

Rule 4(m): An Impermissible Detour Around § 546's Statute of Limitations

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The recovery of preferential transfers was intended by Congress to bring back into the bankruptcy estate transfers of the debtor's property that unduly favored certain creditors over others. Debtors who actually reorganize through a chapter 11 case are unlikely to pursue preference actions, as they do not want to sue their vendors who have supported them through the chapter 11 ordeal. Nevertheless, in a failed chapter 11 case, a liquidating case or one converted to chapter 7, the preference recoveries may be the only assets remaining to pay administrative claims or to make distributions to general unsecured creditors, and the debtor may pursue them regardless of a creditor's cooperation.



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Congress incorporated in 11 U.S.C. § 546 a statute of limitations, which requires that claims to recover preferential transfers be brought within two years of the debtor's petition date or, in the event a trustee is appointed prior to the expiration of the two years, within one year of the trustee's appointment. As such, it is clear that Congress did not intend that the ability to recover preferential transfers exist forever. Due to the statute of limitations encompassed in § 546 of the Bankruptcy Code, debtors, creditor trustees and chapter 7 trustees often face the unenviable position of having to quickly rush to prepare hundreds—if not thousands—of complaints to recover preferential transfers as the statute of limitations is about to run.

In a number of recent cases, the trustee or debtor plaintiffs have sought to extend the statute of limitations through the use of Rule 4(m) of the Federal Rules of Civil Procedure, which is incorporated into Rule 7004 of the Federal Rules of Bankruptcy Procedure. A recent example

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is the *Delphi* bankruptcy,¹ in which the debtors received multiple time extensions under Rule 4(m) in which to serve adversary complaints that had been filed under seal, despite the fact that the defendants in those adversary cases were given no notice of the claims against them, thus no opportunity to oppose the motions or request dismissal of the claims. In some *Delphi* adversary cases, the court-granted extensions allowed the debtors to serve notice of the complaints on defendants two or more years after the statute of limitations would have expired. This article will examine the use of Rule 4(m) as a way to keep a cause of action "alive"

A majority of courts have held that § 546 imposes a statute of limitations on the bringing of actions to recover certain assets of the debtor, including actions to recover preferential transfers and fraudulent conveyances.³

Thus, preference avoidance actions must be brought within two years of the commencement of a case under title 11, or one year after the appointment or election of the first trustee in a case, if the appointment or election occurs within the first two years of the commencement of the case.⁴

Rule 3 of the Federal Rules of Civil Procedure provides that "[a] civil action is commenced by filing a complaint with the court."⁵ Thus, commencing an action prior to the expiration of the statute by

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until such time as the plaintiff chooses to prosecute it, and present the argument as to why bankruptcy judges should not use Rule 4(m) to extend the statute of limitations beyond that authorized in § 546.

Statutes of Limitations and Rule 4(m)

The purpose of a statute of limitations is to put an "end date" on the time in which a plaintiff may bring a claim against a prospective defendant in order to allow the defendant relief from the threat of a lawsuit. Statutes of limitations are primarily designed to ensure fairness by preventing the revival of stale claims after the evidence has been lost and the witnesses' memories have faded.² They set limits on the time that defendants must retain documents and other information that might assist the defendant in mounting a defense, in addition to providing defendants with assurance that after a certain point in time, they need not create reserves or make certain corporate disclosures that might be necessary if a claim is pending.

filing a complaint is usually sufficient.⁶ However, Rule 3 must be construed with Rule 4, which governs the service of summonses and protects defendants by requiring service of the complaint within a reasonable timeframe. Rule 4(m), which is incorporated into the Bankruptcy Rules by Rule 7004(a)(1), provides that if defendants in an adversary proceeding are not served with the complaint within the 120-day period set forth under Rule 4(m), the action may be dismissed and the plaintiff barred from commencing a new action.⁷

³ See, e.g., *Pugh v. Brook (In re Pugh)*, 158 F.3d 530 (11th Cir. 1998); *McFarland v. Leyh (In the Matter of Tex. Gen. Petroleum Corp.)*, 52 F.3d 1330, 1337-38 (5th Cir. 1995); *Iron-Oak Supply Corp. v. Nibco Inc. (In re Iron-Oak Supply Corp.)*, 162 B.R. 301, 307 (Bankr. E.D. Cal. 1993); *Amazing Enters. v. Jobin (In re M & L Bus. Machines Inc.)*, 153 B.R. 308, 311 (D. Colo. 1993) (noting that "the limitations period established in § 546 is not jurisdictional, can be waived, and is subject to the doctrines of equitable estoppel and equitable tolling" (citations omitted)); *Brandt v. Gelardi (In re Shape Inc.)*, 138 B.R. 334, 337 (Bankr. D. Me. 1992) (holding that § 546 is true statute of limitations that can be extended by agreement of parties); *Moglia v. Inland Plywood Co. (In re Outboard Marine Corp.)*, 299 B.R. 488 (Bankr. N.D. Ill. 2003); see also Lawrence P. King et al., *Collier on Bankruptcy* ¶ 546.02[4] (15th rev. ed. 1998) (noting that "if not timely asserted, a defendant may waive its statute of limitations defense under section 546(a)").

⁴ 11 U.S.C. § 546(a)(1).

⁵ Fed. R. Civ. P. 3 (applied to bankruptcy proceedings by Rule 7003 of Federal Rules of Bankruptcy Procedure).

⁶ 1 *Moore's Federal Practice* § 3.02[3][a] (Matthew Bender 3d ed.).

¹ *In re DPH Holdings Corp., et al.*, No. 05-44481 (Bankr. S.D.N.Y. Oct. 8, 2005).
² *Burnett v. N.Y. Cent. R.R. Co.*, 380 U.S. 424, 428 (1965).

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A plaintiff in an adversary proceeding can extend the time to serve the complaint by making a motion for an extension of time, pursuant to Rule 4(m), under which the time for service can be extended at the court's discretion.⁸ Nevertheless, many courts have held that if the sole reason for the request is the fact that the statute of limitations would otherwise run out, courts are permitted to—and perhaps should—refuse to allow an extension under Rule 4(m).⁹

Examples

The aggressive method employed by the debtors in the *Delphi* action is the most recent example of the problems inherent in using Rule 4(m) to extend the service of summons and effectively extend the statute of limitations under § 546. The debtors in *In re Safety-Kleen Corp., et al.*¹⁰ were successful, over several defendants' objections, in extending the time for service of more than 400 preference complaints for almost two years. In June 2002, just before the two-year statute of limitations for preference actions was set to expire, the debtor filed adversary complaints against various defendants seeking to avoid and recover preferential or fraudulent transfers. Beginning in August 2002, the debtors filed several motions in which they sought additional time beyond the 120 days allowed under Rule 4(m) to serve the adversary complaints. The debtors represented that the extensions were necessary to an efficient

reorganization, because it was important that the adversary proceedings remain "dormant." Notice of the motions to extend time for service was not formally provided to the defendants. However, the debtors did notify the defendants of the pending actions by letter, explaining the status of the actions and informing the defendants that they need not take action until the complaints were served. The court granted the debtors' motions, ultimately extending the time for service until July 2004, almost two years longer than would have originally been allowed under Rule 4(m). Certain defendants filed motions to vacate the *Safety-Kleen* court's orders extending the time for service. Among other assertions, the defendants argued that the delay in service was tactical and could not be justified under Rule 4(m), as there was no good cause for the delays, which had nothing to do with any problems the debtors had with effectuating service. The court denied the defendants' motions.

The use of Rule 4(m), which is meant to protect putative defendants from being sued without timely notice, should not be used as a detour around the matured statute of limitations.

A similar strategy was employed by the debtors in *Interstate Bakeries*. At the time the statute of limitations was about to run, the debtors' exclusive time to file a plan had been extended for an additional period, and the debtors and the official committee did not believe it was in the best interest of the estate to prosecute preference actions when the outcome of the reorganization remained unknown. The debtors sought bankruptcy court approval of a procedural order that would allow it to file a single complaint against all trade and other preference defendants and a separate complaint against the prepetition lenders. The motion seeking the procedural order included a copy of the draft complaint and was served on all parties listed as potential preference defendants. The court entered an order extend-

ing the deadlines under Bankruptcy Rule 7004 and Rule 4(m) for approximately 90 days or to the 90th day after the effective date of a confirmed plan. With the entry of the order, the debtors were not required to prosecute the preference claims until such time as the complaint was properly served on the defendants following the filing of separate amended complaints against each preference defendant. In conjunction with the entry of the procedural order, the debtors, in consultation with the creditors' committee, sent a memorandum to each of the named non-lender defendants, explaining the purpose of the procedural order as well as contact information for the debtors' and committee counsel.¹¹ The objections that were filed to the motions were resolved by the court.

In *Calpine*,¹² prior to the timely filing of any adversary complaints, the debtors made a motion to establish procedures that would allow the debtors additional time to serve their preference complaints. The debtors represented that they were engaged in negotiations with many of the potential preference defendants to toll the application of the statute of limitations, but that many of the agreements were not signed, and the debtors were concerned that the statute would run before they were finalized. The debtors filed a motion asking that the deadline for service of the adversary complaints be extended approximately 60 days beyond the allotted 120 days under Rule 4(m). The debtors also requested that the court allow them to file the complaints under seal, and to implement a stay of the adversary proceedings until service was effectuated. The motion was ultimately granted.

Delphi Defendants' Arguments

In *Delphi*, the debtors went a step further, seeking multiple extensions to serve process after filing hundreds of adversary cases under seal shortly before the statute of limitations ran. Actual notice of the requests for extensions was never provided to the named defendants. Consequently, the named defendants were never aware of the complaints, nor were they able to determine whether they had been named as defendants, given that the adversary complaints were filed

⁷ *Id.*; Wright and Miller, *Federal Practice and Procedure: Civil* 3d § 1056 and n.32 (noting that "[a] dismissal for failing to make service in timely fashion leaves the plaintiff in the same position as if the action never had been commenced, and it is possible that the statute of limitations will have expired between the original commencement by filing under Rule 3 and the dismissal for failure to comply with the 120-day requirement") (citing 128 Cong. Rec. 9848, 9851, reprinted at 96 F.R.D. 122); see also Fed. R. Civ. P. 6(b), reflected in Bankruptcy Rule 9006(b) (granting bankruptcy court discretion to extend certain deadlines "with or without motion or notice" if request is made prior to expiration of deadline, or if request is made subsequent to expiration of specified period, by motion on showing of excusable neglect).

⁸ Fed. R. Civ. P. 4(m); see also *Petrucelli v. Bohringer and Ratzinger*, 46 F.3d 1298, 1305 (3d Cir. 1995).

⁹ See, e.g., *Zapata v. City of New York*, 502 F.3d 192, 198 (2d Cir. 2007) (holding that court may, in its discretion, deny extension solely based on prejudice to defendant arising from running of statute of limitations); *McCurdy v. Am. Bd. of Plastic Surgery*, 157 F.3d 191, 197 (3d Cir. 1998) (upholding district court's refusal to grant Rule 4(m) extension, stating that while courts should strive to resolve cases on their merits, "justice also requires that the merits of a particular dispute be placed before the court in a timely fashion so that the defendant is not forced to defend against stale claims"); *Panaras v. Liquid Carbonic Indus. Corp.*, 94 F.3d 338, 341 (7th Cir. 1996); *Petrucelli*, 46 F.3d at 1306; *In re Lenox Healthcare Inc.*, 311 B.R. 404, 408 (Bankr. D. Del. 2004); cf. *Adams v. AlliedSignal Gen. Aviation Avionics*, 74 F.3d 882, 887-88 (8th Cir. 1996) (denying Rule 4(m) motion despite running of statute of limitations, given plaintiffs' "repeated opportunities to correct their service insufficiencies"); *In re Telligent Servs. Inc.*, 372 B.R. 594, 601 (Bankr. S.D.N.Y. 2007) (affirming bankruptcy court's dismissal of adversary proceeding for failure to serve complaint under Rule 4(m), despite that statute of limitations had run, and despite that defendant was on notice of claims).

¹⁰ *In re Safety-Kleen Corp., et al.*, No. 00-2303 (Bankr. D. Del. June 9, 2000).

¹¹ See "Putting Preference Claims on Hold in the Wonder[®], Hostess[®] Chapter 11" by Bruce S. Nathan and Scott Cargilli, *ABI Journal*, December/January 2007.

¹² *In re Calpine Corp.*, No. 05-60200 (Bankr. S.D.N.Y. Dec. 20, 2005).

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under seal, and the plan documents did not disclose the defendants' identities.

The debtors based the early requests (which were for limited extensions of approximately two months each) on the debtors' representation that they did not intend to pursue the causes of action, as it was expected that they would consummate a 100 percent plan. The debtors also explained that they did not want to prosecute vendors with which it was attempting to negotiate supply contracts. After several years, it became clear to the debtors that they would not be able to become "effective" with the 100 percent plan, and they filed a modified plan providing for a small percentage distribution to creditors. Throughout this time, the debtors continued to seek extensions under Rule 4(m) of the time in which it was required to effectuate service of summons of the adversary complaints, without notice to the defendants who were blithely unaware that the complaints had been filed.

The preference defendants in *Delphi* have asserted a number of arguments in favor of dismissal of the adversary proceedings, based on the debtors' failure to notify the defendants of the pending actions or the motions to extend time pursuant to Rule 4(m). Among other things, the defendants have argued that, unlike in the other cases discussed above, the

debtors in *Delphi* deliberately hid the existence of the preference actions from the defendants by filing the actions under seal, disclosing only the case numbers and not the defendants in the disclosure statement, and failing to give defendants notice and an opportunity to respond to the extension motions. Due to the debtors' actions, many of the preference defendants were unaware of the pending adversary proceedings until they were served with the complaints—in many cases, almost four and a half years after the main case was filed, and almost two and a half years after the statute of limitations under § 546 would have (and was thought to have) run. The impact of not serving the complaints within the Rule 4(m) allowed time or any other reasonable extension illustrates the due-process rationale of Rule 4(m). Because of the delay in service of process, the defendants have lost records and employees, and failed to put aside reserves, disclose the claims in Securities and Exchange Commission filings, and otherwise made ultimate defense extremely difficult on the defendants.

Alternatives Available to the Use of Rule 4(m)

Barring preference plaintiffs from using Rule 4(m) to extend the statute

of limitations in the manner attempted in *Delphi* will not prohibit plaintiffs from being able to delay prosecution of preference actions. The requirements of Rule 4(m) do not prevent a plaintiff from seeking agreements from defendants to extend the time to serve or to toll the statute of limitations. A debtor may seek to postpone prosecution of an adversary proceeding through a tolling agreement, equitable tolling, or a motion or agreement to stay the actions following service. Each of these methods requires notice to the defendants and an agreement or a procedural order from the court. None of these alternatives seeks to misconstrue or misuse Rule 4(m) to extend the time for service and effectively toll the statute of limitations or otherwise allow the debtor to postpone prosecution of an adversary proceeding.

Conclusion

As the Ninth Circuit recently stated, "[n]o court has ruled that the discretion [under Rule 4(m)] is limitless."¹³ The use of Rule 4(m), which is meant to protect putative defendants from being sued without timely notice, should not be used as a detour around the matured statute of limitations. ■

¹³ *Efaw v. Williams*, 473 F.3d 1038, 1041 (9th Cir. 2007).

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