

Clients & Friends Memo

Taking Apart Section 544(b): Supreme Court Clarifies Scope of Sovereign Immunity in Avoidance Actions

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On March 26, 2025, the Supreme Court held in an 8-to-1 decision authored by Justice Ketanji Brown Jackson that Section 106(a) of the Bankruptcy Code waives the federal government's sovereign immunity with respect to Section 544(b) of the Bankruptcy Code, but not with respect to the underlying state-law claims trustees typically rely on when bringing avoidance actions under Section 544(b). While the ruling is relatively narrow in scope, any Supreme Court bankruptcy ruling warrants attention from the industry. The ruling limits the ability of trustees or debtors in possession to claw back prepetition transfers to the federal government or other governmental entities entitled to sovereign immunity by ensuring only the two-year federal "look-back" period applies rather than the typically longer state-law period. See *U.S. v. Miller*, No. 23-824, 2025 WL 906502 (U.S. March 26, 2025).

Background

The *Miller* case involved a Chapter 7 trustee's efforts to recover \$145,000 in funds that the debtor's shareholders misappropriated from the debtor to satisfy their own personal federal tax liabilities. The trustee sought to recover these payments for the benefit of the debtor's estate by bringing a claim against the Internal Revenue Service under Section 544(b) of the Bankruptcy Code. Section 544(b) empowers a trustee or debtor in possession to avoid any transfer that is "voidable under applicable law by a creditor holding an unsecured claim" against the debtor. Many trustees prefer Section 544(b) over the Bankruptcy Code's own fraudulent transfer provision in Section 548, because state law often allows for longer look-back periods. Indeed, Section 548 has a limited two-year look-back period, but most states permit creditors to challenge fraudulent transfers that occurred more than two years before the bankruptcy filing.

Here, the trustee invoked Utah's fraudulent transfer statute as the "applicable law" under Section 544(b). In response, the federal government argued that no actual unsecured creditor could have brought the state-law claim outside of bankruptcy because sovereign immunity would bar such a suit. Since Section 544(b) requires that the trustee step into the shoes of an actual creditor, the government maintained that the trustee's claim must fail. The lower courts rejected the government's position, but the Supreme Court reversed.

The Interplay of Sections 544(b) and 106(a)

The Supreme Court's analysis hinged on Section 544(b)'s interplay with Section 106(a) of the Bankruptcy Code. Section 106(a) provides that "sovereign immunity is abrogated as to a governmental unit . . . with respect to" a series of Bankruptcy Code provisions, including Section 544(b).

In analyzing Section 544(b), Justice Jackson analogized the statute and related state laws to a set of nesting dolls. The largest, outermost doll is Section 544(b) itself, which allows trustees to avoid certain transfers that an unsecured creditor could have avoided under "applicable law." For Section 544(b) to apply, though, the trustee must also assert an underlying state-law cause of action, which Justice Jackson described as being "nested within" the larger Section 544(b) claim.

Crucially, the state-law cause of action also contains its own, smaller nesting doll: the "actual creditor" requirement. If the trustee cannot identify an actual creditor who could have brought the state-law claim outside of bankruptcy, the entire Section 544(b) claim fails. The Supreme Court held that sovereign immunity prevented the Miller trustee from satisfying this "actual creditor" requirement, meaning that the trustee's larger claim under Section 544(b) also could not succeed.

Specifically, Justice Jackson recognized that Section 106(a) abrogates sovereign immunity to permit a bankruptcy trustee to bring certain claims against the government under the Bankruptcy Code, but held that Section 106(a) does not alter or expand the substantive rights or defenses applicable to those claims. Justice Jackson pointed to the plain language of Section 106(a)(5), which expressly states that Section 106(a)'s abrogation of sovereign immunity does not "create any substantive claim for relief or cause of action not otherwise existing" under applicable law. Expanding Section 106(a)'s waiver of sovereign immunity to cover state-law fraudulent transfer claims would violate that limitation.

It has long been understood that defendants in a suit under Section 544(b) are permitted to raise the same defenses they could raise in a suit under state law. According to Justice Jackson, "[t]his long-settled understanding of the trustee's § 544(b) powers—and their limits—underscores why it would be so anomalous to treat § 106(a) as expanding the trustee's rights beyond those of an actual creditor."

In addition, Justice Jackson relied on the long-standing principle that Congress must use "unmistakable" language to abrogate sovereign immunity. Under that principle, any ambiguity in the scope of a sovereign immunity waiver must be construed in favor of the sovereign. Justice Jackson recognized that Section 106(a) "unmistakably" waives sovereign immunity for the federal cause of action created by Section 544(b). She held that no similarly "unmistakable" waiver existed with respect to the state-law claims nested within Section 544(b)'s "applicable law" clause. Therefore,

notwithstanding Section 106(a)'s waiver of sovereign immunity with respect to Section 544(b) itself, sovereign immunity continued to bar the trustee's underlying state-law claims.

Takeaways

- *U.S. v. Miller* narrows the toolbox available to bankruptcy trustees and debtors in possession. While Section 544(b) remains a valuable mechanism for extending the reach of avoidance actions by incorporating state law, *Miller* limits its use against the federal government or other governmental entities entitled to sovereign immunity.
- The decision is particularly significant in cases involving tax payments, where trustees or debtors in possession have often looked to state fraudulent transfer statutes with longer look-back periods to recover prepetition transfers from sovereign entities.
- Interestingly, the Supreme Court suggested that its reasoning with respect to Section 544(b) might not apply to fraudulent transfer actions under Section 544(a) of the Bankruptcy Code. Whereas Section 544(b) requires the trustee to step into the shoes of an actual creditor, Section 544(a) only requires the trustee to step into the shoes of a *hypothetical* creditor. This provision states that the trustee may avoid certain transactions that would be voidable by “a creditor that extends credit to the debtor at the time of the commencement of the [bankruptcy] case, . . . whether or not such a creditor exists.” Whether Section 544(a) claims are also subject to sovereign immunity defenses therefore appears to be a question that *Miller* leaves open, and that the Supreme Court or other courts may need to address in the future.

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