the Doctrine

Section 548(e) is composed of four elements that must all be met in order for the trustee to avoid transfers by the debtor made within 10 years before the debtor's bankruptcy petition is filed:

- Such transfer was made to a self-settled trust or similar device.
- Such transfer was by the debtor.
- The debtor is a beneficiary of such trust or similar device.
- The debtor made such transfer with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted. (See 11 U.S.C. § 548(e)(1).)

Under common law, and before the enactment of § 548(e), creditors and trustees in bankruptcy were able to reach the assets held in a self-settled spendthrift trust of which the debtor was beneficiary. In order to allow their citizens to shield the assets in such trusts, several states passed statutes providing for the creation of self-settled trusts beyond the reach of creditors: Alaska, Delaware, Nevada, Rhode Island and Utah (though not Illinois, where *Porco* was decided).

In response to this protectionist trend, Congress passed § 548(e). The intended effect of this section, as expressed in the statute's legislative history, was to reinstate the common law rule and allow creditors to reach assets transferred to self-settled trusts. Moreover, the statute was framed broadly, allowing courts to scrutinize not only a "self-settled trust" but also any device "similar" to such a trust. Not surprisingly, the question ultimately arose as to the scope of the "similar device" clause. As the answer to this question is not contained in the Bankruptcy Code, the court in *Porco* looked to state trust law.

Facts of the Case

Porco was a business involved in sausage manufacturing and other related activities in Belleville, Ill. According to the opinion, Amy Bouvet was *Porco*'s primary shareholder and chief operating officer. *Porco* operated its business on real estate owned by one of the company's minority shareholders, Martin Ward. A dispute arose between *Porco* and Ward concerning the company's operations, leading to two lawsuits that were eventually settled. Under the settlement agreement, certain real estate would be conveyed by Ward to *Porco* free and clear of any encumbrances and, in exchange, *Porco* would pay off

certain indebtedness of Ward's in the amount of \$144,978 and would obtain the release of Ward from a personal guaranty on a \$500,000 line of credit.

Once the settlement agreement was executed, Bouvet authorized the real estate to be deeded to Fog LLC, an entity of which she was the lone shareholder. The general warranty deed reflecting the real estate transfer was recorded on Oct. 28, 2004. Porco received nothing in return for the transfer of its contractual interest in the real estate, according to the opinion.

On June 22, 2009, Porco filed a voluntary petition for relief under Chapter 7 of the code, the court said. Porco's Chapter 7 trustee opted not to bring an action to avoid and recover the earlier real estate transfer to Fog. Instead, Quality Meat Products LLC, an unsecured creditor of Porco, obtained the court's permission to pursue the matter. In its adversary proceeding instituted on Nov. 2, 2009, Quality Meat sought to avoid and recover the conveyance of real estate to Fog as a fraudulent transfer under § 544(b), and as a self-settled trust or similar device under § 548(e). In response, Porco and Bouvet moved for dismissal of: (a) the fraudulent conveyance count as time-barred by the applicable four-year statute of limitations; and (b) the self-settled trust or similar device count for failure to state a claim.

Issues Before the Court

The motion to dismiss presented the court with novel questions under § 544 and § 548. Regarding the statute of limitations applicable under § 544, the question examined by the court was when the statutory period began to run — when the real estate was conveyed from Ward to Fog, or when the bankruptcy case was filed and Porco's creditors would have had reason to inquire into and discover the transfer. With respect to the self-settled trust or similar device count, the question was whether the "similar device" language of § 548 can be read broadly enough to include a resulting or constructive trust.

Statute of Limitations Analysis

Section 544(b) incorporates applicable state fraudulent transfer law, and the applicable statute in Illinois sets a four-year statute of limitations. Porco and Bouvet claimed that Quality Meat's fraudulent transfer action was time-barred because the conveyance of the real estate from Ward to Fog was recorded on Oct. 28, 2004, over four years before either the bankruptcy petition was filed on June 22, 2009, or the adversary proceeding was commenced on Nov. 2, 2009.

Quality Meat responded that the appropriate starting date for the statute of limitations was not the recording of the deed from Ward to Fog, because this was not the subject of the fraudulent conveyance action. It argued that the court should not focus on the conveyance of real estate from Ward to Fog, because the recorded deed from Ward to Fog did not evidence Porco's interest in the transaction, and anyone searching the real estate transfer records would have no reason to believe that Porco had transferred its contractual rights in the real estate to Fog, the grantee named in the deed. Instead, Quality Meat argued that the fraudulent transfer was the concealed transfer of equitable and contractual rights to the real estate from Porco to Fog. As the court stated Quality Meat's position, "the deed shows Ward transferred the real estate to Fog, and this conveyance could not 'reasonably have been discovered' until the filing of the bankruptcy case, as there was no public record indicating the Debtor's interest in the real estate."

The court agreed that the statute of limitations did not begin until the bankruptcy petition date. The adversary proceeding was filed within a year of the bankruptcy petition date, thus well within the four-year statute of limitations period. Therefore, the court denied dismissal of the § 544(b) claim.

'Similar Device' Analysis

Porco and Bouvet also sought to dismiss the avoidance action under § 548(e) for failure to state a claim for which relief could be granted. Quality Meat's complaint alleged that the transfer from Ward to Fog resulted in a constructive trust, which constituted a device "similar" to a self-settled trust. In their motion to dismiss, Porco and Bouvet argued that the transfer was made by a third-party, thereby taking the transfer outside of § 548(e)'s scope.

To give content to the "similar device" clause, the court looked to trust law. As a matter of general law, a trust can be either express or implied: An express trust is "a trust that owes its origins to an expression of intent by a settlor that a trust shall come into being, coupled with the performance of some necessary act of transfer or conveyance," the court said, citing the 2008 edition of Ronald Chester, George Gleason Bogert and George Taylor Bogert's treatise, *The Law of Trusts and Trustees*. The complaint in *In re Porco Inc.* did not allege that the defendants intended to create a trust, and therefore the transfer in question was not to a self-settled trust.

However, in lieu of an express trust, an implied trust may arise by operation of law, taking the form of either a resulting trust or a constructive trust. Under Illinois law, the court said, a resulting trust is "generally created where an express trust fails or where an express trust terminates prior to the exhaustion of the trust estate, or where one person pays for property and another takes title," citing a 1995 Illinois appellate court opinion, *Midwest Decks Inc. v. Butler & Baretz Acquisitions Inc.* A constructive trust is "generally imposed where actual or constructive fraud is considered as equitable grounds for raising the trust or where there is a fiduciary duty and a subsequent breach of that duty," the court continued, citing *Amendola v. Bayer*, a 1990 7th Circuit case.

The threshold question addressed by the court was whether the "similar device" clause included implied trusts, which would arguably capture transactions such as the one in question. In granting the motion to dismiss on this issue, the court explained that expanding the reach of § 548(e) to resulting or constructive trusts was inconsistent with Congress' purpose of addressing state legislation allowing "domestic asset protection trusts." These, the opinion said, "generally require (1) an irrevocable trust; (2) an independent trustee; (3) absolute discretion; and (4) distributions to beneficiaries, including the settlor," all elements that "contemplate the creation of an express trust." By contrast, resulting trusts and constructive trusts "are remedial in nature and arise by operation of law. They are created by the courts and not by the express grant of a settlor." Therefore, the court concluded that implied trusts cannot be considered "similar devices" to self-settled trusts for purposes of § 548(e). Because the court limited the scope of § 548(e) in this manner, it did not address the question of whether an implied trust was created under the facts of this case.

Scope of Avoidance Powers

Addressing an issue of apparent first impression, *Porco* presents an important test case for the scope of a trustee's avoidance powers under § 548(e). Section 548(e) provides for a remarkable 10-year clawback period. In addition, the open-ended nature of the "similar device" clause potentially gives courts the discretion to apply the trustee's avoidance powers to transactions involving entities that are not express trusts. Arguably, the language of § 548(e) could be interpreted broadly enough to capture the transfer from a business entity owned by an individual to another entity owned by that same individual. Here, the Bankruptcy Court for the Southern District of Illinois declined the invitation to give § 548(e) such a broad reading, opting to construe the "similar device" clause narrowly as applying only to expressly formed domestic asset protection trusts.

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