

# WEIL'S SCOTUS TERM IN REVIEW

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## Supreme Court Holds Federal Government Not Subject to Fraudulent Transfer Suit Brought Under State Law

By Mark A. Perry and Josh Wesneski

Today, in a 8-1 decision authored by Justice Jackson, the Supreme Court in *United States v. Miller* held that the waiver of sovereign immunity in Section 106(a) of the Bankruptcy Code applies only to claims against the government brought by a trustee pursuant to Section 544(b) and not to the state-law claims that give rise to a Section 544(b) claim.

The trustee in a bankruptcy suit is responsible for maximizing the value of the bankruptcy estate, including by avoiding unlawful transfers of assets by the debtors prior to the initiation of bankruptcy. A trustee has several statutory tools for doing so. One of those tools is Section 544(b) of the Bankruptcy Code, which permits a trustee to “avoid any transfer of an interest of the debtor that is voidable under applicable law by a creditor holding an unsecured claim.” The provision therefore requires the trustee to establish: (1) that “applicable law” (typically state law) renders a transfer “voidable” and (2) that there exists an actual “creditor holding an unsecured claim” who could seek to void the transfer under that “applicable law.” These requirements essentially mean that the trustee has only the same avoidance powers as any creditor were that creditor to pursue an avoidance action on its own behalf. Separately, Section 106(a) of the Bankruptcy Code waives the sovereign immunity of the federal government against suits for damages “with respect to” various sections of the Bankruptcy Code, including Section 544.

*Miller* arose from the bankruptcy of a Utah-based transportation business whose owners had, prior to bankruptcy, misappropriated funds from the company to pay off their own income-tax obligations to the IRS. In bankruptcy, the trustee invoked Utah law to pursue an avoidance claim against the United States. The United States did not dispute that the elements under Utah law for avoidance were satisfied, but contended there was no actual “creditor holding an unsecured claim” who could pursue a claim against the federal government, because the government would enjoy sovereign immunity in such a hypothetical suit. The bankruptcy court, district court, and the Tenth Circuit all rejected that argument, relying on Section 106(a) to hold that the United States’ sovereign immunity for the underlying state law claim had been waived.

The Supreme Court reversed. Writing for the majority, Justice Jackson framed the question as whether Section 106(a) waives sovereign immunity “with respect to whatever state-law cause of action a trustee might invoke as the source of ‘applicable law’ for his or her § 544(b) claim.” Answering that question in the negative, the Court explained that waivers of sovereign immunity are jurisdictional only and therefore do not create any substantive right to suit. The trustee’s interpretation of the statute, the Court reasoned, would effectively modify the elements of a Section 544(b) claim by no longer requiring the trustee to identify an actual creditor who could pursue an avoidance action on its own behalf. The Court went on to hold that the text and structure of the statutes confirm that reading, noting that Section 106(a) clarifies that it does not “create any substantive claim for relief” and that eliminating the “actual creditor” requirement would upend the statutory structure and longstanding precedent. The Court rejected the trustee’s arguments that the language of Section 106(a)—effecting a waiver “with respect to” any of the listed statutes—justified interpreting the sovereign immunity waiver broadly.

Justice Gorsuch dissented in a short opinion, asserting that the majority had conflated the doctrine of sovereign immunity with the substantive elements of the claim. He instead would have joined the majority of circuits holding that trustees may invoke Section 544(b) to pursue avoidance claims against the federal government.

The immediate significance of the decision is that it reduces a bankruptcy trustee’s ability to recover funds fraudulently transferred to the U.S. government. This issue is most likely to arise in circumstances where, like in *Miller*, a controlling party has access to a

debtor’s funds and misuses those funds to repay their own debts. Still, the decision does not affect a trustee’s broad authority to avoid fraudulent transfers made to insiders, affiliates, or other collusive parties.

More broadly, the decision reinforces and arguably extends the Supreme Court’s longstanding reluctance to infer a waiver of sovereign immunity in a statute. Notably, the federal government did not argue that it was *immune* from the trustee’s suit—only that no suit could be brought against it pursuant to Section 544(b) because it would enjoy immunity in a hypothetical lawsuit brought by an actual creditor of the estate. And the trustee did not argue that Section 106(a) actually waived the federal government’s sovereign immunity as to such a hypothetical lawsuit brought by a creditor, but rather argued that such immunity should be treated as waived for purposes of evaluating a trustee’s claim under Section 544(b). The case arguably therefore does not actually implicate the policy concerns ordinarily associated with waivers of sovereign immunity, yet the Court applied the standard interpretation rules for such waivers nonetheless.

The decision therefore could signal that the Court is trending toward an exceptionally narrow view of statutes authorizing suit against the United States. When considering taking legal action against the United States for money damages, companies should consult with their counsel to closely examine the statutory basis for waiver of sovereign immunity and evaluate the risk that a court will construe that waiver narrowly. And companies should always consider whether there is equitable, non-damages relief they can seek against the government to avoid sovereign immunity issues altogether.

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