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2018 & 2019 Supreme Court Review

This panel of experts will discuss and analyze important bankruptcy-related Supreme Court and certain important circuit court decisions from the last year. In addition, the panel will discuss the effect of new conservative Justices on bankruptcy cases.

William J. Rochelle, III, Moderator
American Bankruptcy Institute; New York

G. Eric Brunstad, Jr.
Dechert LLP; Hartford, Conn.

Prof. Anthony J. Casey
University of Chicago Law School; Chicago

David R. Kuney
Washington, D.C.

Danielle Spinelli
WilmerHale; Washington, D.C.
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Bill Rochelle • Editor-at-Large
American Bankruptcy Institute
bill@abi.org • 703.894.5909
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66 Canal Center Plaza, Suite 600 • Alexandria, VA 22014 • www.abi.org
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Decided Last Term
Supreme Court says that activities not required by state law in nonjudicial foreclosure may be covered by the FDCPA.

Nonjudicial Foreclosure Is Not Subject to the FDCPA, Supreme Court Rules

The Supreme Court ruled unanimously today that nonjudicial foreclosure is not subject to regulation by the federal Fair Debt Collection Practices Act, known as the FDCPA, 15 U.S.C. § 1692-1692p.

The opinion for the Court by Justice Stephen G. Breyer contained an important caveat: Nonjudicial foreclosure is exempt from the FDCPA only with regard to actions required by state law.

The Circuit Split

After a homeowner defaulted on his mortgage, the lender hired a law firm, which gave notice that it was retained to conduct nonjudicial foreclosure under Colorado law. The homeowner responded with a letter purporting to invoke rights under Section 1692(g) of the FDCPA, which obliges a debt collector to halt collection activities until it provides the debtor with a “verification of the debt.”

However, the law firm proceeded to initiate nonjudicial foreclosure. The homeowner then filed suit alleging violation of the FDCPA. The district court dismissed the suit, finding that the law firm was not a “debt collector” within the purview of the FDCPA. The Tenth Circuit affirmed, holding that merely enforcing a security interest through nonjudicial foreclosure is not governed by the FDCPA.

The circuits were split. The Fourth, Fifth and Sixth Circuits held that the FDCPA applies to nonjudicial foreclosure, while the Ninth and Tenth Circuits concluded that it does not. The Supreme Court granted certiorari on June 28, 2018, to resolve the split and heard oral argument on January 7.

The Statutory Provisions

The FDCPA applies to “debt collectors,” defined in the first sentence of 15 U.S.C. § 1692a(6) as someone who “regularly collects or attempts to collect, directly or indirectly, debts owed . . . or due another.” The definition makes the statute applicable to a law firm pursuing judicial foreclosure when the lender is entitled to a deficiency judgment.
The case turned on the meaning of the third sentence in Section 1692a(6), which applies to enforcement of security interests. “For the purpose of section 1692f(6) [governing the conduct of someone repossessing property nonjudicially],” the third sentence of Section 1692a(6) says that the “term [debt collector] also includes any person who uses [the mail or interstate commerce] in any business the principal purpose of which is the enforcement of security interests.”

The third sentence applies to nonjudicial foreclosure. However, Section 1692f(6) does not impose all of the FDCPA’s regulations on those who only enforce security interests. Section 1692f(6) only prohibits certain activities, such as threatening to repossess when there is no intention of repossessing or there is no right to repossess. The law firm was not alleged to have violated the proscriptions in Section 1692f(6).

The Unanimous Opinion

Writing for the Court, Justice Breyer said that the FDCPA would apply to nonjudicial foreclosure if the statute contained only the primary definition in the first sentence of Section 1692a(6). If the third sentence did not contain the reference to someone whose principal business “is the enforcement of security interests,” he said that a person engaged in nonjudicial foreclosure proceedings “would qualify as a debt collector for all purposes,” because foreclosure “is a means of collecting a debt.”

Justice Breyer said that the primary definition of “debt collector” in the first sentence in Section 1692a(6) does not apply only to someone who attempts to collect from a debtor. Even if nonjudicial foreclosure were not a direct attempt to collect a debt, he said, “it would be an indirect attempt to collect a debt.” [Emphasis in original.]

The third sentence in Section 1692a(6) changed the result, however. The phrase “[f]or the purpose of section 1692f(6),” Justice Breyer said, “strongly suggests that one who does no more than enforce security interests does not fall within the scope of the general definition. Otherwise why add this sentence at all?” [Emphasis in original.]

Justice Breyer also surmised that Congress did not intend for the FDCPA to be generally applicable to nonjudicial foreclosure “to avoid conflicts with state nonjudicial foreclosure schemes.”

For “those of us who use legislative history to help interpret statutes,” he said that “the history of the FDCPA supports our reading.” He alluded to how competing versions of the bill would or would not have made nonjudicial foreclosure subject to regulation. The third sentence, he said, “has all the earmarks of a compromise: The prohibitions contained in Section 1692f(6) will cover security-interest enforcers, while the other ‘debt collector’ provisions of the Act will not.”
Caveats in the Opinion

Justice Breyer added two caveats to say that specific acts in connection with nonjudicial foreclosure could conceivably be subject to the FDCPA, although nonjudicial foreclosure generally is not.

The homeowner argued that the third sentence applies only to a “repo man,” meaning someone who repossesses personal property and has no interaction with the debtor. Judge Breyer rejected this contention, saying, “if Congress meant to cover only the repo man, it could have said so.”

In the same paragraph, Justice Breyer went on to say it is “at least plausible that ‘threatening’ to foreclose on a consumer’s home without having legal entitlement to do so is the kind of ‘nonjudicial action’ without ‘present right to possession’ prohibited by that section.” He went on to say parenthetically, “We need not, however, decide precisely what conduct runs afoul of Section 1692f(6).”

Of greater significance, Justice Breyer said near the end of his 14-page opinion, “This is not to suggest that pursuing nonjudicial foreclosure is a license to engage in abusive debt collection practices like repetitive nighttime phone calls . . . .”

Because the case before the Court involved “only steps required by state law, we need not consider what other conduct (related to, but not required for, enforcement of a security interest) might transform a security-interest enforcer into a debt collector subject to main coverage of the Act.” [Emphasis in original.]

The Concurring Opinion

Justice Sotomayor concurred in the opinion. Calling it “a close case,” she said that Justice Breyer made “a coherent whole of a thorny section of statutory text.” She was persuaded to concur because the third sentence would be superfluous “if all security-interest enforcement is already covered” by the first sentence.

Justice Sotomayor made two points: (1) “[T]oday’s opinion does not prevent Congress from clarifying today’s opinion if we have gotten it wrong,” and (2) enforcing a security interest does not confer blanket immunity from the FDCPA.

“I would see as a different case one in which the defendant went around frightening homeowners with the threat of foreclosure without showing any meaningful intention of ever actually following through.” In such a case, she said, there would be a question of whether the person was actually in the business of enforcing a security interest or “was simply using that label as a stalking horse for something else.”
The case is Obduskey v. McCarthy & Holthus LLP, 139 S. Ct. 1029, 203 L. Ed. 2d 390 (Sup. Ct.).
Licensee May Continue Using a Trademark after Rejection, Supreme Court Rules

Today, the Supreme Court handed down its decision in Mission Product Holdings Inc. v. Tempnology LLC, 17-1657 (Sup. Ct.), reversed the First Circuit and held that rejection of an executory trademark license does not bar the licensee from continuing to use the mark. As Justice Elena Kagan said, “A rejection breaches a contract but does not rescind it.”

The opinion was almost unanimous, with Justice Neil M. Gorsuch dissenting; he believes the petition for certiorari should have been dismissed as improvidently granted. In his view, the Court could not grant effective relief.

Justice Sonia Sotomayor wrote a concurring opinion to say that nondebtor parties to rejected trademark licenses may have more rights following rejection than parties to other types of intellectual property licenses whose rights are limited by Section 363(n).

The Court granted certiorari in October to resolve a split of circuits.

The Circuit Split

It took decades, but the Supreme Court ruled on May 20 that the Fourth Circuit was wrong almost 35 years ago when it held that rejection of an executory license for intellectual property precludes the nonbankrupt licensee from continuing to use the license. Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc., 756 F.2d 1043 (4th Cir. 1985).

Lubrizol was subjected to withering criticism, prompting Congress three years later to adopt Section 365(n) and the definition of “intellectual property” in Section 101(35A). Together, they allow a nondebtor to continue using patents, copyrights and trade secrets despite rejection of a license.

Congress did not mention trademarks, leading most lower courts to interpret the omission as meaning that rejection cuts off the right to use trademarks.

In 2012, the Seventh Circuit differed with Lubrizol when it handed down Sunbeam Products Inc. v. Chicago American Manufacturing LLC, 686 F.3d 372 (7th Cir. 2012), and held that rejection does not preclude the continued use of a mark. According to Circuit Judge Frank Easterbrook, “nothing about this process [of rejection] implies that any other rights of the other contracting party have
been vaporized.” If a licensor’s breach outside of bankruptcy would not bar continued use of the
mark, the same would hold true in bankruptcy after rejection by the licensor, he said.

In Tempnology’s chapter 11 case, the debtor had granted the licensee a nonexclusive,
nontransferable, limited license to use the debtor’s trademarks. Following Lubrizol, the bankruptcy
court rejected the license and ruled that the licensee could not continue using the license. The
Bankruptcy Appellate Panel reversed, following Sunbeam.


In a 2/1 opinion, the First Circuit majority in Tempnology sided with Lubrizol and criticized
Sunbeam for “largely [resting] on the unstated premise that it is possible to free a debtor from any
continuing performance obligations under a trademark license even while preserving the licensee’s
right to use the trademark.” The majority favored “the categorical approach of leaving trademark
licenses unprotected from court-approved rejection, unless and until Congress should decide
otherwise.” To read ABI’s discussion of the First Circuit’s opinion in Tempnology, click here.

As it had done in the First Circuit, the debtor argued in the Supreme Court that allowing the
licensee to continue using the trademark would force the debtor to continue paying the
onerous burden of policing the quality of the licensee’s use of the mark. Absent quality control,
the debtor contended, the licensor abandons the mark, and it reverts to the public domain. Rejection
frees the debtor from the burden of policing the mark and is thus a necessary adjunct to the power
of rejection, according to the debtor.

Justice Kagan’s Opinion

Mootness

Joined by all justices except Justice Gorsuch, Justice Kagan began by holding that the appeal
was not moot.

Initially, the bankruptcy judge had only granted a plain, vanilla motion to reject the trademark
license. Following rejection, the debtor returned to court, where the bankruptcy judge issued a
declaration saying that rejection terminated the licensee’s use of the mark. Later still, the license
terminated by its own terms.

To counter the notion of mootness, the licensee contended that it had a claim for damages
resulting from its inability to use the mark. The debtor responded by saying that the bankruptcy
court had authorized distribution of the last funds in the estate. The licensee countered by saying
it might prevail on the bankruptcy court to compel other creditors to disgorge distributions.
Justice Kagan held that the appeal remained “a live controversy.” “If there is any chance of money changing hands, [the licensee’s] suit remains alive.” Citing the Court’s precedent, she said that “courts often adjudicate disputes whose ‘practical impact’ is unsure at best, as when ‘a defendant is insolvent.'”

The Merits: Rejection Isn’t Rescission

Justice Kagan said that the text of Section 365 and “fundamental principles of bankruptcy law” lead to a conclusion that rejection is not rescission. In particular, she relied on Section 365(g), which provides that rejection “constitutes a breach of such contract” immediately before the filing of the bankruptcy petition.

Or “more pithily for current purposes,” Justice Kagan said that “rejection is a breach.” In turn, breach “means in the Code what it means in contract law outside bankruptcy.”

As an example, Justice Kagan supposed that a debtor had leased a copy machine to a law firm. Were the debtor to reject the lease, she said the debtor could stop servicing the machine, but the debtor “cannot take it back.”

Applying the same notion to trademarks, Justice Kagan said that “breach does not revoke the license or stop the licensee from doing what it allows.”

Justice Kagan also bought into the idea that the power to reject does not convey the same remedies as avoidance actions, which, she said, are “exceptional cases in which trustees . . . may indeed unwind pre-bankruptcy transfers.”

No Negative Inference from Section 365(n)

The debtor argued that the omission of trademarks from Section 365(n) meant that Congress intended for rejection to cut off use of a mark.

“Still,” Justice Kagan said, “Congress’s repudiation of Lubrizol for patent contracts does not show any intent to ratify that decision’s approach for almost all others. Which is to say that no negative inference arises. Congress did nothing in adding Section 365(n) to alter the natural reading of Section 365(g) — that rejection and breach have the same results.” [Emphasis in original.]

Aiding Reorganization

The debtor argued that it would be better able to reorganize if the court relieved it of the burden of policing the use of the mark. To that, Justice Kagan said, “The Code of course aims to make
reorganization possible. But it does not permit anything and everything that might advance that goal.”

Justice Kagan said that Section 365 therefore does not “relieve the debtor of the need . . . to invest the resources needed to maintain a trademark. . . . The resulting balance may indeed impede some reorganizations, of trademark licensors and others.”

For the Court, Justice Kagan held that rejection “has the same effect as a breach outside of bankruptcy. Such an act cannot rescind rights that the contract previously granted. Here, that construction of Section 365 means that the debtor-licensor’s rejection cannot revoke the trademark license.”

Danielle Spinelli, a former Supreme Court law clerk, represented the licensee. Douglas Hallward-Driemeier, a former Assistant Solicitor General, argued for the debtor. Assistant Solicitor General Zachary D. Tripp argued on behalf of the government in favor of reversing Lubrizol.

Justice Sotomayor’s Concurrence

Justice Sotomayor said she concurred “in full.” She wrote “to highlight two potentially significant features of today’s holding.”

First, Justice Sotomayor said the opinion does not mean that “every trademark licensee has the unfettered right to continue using licensed marks post rejection.” The opinion may not apply, she said, if provisions in the license or “state law” might “bear” on continued use of the mark.

Second, and of greater significance, Justice Sotomayor said that the “holding confirms that trademark licensees’ postrejection rights and remedies are more expansive in some respects than those possessed by other types of intellectual property.” For instance, she said that licensees of patents, copyrights and four other types of intellectual property (which are covered by Section 365(n)) “must make all [their] royalty payments.”

The Dissent

Dissenting, Justice Gorsuch said nothing about the merits. He would have dismissed the certiorari petition for having been improvidently granted.

The case should have been considered moot, Justice Gorsuch said, because the licensee “hasn’t come close to articulating a viable legal theory on which a claim for damages could succeed. And where our jurisdiction is so much in doubt, I would decline to proceed to the merits . . . . [T]here is no need to press the bounds of our constitutional authority . . . .”
The Irony, Import and Utility of the Decision

For appellate jurisprudence, the inability of Justice Gorsuch to prevail in his view about mootness seems to mean that the Court can reach the merits even when the existence of a live controversy is in doubt.

James M. Wilton of Ropes & Gray LLP in Boston, one of the counsel for the debtor, told ABI that “the decision will enhance the negotiating leverage of trademark licensees vis a vis secured lenders and other creditors and make it more difficult for debtor-licensors to rebrand their businesses and reorganize.”

In the very hypothetical that Justice Kagan mentioned, the bankruptcy of a lessor of personal property will not enable the debtor to use rejection as a means for recovering the equipment for lease to someone else at a higher price.

Ironically, some non-debtor third parties would now be better off had Congress not come to their aid. Section 365(n) is not the only Code provision where a party to a rejected contract or lease would have greater rights after Mission Product.

Judge Kagan mentioned real property leases, contracts for the sale of real property and time-share interests in Sections 365(h) and (i). Having balanced the interests of debtor and creditors in those sections, Congress could have given third parties fewer rights and remedies than they might otherwise have been found to have following Mission Product. Nonetheless, the certainty provided by Sections 365(h) and (i) is perhaps a fair trade-off.

The opinion is Mission Product Holdings Inc. v. Tempnology LLC, 139 S. Ct. 1652, 203 L. Ed. 2d 876 (Sup. Ct.).
Supreme Court Rejects Strict Liability for Discharge Violations

Today, the Supreme Court rejected a strict-liability standard for the imposition of contempt for violating the discharge injunction. Instead, the justices held unanimously that the bankruptcy court “may impose civil contempt sanctions when there is no objectively reasonable basis for concluding that the creditor’s conduct might be lawful under the discharge order.”

The opinion for the Court by Justice Stephen G. Breyer also rejected the Ninth Circuit’s idea that a subjective, good faith belief about the inapplicability of the discharge injunction is a defense to contempt. It is unclear from the opinion whether the Court’s standard for a discharge violation also applies to violations of the automatic stay under Section 362.

A Discharge Violation Was Unclear

The procedural history of the case in the lower courts was exceptionally complex. Suffice it to say that the debtor had transferred his interest in a closely held corporation. After the debtor received his chapter 7 discharge, two other shareholders sued him in state court for transferring his interest without honoring their contractual right of first refusal. They also sued the transferee of the stock.

After the debtor raised his discharge as a defense in state court, the parties agreed he would not be liable for a monetary judgment. The state court eventually ruled in favor of the creditors and unwound the transfer.

The creditors then sought attorneys’ fees as the prevailing parties, invoking a fee-shifting provision in the shareholders’ agreement. The state court ruled that the debtor “returned to the fray” and thereby made himself liable for post-discharge attorneys’ fees.

Meanwhile, the debtor reopened his bankruptcy case, seeking to hold the creditors in contempt for violating the discharge injunction. The bankruptcy judge sided with the debtor and imposed sanctions. The Bankruptcy Appellate Panel reversed the finding of contempt, ruling that the creditors’ good faith belief that their actions did not violate the injunction absolved them of contempt.

Meanwhile, the state appellate court and a federal district court in related litigation both ruled that the debtor’s participation in the litigation did not constitute returning to the fray, thus taking
away the grounds for imposing attorneys’ fees and lending credence to the notion that the creditors did technically violate the injunction.

In sum, judges disagreed over whether the discharge injunction applied to the litigation to recover attorneys’ fees.

The debtor appealed the BAP’s opinion to the Ninth Circuit, where Circuit Judge Carlos T. Bea upheld the BAP in April 2018 and found no contempt. However, he expanded the defense available to someone charged with contempt of a discharge injunction. The appeals court held that “the creditor’s good faith belief that the discharge injunction does not apply to the creditor’s claim precludes a finding of contempt, even if the creditor’s belief is unreasonable.”

The debtor filed a petition for certiorari, which the Supreme Court granted in January. Oral argument was held on April 24.

The Standard Borrowed from Equity

In his 11-page opinion, Justice Breyer said the outcome was informed by Section 524(a)(2), the statutory discharge injunction, and by Section 105(a), the bankruptcy version of the All Writs Act.

Those two sections, according to Justice Breyer, “bring with them the ‘old soil’ that has long governed how courts enforce injunctions.” The “old soil,” he said, includes “the traditional standards in equity practice for determining when a party may be held in civil contempt for violating an injunction.”

Justice Breyer cited Supreme Court precedent from 1885 holding that civil contempt should not be found “where there is [a] fair ground of doubt as to the wrongfulness of the defendant’s conduct.” California Artificial Stone Paving Co. v. Molitor, 113 U.S. 609, 618 (1885) (emphasis added by Justice Breyer).

Justice Breyer then cited Schmidt v. Lessard, 414 U.S. 473, 476 (1974) (per curiam), for the notion that “principles of ‘basic fairness requir[e] that those enjoined receive explicit notice’ of ‘what conduct is outlawed’ before being held in civil contempt.”

Although subjective intent is not “always irrelevant,” Justice Breyer said, “This standard is generally an objective one.” [Emphasis in original.] Again citing high court precedent, he said that “a party’s good faith, even where it does not bar civil contempt, may help determine an appropriate sanction.”

Given that the “typical discharge order entered by a bankruptcy court is not detailed,” Justice Breyer held that civil contempt “therefore may be appropriate when the creditor violates a...
discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope.”

The Rejected Standards

Justice Breyer rejected the Ninth Circuit’s “good faith belief” standard. Recognizing the realities of life for debtors, he said that the rule proposed by the circuit court “may too often lead creditors who stand on shaky legal ground to collect discharged debts, forcing debtors back into litigation (with its accompanying costs) to protect the discharge that it was the very purpose of the bankruptcy proceeding to provide.”

On the other hand, he also rejected a strict-liability standard that would authorize a contempt finding “regardless of the creditors’ subjective beliefs about the scope of the discharge order, and regardless of whether there was a reasonable basis for concluding that the creditor’s conduct did not violate the order.”

In support of strict liability, the debtor argued that a creditor can turn to the bankruptcy court for a so-called comfort order declaring that a proposed action would not violate the discharge injunction. To that, Justice Breyer said that a “risk averse” creditor would seek a comfort order “even when there is only a slight doubt” about a violation of discharge. Often, he said, there will “be at least some doubt as to the scope of” the discharge.

Frequent use of comfort orders, Justice Breyer said, would run contrary to Section 523(c)(1), where only three categories of debts require advance determinations of dischargeability.

Frequent resort to comfort orders, according to Justice Breyer, would “alter who decides whether a debt has been discharged, moving litigation out of state courts, which have concurrent jurisdiction over such questions, and into federal courts.”

Because the Ninth Circuit had not employed the proper standard, the Justice Breyer vacated the judgment of the appeals court and remanded “the case for further proceedings consistent with this opinion.”

What About the Automatic Stay?

Does the Supreme Court’s standard for contempt of the discharge injunction also apply to violations of the automatic stay under Section 362(a)?

Justice Breyer said that the language in Section 362(k)(1) “differs from the more general language in Section 105(a).” Section 362(k)(1) allows an individual to recover actual damages, costs, attorneys’ fees and even punitive damages (in “appropriate circumstances”) for “any willful violation” of the automatic stay.
The debtor argued that lower courts have often imposed strict liability for violating the automatic stay. Coupled with the different purpose of the automatic stay, the absence of the word “willful” in the discharge context prompted Justice Breyer to reject the idea of importing lower courts’ standards for violation of the automatic stay to contempt of the discharge injunction.

Parenthetically, Justice Breyer noted that the use of “willful” in Section 362(k)(1) is “a word the law typically does not associate with strict liability.” However, he ducked the question, saying that “[w]e need not, and do not, decide whether the word ‘willful’ supports a standard akin to strict liability.”

Although the Court made no holding about automatic stay violations, Justice Breyer’s parenthetical observation can lay the foundation for contending there is also no strict liability for stay violations.

So, the question remains: Is the contempt standard different for automatic stay violations?

Craig Goldblatt of Wilmer Cutler Pickering Hale & Dorr LLP in Washington, D.C., observed that “the Code sets out a standard for the stay but not the discharge injunction. Bankruptcy lawyers think they serve a similar role and so read them to be parallel. But there is no textual basis for that.”

“In the absence of text,” Goldblatt said in a message to ABI, “the Court says you read the discharge injunction just like you would any injunction outside of bankruptcy. That is all that he needed to say to resolve this case. Because it is not a case about the automatic stay, it presented no basis to opine on how the automatic stay works.”

Goldblatt therefore concluded, “Taggart has nothing at all to do with the automatic stay.” He has argued three bankruptcy cases in the Supreme Court.

Assuming the Court said nothing about automatic stay violations with respect to individuals, what about violations of the stay protecting corporate debtors where there is no statutory standard like 362(k)(1)? Does the absence of a statutory standard for corporate debtors throw the issue back to common law regarding injunctions?

However, the standards may be different, because, as Justice Breyer observed, the automatic stay has a shorter duration and a different purpose in preventing disruptions in the administration of bankruptcy cases.

The high court’s ruling on discharge violations may touch off decades of litigation over the standard for deciding whether someone violated the automatic stay.
The opinion is *Taggart v. Lorenzen*, 139 S. Ct. 1795, 204 L. Ed. 2d 129 (Sup. Ct. June 3, 2019).
Supreme Court Decision on Arbitration Has Ominous Implications for Bankruptcy

Justice Brett M. Kavanaugh wrote his first opinion for the Supreme Court in what *The New York Times* called a “minor arbitration case.”

If Justice Kavanaugh’s ruling in *Henry Schein Inc. v. Archer & White Sales Inc.* is applied rigorously in bankruptcy, it’s a “really big deal,” because bankruptcy judges will not be able to bar creditors from initiating arbitrations over “core” issues such as allowance of claims, objections to dischargeability of debts, and even adequate protection.

Indeed, *Schein* could be interpreted to mean that the bankruptcy court cannot bar a creditor from initiating arbitration against an individual or corporate debtor, even if the call for arbitration was frivolous.

‘Wholly Groundless’

*Schein* was argued on October 29 and decided for the unanimous Court by Justice Kavanaugh on January 8. By contract, the parties agreed to arbitrate before the American Arbitration Association and according to AAA rules.

Later, the plaintiff filed suit under federal and state antitrust laws, seeking damages and an injunction. The contract called for arbitration “except for actions seeking injunctive relief . . . .” The rules of the AAA call for the arbitrator to decide issues of arbitrability.

Invoking the Federal Arbitration Act, 9 U.S.C. § 2, the defendant responded to the complaint by asking the district judge to refer the case to arbitration. Adopted in 1925, the FAA provides that a contract calling for arbitration “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”

Following Fifth Circuit authority, the district court refused to compel arbitration, finding that the demand for arbitration was “wholly groundless” because the plaintiff was seeking an injunction. The Fifth Circuit affirmed.
The Circuit Split

The circuits were split. The Fourth, Fifth, Sixth and Federal Circuits have held that a federal court could refuse to compel arbitration if the demand was “wholly groundless.”

The Tenth and Eleventh Circuits ruled to the contrary, holding that the arbitrator alone is entitled to rule on the arbitrability of the dispute, if the contract so provides.

To resolve the split, the Court granted *certiorari* on June 25.

Justice Kavanaugh’s Rationale

In substance, Justice Kavanaugh said the Court had already decided the question. In 2010, the high court ruled that the parties may agree by contract that an arbitrator, not the court, will resolve threshold arbitrability questions, not just the merits of the dispute. *Rent-A-Center West Inc. v. Jackson*, 561 U. S. 63, 68–70 (2010).

Justice Kavanaugh said that “some federal courts nonetheless will short-circuit the process” by deciding the arbitrability question if the demand for arbitration is “wholly groundless.” Those courts, he said, adopted the “wholly groundless” exception to *Rent-A-Center* “to block frivolous attempts to transfer disputes from the court system to arbitration.”

Reversing the Fifth Circuit, Justice Kavanaugh held that the “court possesses no power to decide the arbitrability issue” if “the parties’ contract delegates the arbitrability question to an arbitrator.”

Justice Kavanaugh reaffirmed the principle that a court can decide whether there was a valid arbitration agreement before referring a dispute to arbitration. “But,” he said, “the court may not decide the arbitrability issue” if “a valid agreement exists, and if the agreement delegates the arbitrability issue to an arbitrator.”

Justice Kavanaugh rejected the policy argument that the “wholly groundless” exception is “necessary to deter frivolous motions to compel arbitration.” He said that arbitrators can quickly and efficiently dispose of frivolous cases, imposing costs and attorneys’ fees on the movant “under certain circumstances.”

Because the lower courts had not considered the issue, Justice Kavanaugh remanded the case for the Fifth Circuit to rule on whether the agreement “in fact delegated the arbitrability question to an arbitrator.” He said the judge “should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so,’” quoting *First Options of Chicago Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).
Fewer and Fewer Exceptions to Arbitration

The implications of Justice Kavanaugh’s opinion for bankruptcy cases are better understood in the context of the progression of recent Supreme Court authority.

In 1987, the Supreme Court ruled that a court could decline to enforce an arbitration agreement if there was an inherent conflict between arbitration and the statute’s underlying purpose. *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 227 (1987).

Building on *McMahon*, the Second, Fourth, Fifth and Ninth Circuits have held in bankruptcy cases that the court may decline to compel arbitration if the issue is “core” and arbitration would represent a “severe conflict” with the Bankruptcy Code.

Last year, the Second Circuit utilized that concept to override an arbitration agreement when a debtor mounted a class action contending that the creditor had violated the discharge injunction. *One Bank NA v. Anderson (In re Anderson)*, 884 F.3d 382 (2d Cir. March 7, 2018), cert. denied Oct. 1, 2018.

*Anderson* and the other circuit decisions overriding arbitration agreements in bankruptcy cases were all decided before *Epic Systems Corp. v. Lewis*, 138 S. Ct. 1612, 1624 (May 21, 2018), where the Supreme Court held last term that the language of a statute must be “clear and manifest” before a court can disregard an arbitration agreement. In *Epic*, the Supreme Court nixed a class action and required individual arbitration of a former employee’s claim that the employer’s failure to pay overtime violated the Fair Labor Standards Act.

*Epic* was a 5/4 decision, with the justices divided on ideological grounds.

Applying *Epic* and *Schein* to Bankruptcy Cases

Assume that a debtor and a creditor had a prebankruptcy agreement to arbitrate all disputes, including any arising in bankruptcy, such as the allowance of claims, counterclaims, preferences, and adequate protection. Further assume that the agreement called for the arbitrator to decide whether the dispute was arbitrable, even following bankruptcy.

If *Epic* and *Schein* were applied rigorously, the bankruptcy judge arguably would have no right to bar the creditor from initiating arbitration. If the dispute raised a core issue — such as the allowance of a claim, dischargeability or adequate protection — the bankruptcy judge might have no power to bar arbitration even if there was a “severe conflict” with bankruptcy law.

A chapter 11 debtor could find itself defending dozens of arbitrations, giving the bankruptcy judge little ability to confirm a plan or avoid liquidation. Or, an individual debtor might be fighting dischargeability in several arbitrations.

Supreme Court authority on arbitration seems headed to a pivotal case for the justices to decide whether bankruptcy represents a general exception to the enforceability of arbitration agreements.

In that regard, bankruptcy cases have an element not present in Epic and Schein. The underpinning of the Bankruptcy Code is centrality of administration. Bankruptcy law has always recognized that an individual cannot win a fresh start and a company cannot reorganize if issues related to bankruptcy must be litigated in several forums. Bankruptcy is designed so one judge decides all core disputes. Even if there is a Stern problem, the case goes to a district judge in the same courthouse.

Epic’s requirement of a statute’s “clear and manifest” exception to arbitration may be found in the centrality of administration of bankruptcy cases. And if that’s not enough, the most conspicuous feature of bankruptcy is the automatic stay.

Surely, a creditor cannot continue or initiate arbitration without relief from the automatic stay. If the automatic stay is not a “clear and manifest” exception to arbitration, it’s hard to imagine what is.

Justice’s Kavanaugh’s opinion reaffirms the power of courts to determine in the first instance whether an arbitration agreement is valid. An arbitration clause purportedly enforceable in bankruptcy could be viewed as an invalid agreement, just like an agreement is invalid if it waives the automatic stay or precludes the filing of bankruptcy.

But the question remains: Is a contract calling for arbitration of bankruptcy issues an invalid contract that the bankruptcy court can override, or does Schein require the bankruptcy court to refer the dispute to an arbitrator who will decide whether bankruptcy questions are arbitrable?

To read ABI’s discussion of Anderson, click here, here and here.

‘Certs’ Granted and Denied for This Term
The appeal to the Supreme Court may become moot if the Senate confirms the appointment of the existing members of the Puerto Rico Oversight Board.

Supreme Court to Say Whether Puerto Rico Oversight Board Was Constitutionally Appointed

With extraordinary alacrity, the Supreme Court granted certiorari on June 20 to decide whether the appointment of the members of the Financial Oversight and Management Board of Puerto Rico violated the Appointments Clause of the Constitution because they were not nominated by the President and confirmed by the Senate.

In the order granting certiorari, the justices accelerated the briefing schedule and directed that oral argument be held on October 15 or 16, the second week of arguments in the Court’s new term.

It is unclear whether the high court will eventually hear or decide the case, because the President on June 18 sent nominations of the current Board to the Senate for confirmation. Should the Senate confirm the appointment of the current Board members, the appeal in the Supreme Court presumably will become moot in large part, if not entirely.

The Puerto Rico case is the second bankruptcy matter that the Supreme Court has decided to review in the next term. By ruling on Ritzen Group Inc. v. Jackson Masonry LLC, 18-938 (Sup. Ct.) (cert. granted May 20, 2019), the high court will shed more light on what is or is not a final order conveying a right of appeal in a bankruptcy case. For ABI’s discussion of Ritzen, click here.

The Proceeding Below and the Motion for a Stay

After the Supreme Court ruled in June 2016 that Puerto Rico was ineligible for chapter 9 municipal bankruptcy, Congress quickly adopted the Puerto Rico Oversight, Management, and Economic Stability Act, or PROMESA (48 U.S.C. §§ 2161 et. seq.). PROMESA was designed so that the island commonwealth could restructure its unsupportable mountain of debt.

The members of the Financial Oversight and Management Board of Puerto Rico were not nominated by the President and confirmed by the Senate. Instead, PROMESA allowed the President to appoint one member of the Oversight Board. The President selected six more from a list of candidates provided by leaders of Congress. If any members appointed by the President were not on the congressional list, Senate confirmation would have been required. Since the six were all on the list, there was no Senate confirmation.
After an initial effort at negotiating a compromise with creditors out of court, the Oversight Board commenced debt-adjustment proceedings for the commonwealth and its instrumentalities beginning on May 3, 2017, in district court in Puerto Rico.

Aurelius Investment LLC and affiliates filed a motion in August 2017 seeking dismissal of Puerto Rico’s debt-adjustment proceedings, arguing that the filing of the petition on behalf of the Commonwealth of Puerto Rico by the Board under Title III of PROMESA violated the Appointments Clause. Holders of Puerto Rico general obligation bonds joined Aurelius but were opposed by the Oversight Board, the official unsecured creditors’ committee, and COFINA bondholders, among others.

District Judge Laura Taylor Swain of New York, sitting in the District of Puerto Rico by designation, handed down an opinion in July 2018 holding that PROMESA and the Board were properly constituted under the Territories Clause of the Constitution, Article IV, Section 3, Clause 2. In re The Financial Oversight and Management Board for Puerto Rico, 318 F. Supp. 3d 537 (D.P.R. July 13, 2018). To read ABI’s discussion of the district court opinion, click here.

On appeal, the First Circuit reversed, holding that the appointment of the members of the Oversight Board violated the Appointments Clause of the Constitution because they were not nominated by the President and confirmed by the Senate. Relying on the de facto officer doctrine, the appeals court went on to rule that its opinion would “not eliminate any otherwise valid actions of the Board prior to the issuance of our mandate in this case.” Aurelius Investment LLC v. Commonwealth of Puerto Rico, 915 F.3d 838 (1st Cir. Feb. 15, 2019). For ABI’s report on the First Circuit opinion, click here.

Without prompting from the parties, the First Circuit held up the issuance of the mandate for 90 days, giving the Senate time to confirm the appointment of the Board members. The appeals court did not enter a stay.

The Oversight Board filed its petition for certiorari on April 23. Four other petitions followed, by the U.S. Solicitor General, Aurelius, the official creditors’ committee, and a labor union in Puerto Rico.

The justices of the Supreme Court met in conference on Thursday, June 20, to consider the petition. Ordinarily, the Court issues orders granting or denying petitions on the following Monday. Instead, the Court issued its order on June 20 granting the petition, setting out a briefing schedule, and stating that oral argument will be held on October 15 or 16, the second week the justices will hear arguments in the coming term.

Meanwhile, the First Circuit had declined to issue a stay at the Board’s request but instead further delayed issuance of the mandate until July 15. On June 18, the Oversight Board filed a motion again asking the First Circuit to delay issuance of the mandate until the Supreme Court...
finally disposes of the appeal. The Board asked the appeals court to act by June 24, so time enough would remain to ask the Supreme Court for a stay pending appeal.

The Questions Presented

The justices granted certiorari to review two questions: (1) Did the Appointments Clause of the Constitution require Senate confirmation of the members of the Oversight Board; and (2) does the de facto officer doctrine allow the Board to continue acting validly prior to the issuance of the mandate?

The first briefs are due by July 25, with the last briefs due on October 8. The justices slapped page limits on all the briefs, with the longest allocated 20,000 words.

Senate confirmation of Board members would seemingly moot the appeal in the Supreme Court. However, the Board told the First Circuit “there is virtually no possibility that the Senate will confirm the Board members before the mandate issues on July 15.”

Even if the chief issues become moot following Senate Confirmation, questions remain regarding the validity of actions taken by the Board before and after the First Circuit’s opinion. It is questionable whether the Supreme Court would reach out to decide those more amorphous questions if the issue in chief becomes moot. If questions remain, the Court might remand the case to the First Circuit.

The appeal is Financial Oversight and Management Board for Puerto Rico v. Aurelius Investment LLC, 18-1334 (Sup. Ct.).
Supreme Court Agrees to Rule on What Is or Is Not a ‘Final, Appealable’ Order

In addition to ruling on the effect of rejecting a trademark license, the Supreme Court yesterday agreed to review one bankruptcy case and denied a petition for certiorari in another.

In *Ritzen Group Inc. v. Jackson Masonry LLC*, the Court granted certiorari to shed more light on what is or is not a final order conveying a right of appeal in a bankruptcy case. The justices declined to review *Davis v. Tyson Prepared Foods Inc.*, a case that could have said whether passively holding property of the estate violates the automatic stay under Section 362(a).

Yesterday, the high court ruled that rejecting an executory trademark license does not bar the licensee from continuing to use the license. To read ABI’s report on *Mission Product Holdings Inc. v. Tempnology LLC*, 17-1657 (Sup. Ct. May 20, 2019), click here.

*Ritzen* and Final Orders

In *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686 (2015), the Supreme Court ruled that an order denying confirmation of a chapter 13 plan is not a final order conferring a right to appeal. In *Ritzen*, the high court will have an opportunity to flesh out the definition of finality.

The creditor who lost in *Ritzen* contends that the Sixth Circuit deepened an existing circuit split by erroneously holding that an order denying a motion to modify the automatic stay is always a final order that must be appealed immediately.

In bankruptcy court, the creditor lost a motion to modify the automatic stay in Section 362 but did not appeal within 14 days. Instead, the creditor appealed from denial of the lift-stay motion months later when the bankruptcy judge sustained the debtor’s objection to the creditor’s claim.

In October, the Sixth Circuit upheld the district judge who had dismissed the stay appeal for being untimely. *Ritzen Group Inc. v. Jackson Masonry LLC (In re Jackson Masonry, LLC)*, 906 F.3d 494 (6th Cir. Oct. 16, 2018). To read ABI’s analysis of the Sixth Circuit’s opinion, click here.

The Sixth Circuit cited five other circuits and the *Collier* treatise for saying that courts “almost uniformly” hold that denial of a lift-stay motion is an appealable order. However, the Sixth Circuit went on to lay down a two-part rule to determine whether any type of order is final and therefore appealable.
Interpreting the governing statute, 28 U.S.C. § 158(a), the Sixth Circuit said that an order is final if it was entered in a “proceeding” and if the order terminated that proceeding. Because a lift-stay motion is a core “proceeding,” denial of motion was final because it was procedurally complete and precluded the creditor from pursuing its claim against the debtor outside of bankruptcy court, citing Bullard.

In the petition for certiorari, the creditor contends there is a split of circuits, with eight circuits holding that orders denying lift-stay motions “are categorically appealable.” On the other hand, the petitioner claims that the First and Third Circuits take a flexible approach by saying that denying a modification of the stay sometimes may not be final.

The petitioner believes that the Sixth Circuit misapplied Bullard and Gillespie v. U.S. Steel Corp., 379 U.S. 148, 152 (1964). In Gillespie, the petitioner says, the Supreme Court said that finality is sometimes a “close question” and that it is “impossible to devise a formula to resolve all marginal cases.”

The petitioner may be correct in interpreting Supreme Court precedent. The Sixth Circuit did establish a seemingly rigid, two-part test for all cases, arguably at odds with Gillespie. However, the Sixth Circuit may have correctly applied Bullard and Gillespie to the case before the appeals court. In Bullard, the high court ruled that an order denying confirmation of a chapter 13 plan was not a final, appealable order because denying confirmation did not terminate the proceeding, unlike denial of a lift-stay motion.

In deciding Ritzen, the Supreme Court might lay down a one-size-fits-all rule to discern between orders that are final and those that are not. A more difficult question arises with denials of lift-stay motions.

Suppose that the bankruptcy court denies a lift-say motion without prejudice, saying the creditor can apply again because the passage of time might inform a difficult result. In times past, some bankruptcy judges routinely denied stay motions without prejudice, ostensibly to preclude the creditor from appealing.

Ruling that denials of stay motions are never appealable can effectively preclude appellate review, because later events in the case can moot the stay appeal. To this writer, a hard-and-fast rule may appeal to those seeking an answer in the statute, but rigidity ignores the realities of bankruptcy practice.

For decades, courts have been taking a flexible approach to appealability in bankruptcy cases. Bullard cut back on the notion of flexibility, and Ritzen may allow the Court to impose a more inflexible standard.
With certiorari granted this spring, the case will be argued in the fall of 2019, unless the parties request extensions of time to file their briefs on the merits. A decision could be expected two or three months later.

The Automatic Stay Case

The high court refused to permit a final appeal in Davis v. Tyson, where the Tenth Circuit held that the automatic stay does not prevent a statutory worker’s compensation lien from attaching automatically after bankruptcy to a recovery in a lawsuit. Davis v. Tyson Prepared Foods Inc. (In re Garcia), 740 Fed. Appx. 163 (10th Cir. Oct. 17, 2018). To read ABI’s analysis of Davis, click here.

The outcome in Davis was not surprising, because the Tenth Circuit had ruled in WD Equipment v. Cowen (In re Cowen), 849 F.3d 943 (10th Cir. Feb. 27, 2017), that passively holding an asset of the estate in the face of a demand for turnover does not violate the automatic stay in Section 362(a)(3) as an act to “exercise control over property of the estate.”

The circuits are split. According to the debtor who sought Supreme Court review in Davis, the Second, Seventh, Eighth, Ninth and Eleventh Circuits have held that passively holding estate property or passively obtaining an interest in estate property after filing violates the automatic stay. In those circuits, for example, a creditor who repossessed an auto before bankruptcy must automatically return the car after the debtor files a chapter 13 petition, on pain of contempt.

The Tenth and the District of Columbia Circuits have ruled to the contrary, holding that an affirmative action is required to underpin an automatic stay violation.

Although the Court will not rule on Davis, the same issue likely will come to the justices again, sooner rather than later. Last week, the identical question was argued in the Seventh Circuit in City of Chicago v. Fulton, 18-2527 (7th Cir.). Indeed, Fulton may turn out to be a better vehicle for the Supreme Court to resolve the circuit split.

Fulton deals with cars impounded by the City of Chicago for unpaid parking tickets. Chicago believes that the mere filing of a chapter 13 petition does not compel the automatic turnover of an impounded car. The debtors argue that holding onto a car violates the automatic stay.

At last week’s oral argument, the appeals court panel seemed to believe that the outcome was already decided in that circuit by Thompson v. General Motors Acceptance Corp., 566 F.3d 699 (7th Cir. 2009). There, the Seventh Circuit ruled that passively holding an asset is an act to “exercise control” that violates the automatic stay under Section 362(a)(3).

Whoever wins in Fulton, there is likely to be a petition for certiorari. If the Seventh Circuit hands down a decision this summer, the request for Supreme Court review could arrive before the year’s end.
The cases are *Ritzen Group Inc. v. Jackson Masonry LLC*, 18-938 (Sup. Ct.) (cert. granted May 20, 2019), and *Davis v. Tyson Prepared Foods Inc.*, 18-941 (Sup. Ct.) (cert. denied May 20, 2019).
Supreme Court to Tackle a Bankruptcy Tax Refund Circuit Split

To resolve a split of circuits, the Supreme Court has granted certiorari to decide whether state or federal law governs the ownership of tax refunds when a subsidiary generated the losses but the government pays the refund to the bankrupt corporate parent.

The issue came to the fore in the wake of the banking crisis beginning some 10 years ago. A bank would fail and be taken over by the Federal Deposit Insurance Corporation, or FDIC. The bank’s parent holding company often would end up in bankruptcy.

The parent and subsidiary typically would have a prebankruptcy tax allocation agreement, or TAA, calling for the parent holding company to file a consolidated tax return for the corporate group. Usually, the failed bank would have incurred the losses giving rise to a tax refund. However, the Internal Revenue Service would pay the refund to the parent corporation as the entity that filed the tax return.

When the tax refund arrives from the IRS, does the bankrupt parent keep the cash, or does it go to the FDIC as receiver for the failed bank? That’s where the courts are split.

The Two Results

Courts resolved the question by employing two conflicting methodologies leading to different results.

The first group of courts employ state law to decide who keeps the refund. Sometimes, the TAA would create a valid trust or agency arrangement under state law. In those cases, the refund would not be property of the bankrupt estate of the parent holding company. Consequently, the refund would end up in the hands of the FDIC.

When the TAA did not create a trust or agency relationship, the first group of courts would conclude that the TAA resulted in a debtor/creditor relationship between the parent and the subsidiary. In those cases, the first group of courts would conclude that the FDIC had nothing more than an unsecured claim against the bankrupt parent. Creditors of the bankrupt parent, sometimes bondholders, would benefit because the parent might otherwise have precious few assets aside from the tax refund.
The second group of courts employ the so-called *Bob Richards* rule, derived from a Ninth Circuit opinion in 1973. *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262 (9th Cir. 1973). Those courts adopted a presumption — evidently a creation of federal common law — that the subsidiary with the losses is presumptively entitled to the refund absent a TAA that clearly gives the refund to the parent.

Under the same set of facts, the FDIC would come out on top in courts following the *Bob Richards* presumption.

The split worked out like this: The Fifth, Ninth and Tenth Circuits follow *Bob Richards*. Naturally, the FDIC does too.

The Second, Third, Sixth and Eleventh Circuits reject *Bob Richards* and employ state law to decide who owns the refund and whether the TAA creates an unsecured debtor/creditor relationship.

The Case on *Certiorari*

In the case to be heard in the Supreme Court, the parent holding company ended up in chapter 7 with a trustee. The bank subsidiary was taken over by the FDIC, as receiver. The bank subsidiary’s losses resulted in a $4 million tax refund payable to the parent under a TAA.

The bankruptcy court in Colorado granted summary judgment in favor of the holding company’s trustee. Finding that the TAA did not create a trust or agency under Colorado law, the bankruptcy court believed the parent and subsidiary had a debtor/creditor relationship under the TAA, meaning that the parent was the owner of the tax refund.

The district court reversed, believing that the Tenth Circuit had previously adopted *Bob Richards*. The Tenth Circuit affirmed, ruling that the case was governed by federal common law, not state law, unless the TAA unambiguously specified where the refund would go. Because the TAA did not unambiguously favor the holding company, the refund went to the FDIC as receiver.

Citing the split of circuits, the bankruptcy trustee filed a petition for *certiorari* in April. The justices of the Supreme Court considered the petition at two conferences and granted *certiorari* on June 27. The case will be argued in the term to begin in October. The date for argument has not been set as yet.

How Will the Justices Rule?

In recent years, the Supreme Court has often resolved bankruptcy cases based on textualism, limitations on the powers of federal courts or deference to state law.
In *Butner v. U.S.*, 440 U.S. 48 (1979), the Supreme Court ruled that state law determines the nature and extent of a debtor’s property interests. If the justices adhere to *Butner*, they may invoke state law, reverse the Tenth Circuit, overrule *Bob Richards*, and reinstate the judgment of the Colorado bankruptcy court giving the refund to the parent holding company.

The bankruptcy trustee also argues that courts adopting *Bob Richards* disregarded the rules for creating federal common law. According to the trustee, the Supreme Court requires a “significant conflict between some federal policy or interest and the use of state law” before a court is entitled to create federal common law. *O’Melveny & Myers v. FDIC*, 512 U.S. 79, 87 (1994).

Of course, the bankruptcy trustee sees no significant conflict with federal policy and thus no reason to adopt the *Bob Richards* presumption.

It is not entirely clear to this writer that the Supreme Court will reach the *Bob Richards* issue. Arguing on behalf of the FDIC, the U.S. Solicitor General contends that the Tenth Circuit applied Colorado law in concluding that the refund belonged to the FDIC. If the justices are persuaded that the Tenth Circuit invoked state law and did not rely on the *Bob Richards* presumption, the Court might dismiss the *certiorari* petition as having been improvidently granted.

The Significance of the Outcome

Obviously, the outcome in the Supreme Court will be significant in the liquidation of banks by the FDIC. In chapter 11 reorganizations of large non-bank companies with multiple debtors, the ruling by the high court will affect valuations underpinning the treatment of creditor classes under chapter 11 plans.

*The case in the Supreme Court is Rodriguez v. Federal Deposit Insurance Corp.*, 18-1269 (Sup. Ct.).
Arguably ignoring Sections 506(a) and 506(d), Dewsnup barred chapter 7 debtors from stripping down undersecured mortgages.

The Supreme Court Refuses to Revisit Dewsnup

The Supreme Court won’t be overruling Dewsnup this year, and probably never. Yesterday, the justices denied the petition for certiorari in Ritter v. Brady, 18-747 (Sup. Ct.).

Dewsnup was the notorious 1992 decision where the Supreme Court held that a chapter 7 debtor may not employ Sections 506(a) and 506(d) to “strip down” an undersecured mortgage. Dewsnup v. Timm, 502 U.S. 410 (1992). Justice Antonin Scalia wrote a vigorous dissent, accusing the majority of ignoring the plain language of the statute in adopting a policy contrary to decisions that Congress made by enacting the Bankruptcy Code.

Twenty-three years later, the justices seemed primed to revisit Dewsnup. At oral argument in Bank of America N.A. v. Caulkett, 135 S. Ct. 1995 (2015), several justices apparently thought Dewsnup was wrongly decided. Indeed, the unanimous opinion in Caulkett, written by Justice Clarence Thomas, said that “straightforward reading of the statute” would allow a debtor to strip off an underwater mortgage.

The Dewsnup issue arose in Ritter, where the chapter 7 debtor sought to strip off a wholly underwater mortgage. All the way through the Ninth Circuit, the courts summarily denied the debtor’s request, saying the issue had been decided definitively by the Supreme Court in Caulkett.

Scott L. Nelson of the Public Citizen Litigation Group of Washington, D.C., along with Bradley Girard and Brian Wolfman of the Georgetown Law Appellate Court Immersion Clinic, filed a certiorari petition in December. Several law professors and former judges, including Eugene Wedoff, Leif M. Clark and Bruce A. Markell, filed amicus briefs urging the Court to grant certiorari.

In a terse order, the Court denied the certiorari petition on February 19.

Craig Goldblatt, a partner at Wilmer Cutler Pickering Hale and Dorr LLP in Washington, D.C., explained why the court declined to re-examine Dewsnup. In a message to ABI, Goldblatt said, “The Court regularly notes that principles of stare decisis apply with special force in statutory cases, since Congress is presumed to acquiesce in the Court’s prior rulings and is able to enact legislation if it believes the Court got it wrong. Indeed, there are only a handful of occasions in recent decades in which the Court overruled prior statutory decisions.”
In the *certiorari* petition and in the *amicus* briefs, those who disagree with *Dewsnup* gave it their best shot. The papers persuasively explained where *Dewsnup* went off the rails, but the justices have shown their disinclination to revisit the issue, not now and perhaps never.

The petition for *certiorari* is in *Ritter v. Brady*, 18-747 (Sup. Ct.).
The Eleventh Circuit had held that coal producers can sell assets and insulate the buyer from liability for paying retirees’ health benefits.

Supreme Court Denied ‘Cert.’ on Termination of Retiree Benefits

In late December, the Eleventh Circuit handed down an important decision holding that any company, including a coal producer, can terminate retiree health benefits, even if the company sells its assets under Section 363 and converts from chapter 11 to chapter 7.

The mine workers’ union filed a petition for certiorari, which the Supreme Court tersely denied on June 24. However, the union was not challenging the appeals court’s interpretation of Section 1114, authorizing the termination of retiree health benefits. Instead, the union claimed there was a split of circuits regarding the tax Anti-Injunction Act (26 U.S.C. § 7421(a)).

To the union’s way of thinking, assessments imposed on coal producers to fund health benefits are taxes under the 1992 federal Coal Act. The Coal Act made successors and purchasers liable to fund retiree health benefits.

In the petition for certiorari, the union argued that the Anti-Injunction Act deprived the bankruptcy court of jurisdiction because insulating the purchaser from payments under the Coal Act amounted to an injunction preventing the collection of a tax.

After extensive analysis, the Eleventh Circuit held that the obligation to pay retiree health benefits was not a tax, thus giving the bankruptcy court jurisdiction to invoke Section 1114.

Even though the union’s petition for certiorari was unopposed, the Supreme Court denied the petition following the justices’ first conference on the case.

The petition for certiorari was *United Mine Workers of America Combined Benefit Fund v. Toffel,* 18-1468 (Sup. Ct.).
Possible for This Term
Disagreeing with the Tenth and D.C. Circuits and siding with four other circuits, the Seventh Circuit rules that passively holding estate property violates the automatic stay.

Seventh Circuit Solidifies a Circuit Split on the Automatic Stay

Solidifying a split of circuits, the Seventh Circuit ruled that the City of Chicago must comply with the automatic stay by returning impounded cars immediately after being notified of a chapter 13 filing.

The decision lays the foundation for the Supreme Court to grant certiorari and decide whether violation of the automatic stay requires an affirmative action or whether inaction amounts to control over estate property and thus violates the stay.

The Second, Seventh, Eighth, Ninth and Eleventh Circuits hold that a secured creditor or owner must turn over repossessed property immediately or face a contempt citation. The Tenth and the District of Columbia Circuits have ruled that passively holding an asset of the estate in the face of a demand for turnover does not violate the automatic stay in Section 362(a)(3), which prohibits “any act . . . to exercise control over property of the estate.”

The same issue was argued on May 23 in the Third Circuit, where the lower courts were siding with the minority. See Denby-Peterson v. NU2U Auto World, 18-3562 (3d Cir.). For ABI’s report on Denby, click here.

The Impounded Cars in Chicago

Four cases went to the circuit together. The facts were functionally identical.

The chapter 13 debtors owed between $4,000 and $20,000 on unpaid parking fines. Before bankruptcy, the city had impounded their cars. Absent bankruptcy, the city will not release impounded cars unless the fines are paid. If the cars are not redeemed by their owners, most of them are scrapped.

In 2016, Chicago passed an ordinance giving the city a possessory lien on impounded cars.

After filing their chapter 13 petitions, the debtors demanded the return of their autos. The city refused to release the cars unless the fines and other charges were paid in full.
The debtors mounted contempt proceedings in which four different bankruptcy judges held that the city was violating the automatic stay by refusing to return the autos. After being held in contempt, the city returned the cars but appealed.

In all four cases, the owners confirmed chapter 13 plans treating the city as holding unsecured claims. The city did not object to confirmation or appeal.

In the four cases, the city never sought adequate protection for its alleged security interests under Section 363(e).

Thompson Controls

Circuit Judge Joel M. Flaum was not writing on a clean slate in his June 19 opinion, given the circuit’s controlling precedent in Thompson v. General Motors Acceptance Corp., 566 F.3d 699 (7th Cir. 2009). Thompson, he said, presented “a very similar factual situation.”

Although Thompson came down only 10 years ago, Judge Flaum nonetheless wrote a comprehensive, 27-page opinion, perhaps sensing that the case will go to the Supreme Court on certiorari.

In Thompson, Judge Flaum said, “we held that a creditor must comply with the automatic stay and return a debtor’s vehicle upon her filing of a bankruptcy petition. We decline the City’s request to overrule Thompson.” He also agreed with the bankruptcy courts “that none of the exceptions to the stay apply.”

Quoting extensively from Thompson, Judge Flaum said that the Seventh Circuit had already “rejected” the city’s contention that “passively holding the asset did not satisfy the Code’s definition of exercising control.” He noted that Congress amended Section 362 in 1984 by adding subsection (a)(3) and making the automatic stay “more inclusive by including conduct of ‘creditors who seized an asset pre-petition,’” citing U.S. v. Whiting Pools Inc., 264 U.S. 198, 203-204) (1983).

Again citing Whiting Pools, Judge Flaum said that Section 362(a)(3) “becomes effective immediately upon the filing of the petition and is not dependent on the debtor first bringing a turnover action.” He added, the “creditor . . . has the burden of requesting protection of its interest in the asset under Section 363(e).”

Judge Flaum found support for his conclusion in Section 542(a). Again quoting Thompson, he said the section “‘indicates that turnover of a seized asset is compulsory.’” Thompson, supra, at 704.
“Applying *Thompson*,” Judge Flaum held “that the City violated the automatic stay . . . by retaining possession . . . after [the debtors] declared bankruptcy.” The city, he said, “was not passively abiding by the bankruptcy rules but actively resisting Section 542(a) to exercise control over the debtors’ vehicles.”

Telling Chicago how to proceed in the future, Judge Flaum said the city must turn over the car and may seek adequate protection on an expedited basis. The burden of seeking adequate protection, he said, “is not a reason to permit the City to ignore the automatic stay and hold captive property of the estate, in contravention of the Bankruptcy Code.”

In sum, Judge Flaum declined the city’s invitation to overrule *Thompson*. He said, “Our reasoning in *Thompson* continues to reflect the majority position and we believe it is the appropriate reading of the bankruptcy statutes.”

**Exceptions to the Automatic Stay**

Judge Flaum devoted the last third of his opinion to explaining why Chicago was not eligible for any of the exceptions to the automatic stay.

Section 362(b)(3), allowing acts to perfect or continue perfection of liens, does “not permit creditors to retain possession of debtors’ property,” Judge Flaum said. Rather, it allows creditors to file notices to continue or perfect a lien when bankruptcy has intervened. The city, he said, could perfect its possessory lien by a filing with the Secretary of State.

Judge Flaum cited Illinois decisions holding that giving up possession involuntarily does not destroy a possessory lien. The notion that turning over cars would abrogate the possessory lien was one of Chicago’s primary arguments on appeal.

Judge Flaum held that Section 362(b)(4), excepting police or regulatory powers from the automatic stay, did not apply. On balance, he said, the municipal machinery to impound cars “is an exercise of revenue collection more so than police power.”

**Is Certiorari Next?**

In the term that ends this month, the Supreme Court denied a petition for *certiorari* raising the same question. *See Davis v. Tyson Prepared Foods Inc.*, 18-941 (Sup. Ct.) (cert. denied May 20, 2019).

*Davis*, from the Tenth Circuit, was a challenge to the Tenth Circuit’s holding in *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017). In *Cowen*, the Tenth Circuit ruled that passively holding an asset of the estate in the face of a demand for turnover does not violate
the automatic stay in Section 362(a)(3) as an act to “exercise control over property of the estate.”
To read ABI’s discussion of the denial of certiorari, click here.

In this writer’s opinion, the Chicago parking ticket cases are a better vehicle for certiorari because they raise the issue more cleanly. Davis was a step or two removed from the question of whether overt action is required to violate the automatic stay.

Given the recent change in administration in Chicago, it is not certain that the city will pursue certiorari.

Eric Brunstad told ABI, “The issue is certainly not going away. I predict that eventually the Supreme Court will grant certiorari in a case involving the issue and resolve the conflict among the courts of appeals.” Brunstad represented the debtor who unsuccessfully sought Supreme Court review in Davis.

The opinion is In re Fulton, 18-2527, 2019 BL 225881 (7th Cir. June 10, 2019).
Cutting-Edge Issues in Avoidance Actions

This panel of experts will discuss timely issues in avoidance actions, including the circuit split regarding unpaid new value and other cutting-edge avoidance issues.

Steven M. Berman, Moderator
Shumaker, Loop & Kendrick, LLP; Tampa, Fla.

Edward T. Gavin
Gavin/Solmonese LLC; Wilmington, Del.

Shanti M. Katona
Polsinelli; Wilmington, Del.

Hon. Deborah L. Thorne
U.S. Bankruptcy Court (N.D. Ill.); Chicago
NATIONAL CONFERENCE OF BANKRUPTCY JUDGES
CUTTING-EDGE ISSUES IN AVOIDANCE ACTIONS PANEL

STEVEN M. BERMAN
SHUMAKER, LOOP & KENDRICK, LLP – TAMPA

EDWARD T. GAVIN
GAVIN/SOLMONESE – WILMINGTON

SHANTI KATONA
POLSINELLI – WILMINGTON

HON. DEBORAH THORNE
UNITED STATES BANKRUPTCY COURT FOR THE
NORTHERN DISTRICT OF ILLINOIS – CHICAGO

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I. Venue Selection – How Different Jurisdictions Interpret Issues in Avoidance Actions.

A. How do different Circuits address critical vendors?

Although bankruptcy courts throughout the United States generally agree that debtors have a limited ability to classify certain classes of vendors as necessary for an effective reorganization, a critical vendor’s ability to insulate itself from avoidance liability varies with each jurisdiction. This variation largely stems from two competing goals of bankruptcy—facilitating successful reorganizations and treating similarly situated creditors equally.

From the inception of the Bankruptcy Code, courts have come to varying conclusions as to when critical vendor status is appropriate. Generally, a court may exercise its authority under the Bankruptcy Code to issue orders providing for the payment of pre-petition amounts to critical vendors if the record establishes that: (i) the payments are necessary to the reorganization process; (ii) sound business justification exists in that critical vendor(s) refuse to continue to do business with the debtor absent being afforded critical vendor status; and (iii) the disfavored creditors are at least as well off as they would have been had the critical vendor order not been entered.²

Given an avoidance plaintiff’s burden to prove that a transfer allowed a particular creditor to receive more than it would in a hypothetical chapter 7 liquidation, one question lingers: what if that particular creditor was afforded critical vendor status allowing for

² In re Tropical Sportswear Int’l Corp., 320 B.R. 15, 17 (Bankr. M.D. Fla. 2005); see In re Ionosphere Clubs, Inc., 98 B.R. 174, 175–77 (Bankr. S.D.N.Y. 1989) (A bankruptcy court’s use of its equitable powers to “authorize the payment of pre-petition debt when such payment is needed to facilitate the rehabilitation of the debtor is not a novel concept.”).
postpetition satisfaction of prepetition amounts owed and thus, given this preferred status, would have the totality of its claims paid as a critical vendor?

i. For a “critical” vendor to be shielded from preference liability, the critical vendor order must explicitly provide for such protection.

In Osborne v. Howell Electric Motors (In re Fultonville Metal Prod Co.), the liquidating trustee sought to avoid the debtor’s prepetition payments to a supplier as preferences or constructively fraudulent transfers. The vendor, Howell, contended that the preference suit sought to circumvent the court’s critical vendor order, which Howell argued confirmed the necessity of the debtor’s prepetition payments to Howell. Howell further argued that the debtor “relinquished its right to recover the prepetition transfers when it requested and obtained critical vendor status for Howell.” To that end, the Fultonville court first noted that granting a party critical vendor status involves an exception to the fundamental bankruptcy principle of equality of distribution to creditors of equal rank, and went on to rule that “any rights claimed by a creditor as attendant to its ‘critical vendor’ status should also be viewed with circumspection.” The court then noted that “[n]either the Critical Vendor Motion nor the Critical Vendor Order contains any provision regarding the release from” avoidance liability, and Howell failed to establish that the court would have approved the debtor’s motion had the debtor asked to pay all of Howell’s prepetition claims, including the amounts subject to the preference action.

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4 Id. at 312.
5 Id.
6 Id. at 313.
7 Id. at 313–14.
Another novel theory was asserted by a vendor in *Zenith Indus. Corp. v. Longwood Elastomers, Inc. (In re Zenith Indus. Corp.)*. In *Zenith*, a supplier asserted that its status as a critical vendor “negates the requisite showing under 11 U.S.C. § 547(b)(5)” that it received more on account of the transfer than it would have in a hypothetical chapter 7 liquidation. The plaintiff sought to strike Longwood’s defense. In striking Longwood's critical vendor defense, the *Zenith* court emphasized that even if the parties stipulated that Zenith would have included the pre-petition payment in its essential vendor motion, Longwood's defense would still fail: “It is speculative to conclude that no party in interest . . . would have objected or that the Court would have granted a motion that had not been made . . ..” This decision distinguished itself from the Third Circuit’s decision in *Kimmelman v. Port Authority of N.Y. & N.J. (In re Kiwi Int'l Air Lines, Inc.)*, where the court held that an unsecured creditor whose claim was paid in full postpetition—either pursuant to a court order or court-approved stipulation—cannot be compelled in a preference action to turn over amounts related to pre-petition payments.

In *AFA Inv. Inc. v. Trade Source, Inc. (In re AFA Inv. Inc)*, the Bankruptcy Court for the District of Delaware denied summary judgment to chapter 11 debtors who filed a preference claim against Trade Source—a critical vendor. The court considered whether Trade Source received more on account of the transfer than it would have received in a hypothetical chapter 7 liquidation. The court focused on the fact that the debtors identified Trade Source as a critical vendor and executed a separate agreement obligating the debtors to pay Trade Source its prepetition claim contingent on Trade Source’s continuation of the

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9 Id. at 813.
provision of services. The court approved the debtor’s critical vendor motion and the debtor executed and fully complied with its agreement to pay Trade Source’s prepetition claims. The court sided with Trade Source and noted that the Third Circuit cannot compel an unsecured creditor in a preference action to turn over amounts related to pre-petition payments that were paid in full postpetition pursuant to a court order or court-approved stipulation. The court emphasized that “had the alleged preferential payment not been made pre-petition, Trade Source would have received that payment postpetition, as part of the continued services agreement it had with the [d]ebtors.” Therefore, the court denied summary judgment because debtors could not establish that Trade Source received more on account of the transfer than it would have under a chapter 7 liquidation.

Even more recently, the Bankruptcy Court for the Eastern District of New York recently addressed a similar question in In re Personal Communications Devices, LLC. There, a repair services vendor was denied summary judgment in a preference avoidance action brought by a liquidation trust. Ultimately, noting that the court’s critical vendor order neither required the debtors to make any payments to critical vendors nor did it provide a waiver of preference liability for the vendor. Nonetheless, the vendor argued (and provided expert testimony) that, had its critical supplies stopped flowing to the debtor, the chapter 11 case would have failed. The court declined to speculate whether it might have approved a

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12 Id. at 243.
13 Id. at 244.
14 Id.
16 Id. at 668.
17 Id. at 670.
waiver of seven-figure preference liability in addition to the debtor paying nearly $1,000,000 on prepetition claims and ultimately denied the vendor’s motion for summary judgment.\textsuperscript{18}

Although critical vendor motions normally come at a time when the debtor is trying to hastily get invoices paid and vital services continued, a vendor in a favorable bargaining position may be able to successfully bargain for a preference waiver in the proposed critical vendor order. While this may raise objections and thereby lengthen this often time-sensitive process, it is the only sure-fire way for a vendor to ensure it is shielded from preference liability.

II. **Can You Eat Your Cake and Have it Too? - How § 503(b)(9) Treatment and Other Preferred Status Can Conflict with Avoidance Actions.**

The favorable treatment afforded to creditors through administrative expense priority, UCC status, and reclamation can prove to be a double-edged sword when defending avoidance actions. The cases discussed below provide some insight into this conflict-filled area.

A. **Is the “new-value” defense only available if the new value remains unpaid?**

The exception to preference liability set forth in § 547(c)(4)—the “new-value” exception—has fomented litigation in recent years, primarily with respect to the question of when the new value provided to the debtor may be credited against preference liability. Currently, courts are split as to whether new value provided by a creditor must remain unpaid by the debtor in order to offset preference liability.\textsuperscript{19} This split weighs heavily on creditors who are otherwise afforded “preferred” status whether it be as a critical vendor, entitlement to administrative expense priority payments pursuant to § 503(b)(9), or

\textsuperscript{18} Id.

reclamation rights under § 546(c). Courts requiring that new value remain unpaid for a creditor to assert this defense place partially-repaid creditors in a perilous position without the availability of a useful and relatively inexpensive defense. Choice of venue should also be an important consideration for would-be debtors depending upon whether maximizing chapter 5 recoveries or getting support from existing vendors is of paramount import in the reorganization strategy.

With the enactment of the Bankruptcy Code, earlier cases on the subject of the “new value” exception held that the defense would not apply if the creditor received payment for the new value it conferred upon the debtor.20 The “remains unpaid approach” has become less popular in recent years, with a number of courts focusing on whether the new value has been repaid by an otherwise avoidable transfer. While the Fourth, Fifth, Eighth, and Ninth Circuit Courts of Appeal have all formally adopted the “subsequent advance approach” and hold that new value doesn’t have to remain unpaid to qualify for the new-value defense, bankruptcy courts in other jurisdictions have weighed in on the split and many side with this emerging trend.21

While neither approach has its grounding in express statutory language, courts following either of these approaches cite to competing policy goals as justification for their respective positions. For example, courts following the “remains unpaid” approach fear that creditors will get a windfall if the debtor later pays for the new value and the creditor is still

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20 Id.; see also In re Jet Florida System, Inc., 841 F.2d 1082 (11th Cir. 1988); In re Prescott, 805 F.2d 719 (7th Cir. 1986).
allowed to assert the new-value defense.\(^22\) These courts favor the equality of treatment for similarly situated creditors over the counter-veiling policy objective of encouraging creditors to continue doing business with a distressed debtor. Instead of barring the new-value defense anytime new value has been repaid, courts following the “subsequent advance approach” hold that new value may be repaid so long as that payment is avoidable by some other means.\(^23\)

B. Critical vendors and avoidance actions

Even once a creditor is afforded critical vendor status, they may still be subjected to what they view as inherent unfairness. For example, some creditors may feel that they have been treated inequitably when they realize that only a small portion (or none) of their proof of claim will be paid, and, adding insult to injury, the creditor is also the defendant in an avoidance action for the negligible prepetition payments they received.\(^24\) However, two decisions in Delaware provide preference defendants with extraordinary protection from liability.\(^25\)

i. Critical vendors can “double-dip” in Delaware

Under Friedman’s a preference defendant may assert an undiminished “new value” defense under § 547(c)(4), even when a portion (or all) of that prepetition new value is paid

\(^{22}\) See, e.g., In re Hancock-Nelson Mercantile Co., Inc., 122 B.R. 1006 (Bankr. D. Minn. 1991) (stating that the “the subsequent advance no longer remains an unpaid receivable on the creditor-supplier’s books, so there is no reason why it should get ‘credit’ for it in the larger-scale adjustment of relationships which takes place in” avoidance actions).

\(^{23}\) See, e.g., In re JKJ Chevrolet, Inc., 412 F.3d 545 (4th Cir. 2005) (stating that the proper inquiry was not whether the creditor had been paid for this new value, but whether it had been paid by a transfer not subject to being avoided by the trustee).

\(^{24}\) Jeremy R. Fischer, Double-Dipping in Delaware Friedman’s, Quantum Foods and Beyond, 35 Am. Bankr. Inst. J. 34 (2016).

\(^{25}\) Id.
postpetition pursuant to a critical vendor order. In Friedman’s, the debtor paid approximately $82,000 to a creditor during the preference period and the creditor provided additional services amounting to approximately $100,000 for which it was not paid. The creditor received approximately $72,000 pursuant to a critical-vendor order entered by the bankruptcy court. A liquidating trustee sued the creditor for avoidance and recovery of the $82,000 paid prepetition, to which the creditor asserted a full new-value defense based on the $100,000 in services subsequently rendered to the debtor.

The trustee objected to the creditor’s new-value defense, arguing that the defense must be offset by the postpetition payment made pursuant to the critical-vendor order to prevent the creditor from double-dipping to the detriment of the estate. Ultimately, the bankruptcy court ruled that the critical-vendor payments were made postpetition and therefore did not diminish the new value defense. On appeal, the Third Circuit noted that “even if a creditor is paid postpetition for new value it provided pre-petition, the creditor still replenished the estate during the preference period, and therefore aided the debtor in avoiding bankruptcy.” Accordingly, the Third Circuit held that where a payment “is made after the filing of a bankruptcy petition, it does not affect the new value defense.”

After Friedman’s, the Bankruptcy Court for the District of Delaware posited that postpetition administrative expenses could also be set off against preference liability and ultimately rejected the notion that such setoff is a “disguised . . . postpetition new value

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26 Friedman’s Liquidating Trust v. Roth Staffing Cos. LP (In re Friedman’s), 738 F.3d 547 (3d Cir. 2013).
27 Friedman’s, 738 F3d at 551.
28 Id. at 549.
defense.” In *Quantum Foods*, a creditor-vendor was paid approximately $13.75 million during the preference period, and, following the debtor’s bankruptcy filing, continued to provide goods to the estate. The creditor-vendor was allowed a $2.6 million administrative expense under § 503(b)(1)(A) after nonpayment on the goods delivered postpetition. The creditors’ committee filed a suit seeking avoidance and recovery of the prepetition payments, to which the creditor-vendor asserted the right to set off its allowed administrative expense against any preference liability. The parties agreed that *Friedman’s* confines the preference analysis under a new-value defense to prepetition activity, but the creditors’ committee asserted that the creditor’s setoff claim is merely a new-value defense in disguise.

The bankruptcy court declined to conflate the creditor’s right to set off with establishing a new value defense, stating that the creditor’s “setoff claim does not affect the bottom line of the preference calculation; rather, setting off [the creditor’s] Administrative Claim effects only the amount paid to the estate.” Concluding that the creditor’s “claim is an assertion of setoff rights and not a new value defense,” the court also held that, because setoff claim and the committee’s preference claim both arose postpetition, the creditor could set off its preference liability (if any) with the amount paid through administrative claims postpetition.

Collectively, the *Friedman’s* and *Quantum Foods* decisions may mean the creditors defending preference actions in Delaware are entitled to “double-dip.” That is, creditors

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30 Id. at 731–32.
31 Id. at 733–34.
32 Fischer, *supra* note 3.
may be entitled to payment (or setoff) under § 503(b)(9), while also establishing undiminished new-value defenses on the same transactions. While Delaware may allow a creditor to receive administrative expense payments and assert an undiminished new-value defense for the same transaction, other jurisdictions do not view “double-dipping” as favorably.

ii. Critical vendors in other jurisdictions should be wary of asserting § 503(b)(9) treatment and the new-value defense for the same transaction.

In Siegel v. Sony Electronics, Inc. (In re Circuit City Stores, Inc.), the Bankruptcy Court for the Eastern District of Virginia reaffirmed its earlier holding in Circuit City Stores, Inc. v. Mitsubishi Digital Electronics America, Inc. that a vendor-creditor cannot use the delivery of the same goods both to recover a § 503(b)(9) claim and to assert a new value defense under § 547(c)(4). In response to the trustee’s motion for partial summary judgment, Sony filed its cross-motion for summary judgment asking the court to rule as a matter of law that it was entitled to assert a claim for goods delivered to Circuit City during the twenty-day period prior to the petition date both for recovery under § 503(b)(9) and as new value under § 547(c)(4). The court declined to accept Sony’s argument that it should reverse its prior holding and adopt the reasoning of the Third Circuit in Friedman’s Liquidating Trust v. Roth

34 No. 10-03068-KRH, 2010 WL 4956022 (Bankr. E.D. Va. Dec. 1, 2010) (holding “that because the payment of a creditor’s Bankruptcy Code § 503(b)(9) administrative claim for the value of goods transferred to a debtor in the twenty-day period immediately preceding the commencement of a bankruptcy case is an “otherwise unavoidable transfer” as that term is used in § 547(c)(4)(B) of the Bankruptcy Code, the recipient of such a payment is not entitled to utilize the value of those same goods as the basis for a new value defense under § 547(c)(4) of the Bankruptcy Code”).
Staffing Cos. (In re Friedman’s, Inc.), which held that postpetition transfers made pursuant to a prepetition wage order did not affect the calculation of that creditor’s new value defense.35

III. Delaware’s Rule on Mediation in Mega Cases – Is It Fair to Bring Trade Creditors to a Foreign Jurisdiction (ABI Recommendations on Preference Litigation)?

Alternative dispute resolution demonstrably provides an efficient mechanism to reduce the costs of bankruptcy litigation. Many jurisdictions have accepted this reality and have responded favorably by mandating mediation in some (or all) proceedings. Leading this trend is the Bankruptcy Court for the District of Delaware, which, since 2004, has required mediation in cases where the debtor or liquidating agent seeks to avoid preferential transfers. In 2013, the Delaware Bankruptcy Court expanded that requirement to cover any adversary proceeding in a chapter 11 case.36

Courts have employed mediation as an efficient tool in complex bankruptcy cases where there are numerous parties and issues being disputed. For example, in In re Lehman Brothers Holdings, Inc., in the Bankruptcy Court for the Southern District of New York, the debtors engaged in hundreds of mediations under court-ordered alternative dispute resolution procedures.37 This eliminated the need for litigation in every individual case and

35 The Sony Electronics court also referenced a footnote in the Friedman’s decision for the position that the “Third Circuit clearly indicated that it did not intend for its decision to extend to § 503(b)(9) claims.” 515 B.R. at 313 (citing Friedman’s, 738 F.3d 547, 561 n. 9 (3d Cir. 2013) (“Here, we need not resolve the question of whether assertion of a reclamation claim should reduce a new value defense, as we are only considering the effect of payments made pursuant to a Wage Order.”)).
36 Bankr. D. Del. R. 9019-5 (“Except as may be otherwise ordered by the Court, all adversary proceedings filed in a chapter 11 case and, in all other cases, all adversaries that include a claim for relief to avoid a preferential transfer (11 U.S.C. § 547 and, if applicable, § 550) shall be referred to mandatory mediation.”).
37 In re Lehman Bros. Holdings, No. 08-13555 (Bankr. S.D.N.Y.).
allowed the estate to receive recoveries exceeding $2 billion. In *In re Tribune Co.*, the Bankruptcy Court for the District of Delaware used mediation (lasting several months) to draw an end to what it described as “[t]he arduous journey for confirmation of a plan,” which resulted in a plan with broad support that was ultimately confirmed. Recently, in the Bankruptcy Court for the District of Delaware, mediation was used to settle a ceaseless dispute between various entities of The Rockport Company and Adidas that was preventing confirmation of a plan.

However, mediation is not always fruitful. In *In re Nortel. Networks, Inc.*, the court ultimately resolved a dispute when the parties failed compromise after numerous rounds of mediation. In the Bankruptcy Court for the Southern District of New York, mediation efforts failed to resolve the dispute between the debtor and labor unions and the case resulted in liquidation.

There are many benefits to mandatory mediation. First, mediation preserves judicial resources by resolving factual disputes earlier in a case and allows, if necessary, the court to consider the “big” issues within the preference action. Mediation can also be beneficial for an unsecured creditor facing preference liability by mitigating the substantial expenses accessory to preference litigation when the creditor already faces the prospect recovering a small fraction of its unsecured claim. Moreover, mediation is often the best way to resolve complex confirmation disputes and expedite confirmation in chapter 11 cases.

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40 In re The Rockport Company, No. 18-50636 (Bankr. D. Del.).
41 In re Nortel Networks, No. 09-10138 (KG) (Bankr. D. Del.).
42 In re Old HB, Inc (f/k/a Hostess Brands, Inc.), No. 12-22052 (RDD) (Bankr. S.D.N.Y.).
Unfortunately, there are also a number of pitfalls with mandatory mediation. For example, some parties find it unfair to be drawn from near and far to participate in mediation in a jurisdiction of the debtor’s choosing. Additionally, as is evidenced by the cases mentioned above where mediation proved to be unfruitful, where the parties insist on holding their positions, mediation may only increase the time and cost of ongoing litigation. Some commentators suggest that mediation may be used to excess, and that, in the process of facilitating negotiations, it could pressure parties to settle on terms favorable to the mediator. Ultimately, mandatory mediation is likely beneficial in a number of situations that arise in a bankruptcy case where the parties are willing to give up some ground in the name of efficiency.

IV. Cost of Avoidance Actions – Will Creditor’s Receive Anything?

It is axiomatic that the primary function of avoidance actions is to “maximize the bankruptcy estate for the benefit of creditors.” However, the cost of these avoidance actions can result in a majority of the estate being eaten up by legal fees, with the creditors realizing no benefit from the litigation. Although § 550(a) provides that a trustee may recover an avoided transfer “for the benefit of the estate,” this does not require a material

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44 In re Cybergenics Corp., 226 F.3d 237, 243–44 (3d Cir. 2000) (“The power to avoid the debtor's prepetition transfers and obligations” are for the purpose of “maximiz[ing] the bankruptcy estate for the benefit of creditors.”).
benefit for unsecured creditors.45 Further, numerous courts have held that recovery under § 550(a) is not capped by the amount of creditor claims.46

One primary pitfall with avoidance litigation is the cost to both the debtor’s estate and the defendant-creditor.47 The costs associated with avoidance litigation often lead creditors to making quick settlement offers to avoid costs despite the presence of potential defenses.48 Two methods mentioned in these materials—mediation and pre-adversary proceeding proof of diligence—can help combat the rising costs of avoidance litigation. Mediation can reduce the time-consuming factual inquiry required for the prosecution of avoidance claims and the assertion of defenses. Pre-litigation diligence, as employed by the court in the Brook Mays Music case mentioned below, allow the trustee to focus on avoidance claims that provide the most benefit to the estate and avoid attempts to recover amounts where the costs outweigh the benefit to the estate.

45 See, e.g., Gonzalez v. Nabisco Div. of Kraft Foods Inc. (In re Furr’s), 294 B.R. 763 (Bankr. D. N.M. 2003) (stating that “the estate benefits when the action increases the value or assets of the estate,” even when unsecured creditors realize no benefit from the action).
47 See Comments of Kathy Tomlin, ABI Commission to Study the Reform of Chapter 11, AM. BANKR. INST. (May 21, 2013).
V. What Diligence is Required Before Filing Adversary Proceedings?

In larger cases, the number of transferees having potential liability for avoidable transfers can be in the thousands. While many of these potential avoidance claims are valid, others may be subject to obvious, valid defenses, making the pursuit of those claims a waste of judicial resources. But what can a court do to limit the number of frivolous avoidance actions it must hear? Some courts require the trustee in cases with high numbers of potential avoidance actions to submit a report on the avoidable transfers available to the estate.49

A novel, common-sense process to thwart abusive preference litigation was employed by the court in In re Brook Mays Music Co. There, the court required the trustee to submit a preliminary report regarding potential preference actions. The court required that this report include: a list of transfers made to insiders within the preference period, a designation of which recipients of transfers within the 90-day preference period hold already-allowed or potential § 503(b)(9) claims; and other potential defenses likely to be asserted by recipients of the subject transfers.50 The court mentioned its “concern that there should be an expeditious and economical resolution of the case, and that the trustee should cautiously and properly exercise [its] fiduciary duties in this regard.”51 In its report, the trustee included exhibits laying out all of the preferential transfers it intended to pursue, and also proposed the parties that the trustee did not intend to sue. The court acknowledged that, although the Bankruptcy Code does not provide any express limitations on a trustee’s avoidance powers where the only “parties who benefit are professionals and a secured or undersecured lender,” it suggested that “the appropriate strategy for a case is more subtle

50 Id. at *1.
51 Id.
than anything explicitly stated in the Bankruptcy Code—it is more a matter of what is a proper exercise of fiduciary duties.”

VI. Tuition Avoidance Actions – Are Mere Conduit and Good Faith Defenses Available?

Are tuition payments made by parents for their adult children constructively fraudulent transfers? It depends. Bankruptcy courts throughout the United States are torn on whether a debtor receives reasonably equivalent value for higher-education payments made for their adult children. Some of these bankruptcy courts base their decisions on whether the children were classified as minors at the time of the subject transfer, while others permit payments for undergraduate education but not those for post-graduate education. These differences of opinion can be distilled into two distinct views: the strict-textualist reading of the Code which finds that, in the absence of a statutory carve out for a child’s education expenses, the parents do not receive “value” as it is defined by the Code; or, the more liberal approach that finds a distinct—albeit intangible and somewhat speculative—economic benefit received by the debtor.

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52 Id. at *3.
53 See Geltzer v. Oberlin College (In re Sterman), 594 B.R. 229 (Bankr. S.D.N.Y. 2018) (holding that education expenses paid while children were minors were not avoidable but those paid while children were of majority age were avoidable as constructive fraudulent transfers).
54 See Sikirica v. Cohen (In re Cohen), 2012 WL 5360956 (Bankr. W.D. Pa. Oct. 31, 2012), aff’d, 487 B.R. 615 (W.D. Pa. 2013) (holding that undergraduate education expenses for debtor’s children were for reasonably equivalent value while payments made for the debtor’s child in graduate school were not for reasonably equivalent value).
C. Cases finding tuition payments avoidable for lack of reasonably equivalent value.

iii. Payments for post-secondary education

In *Chorches v. Catholic University of America*, Catholic University (“Catholic”) moved to dismiss the chapter 7 trustee’s claim seeking to avoid $30,659.50 in tuition payments made by the debtors for their adult child’s college education.\(^{55}\) The trustee alleged that the payments by the debtors violated both 11 U.S.C 548(a)(1)(B) and Conn. Gen. Stat. §§ 52-552e(a)(2) and 52-552f(a). Catholic argued, among other things, that “parents derive value from the college education of an adult child, because it is commonplace among untold millions of American families, and deeply ingrained in our culture, to treat college tuition payments as a family obligation, no less so than [a] mortgage and grocery payments” and that such transfers should be considered expenses of the family as a single economic unit.

The District Court, Michael P. Shea, J., denied Catholic’s Motion to Dismiss. The court found Catholic’s arguments inconsistent with the Bankruptcy Code. The court referenced the definition of “value” in the Code by “purely economic terms,” *i.e.*, “property, or satisfaction or securing of a present or antecedent debt of the debtor, but ... not ... an unperformed promise to furnish support to the debtor or to a relative of the debtor.”\(^{56}\) The court further noted that “Congress can likewise provide a specific statutory carve-out for tuition payments for adult children if it deems appropriate, but it has not done so to date.” Ultimately, the court held payments for an adult-child does not constitute reasonably equivalent value when the parent receives no value, in purely economic terms, in exchange.

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\(^{56}\) *Id.* (citing 11 U.S.C. § 548(d)(2)(A)).
In Roach v. Skidmore College (In re Dunston), the debtor established qualified tuition savings plans under 26 U.S.C. § 529 (“529 Plans”) for her two children.\(^{57}\) The debtor withdrew $19,112.42 from child A’s 529 Plan and $52,036.73 from child B’s plan and deposited the funds into the debtor's personal checking account. The debtor later withdrew the remaining balance of $27,570.72 from child A’s 529 Plan. The debtor claimed that the funds withdrawn from the 529 Plan were reimbursement for earlier tuition payments she made for her children. The three tuition payments made by the debtor to the college were $29,233.00, $28,603.00, and $29,971.00.

The chapter 7 trustee filed an adversary complaint against Skidmore College (“Skidmore”), seeking to avoid and recover, as constructively fraudulent transfers pursuant to 11 U.S.C. §§ 548(a)(1)(B) and 550, the three payments, totaling $87,807.00, the debtor made to Skidmore for her daughter’s tuition and other costs of attendance. Skidmore then moved for summary judgment.

The Bankruptcy Court, Edward J. Coleman, III, J., granted summary judgment in part for Skidmore as to the first ($29,233.00) and second ($28,603.00) transfers because the record was devoid of sufficient evidence to create an issue of material fact as to whether the debtor was insolvent or became insolvent because of these transfers. The court denied summary judgment on the third transfer ($29,971.00), finding that the trustee met his burden of demonstrating that a genuine issue of material fact exists regarding the debtor's solvency at the time of the third transfer. Moreover, after a careful analysis of opinions on both side of the issue, the court found that debtor did not receive “reasonably equivalent value” in exchange for the transfers. The court reasoned that satisfaction of such a moral

obligation does not provide an “economic” benefit to the debtor; the debtor did not discharge or satisfy any legal duty, nor did the debtor increase her assets in any way that could be used to pay her creditors. Thus, although the court granted summary judgment on the first two transfers due to a lack of insolvency evidence in the record, the court found Skidmore was not entitled to summary judgment on the third and final transfer. Further, the court rejected Skidmore’s argument that the debtor received reasonably equivalent value in exchange for any of the transfers.

In Banner v. Lindsay (In re Lindsay), the chapter 7 trustee filed an adversary proceeding against the debtors seeking a judgment that transfers the debtor made to his wife and to a college where his son was enrolled were avoidable under New York Debtor and Creditor statutes that permitted recovery in circumstances of constructive and actual fraud. The trustee filed a motion for summary judgment.

The Bankruptcy Court, Cecelia Morris, J., held that transfers by the debtors were constructively fraudulent because fair consideration was not received. The court held that the $35,055 in proceeds transferred to the university as tuition for the debtor’s son constituted fraudulent transfers and ordered the debtor to turn this amount over to the trustee. The debtors did not receive reasonably equivalent value for the tuition payments made on behalf of their adult children because the debtors were under no obligation to pay for the adult-child’s secondary-education. Thus, the court held that the transfers to the university as tuition were fraudulent pursuant to Debt. & Cred. §§ 273 and 271-a.
D. Cases finding tuition payments were for reasonably equivalent value.

iv. Payments for post-secondary education

In DeGiacomo v. Sacred Heart University, Inc. (In re Palladino), the chapter 7 trustee brought an adversary proceeding against Sacred Heart University (“SHU”) and sought to set aside $64,696.22 in payments made by the debtors for their daughter’s educational expenses pursuant to both the Bankruptcy Code § 548 and Massachusetts Uniform Fraudulent Transfer Act (“UFTA”), and to recover that sum from SHU for the benefit of the bankruptcy estate.58 Notably, the payments were made while the debtors were operating a Ponzi scheme through their company. SHU then moved for summary judgment.

The Bankruptcy Court, Melvin S. Hoffman, J., held that tuition payments made by the debtors were not constructively fraudulent transfers as they received reasonably equivalent value under the Bankruptcy Code § 548(a)(1)(B) and Massachusetts UFTA § 5(a)(2). The court reasoned that a parent could reasonably assume that paying for a child to obtain an undergraduate degree would enhance the child’s financial well-being, which would confer an economic benefit on the parent. The court further stated that the operative standard in both the Bankruptcy Code and the UFTA is “reasonably equivalent value,” and “the emphasis should be on reasonably.” Therefore, in finding that the tuition payments were for reasonably equivalent value, the court entered summary judgment in favor of SHU.

The court in Eisenberg v. Pennsylvania State Univerisity (In re Lewis), addressed unique facts involving the debtor-parent’s application and approval for education loans for their children.59 Before the debtor filed a chapter 7 bankruptcy petition, the debtor applied and was approved for several Parent PLUS loans to pay for the educational expenses of his two

children at Pennsylvania State University ("PSU"). Proceeds from the Parent Plus loans were paid directly from the Department of Education ("D.O.E.") to PSU without passing through the debtor or his children. The balance owed by the debtor on the Parent PLUS loans totaled $142,990.45. The chapter 7 trustee then brought an adversary proceeding to avoid, as constructively fraudulent transfers, the Parent PLUS loan proceeds paid by the D.O.E. to PSU under the Bankruptcy Code and Pennsylvania’s Uniform Fraudulent Transfer Act. PSU then moved to dismiss the trustee’s avoidance action.

The Bankruptcy Court, Richard E. Fehling, J., held in favor of PSU and dismissed the trustee’s avoidance action. The court found that neither the debtor nor his estate ever held an interest in the proceeds of the Parent PLUS loans and that the debtor received reasonably equivalent value in exchange for the transfers. Even if a Parent PLUS loan was found to be an interest of the debtor in property, the court concluded that the debtor still received “reasonably equivalent value in exchange for the transfers because a “parent’s payment of a child’s undergraduate college expenses is [a] reasonable and necessary expense for maintenance of the family and for preparing family members for the future.” Accordingly, the court granted PSU’s motion to dismiss the trustee’s avoidance action.

Some courts, like the court in Shearer v. Oberdick (In re Oberdick), 60 base their finding that payments for a child’s tuition expenses are not avoidable in the familial obligation to pay for higher education instead of the equivalency of the value received by the debtor. In Oberdick, the chapter 7 trustee brought a fraudulent transfer action against Debtor and his wife ("Defendants"), challenging $328,538.00 worth of expenditures from the Defendants’ account. Under the category of education expenses for this discussion, the trustee

specifically challenged $82,536.22 worth of expenditures from the Defendants’ account during the relevant claw back period that was used to pay for the Defendants' children's college education. The tuition expenses at issue related to the cost of attendance for adult child A to attend the University of Chicago, and adult child B to attend Robert Morris University, and both child A and B were undergraduate students.

The Bankruptcy Court, Thomas P. Agresti, C.J., found in favor of the Defendants and against the trustee on the trustee’s fraudulent transfer action. The court found in favor of the Defendants as to all counts because the court recognized a familial obligation to pay for higher education and based its conclusion on that obligation rather than an analysis of reasonably equivalent value. The court further went on to note that “this Court has little hesitation in recognizing that there is something of a societal expectation that parents will assist with such expense if they are able to do so. If there were some evidence that the [debtors] ... made the education expenditures in question as part of a strategy ... to shield the funds from the reach of [creditors], the Court might view this differently.” Therefore, the court determined that the tuition payments made by the Defendants were not avoidable transfers.

In *Sikrica v. Cohen (In re Cohen)*, the chapter 7 trustee brought a fraudulent conveyance action pursuant to Pennsylvania fraudulent transfer law under 11 U.S.C. § 544(b)(1) and 12 Pa. Cons. Stat. §§ 5104, 5105, and 5108 to avoid transfers that were made on the husband’s behalf to accounts he and his wife owned as tenants by the entireties. The trustee’s challenge was to the debtors’ payment of $102,573.00 made for their children’s post-secondary education, “including $46,059.97 for their son’s undergraduate education,

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$7,562.00 for their daughter’s undergraduate education, and $39,205.00 for their daughter’s graduate education.”

The Bankruptcy Court, Jeffery A. Deller, J., granted judgment in favor of the trustee against the debtor and Mrs. Cohen jointly and severally, on the trustee’s fraudulent transfer action. With respect to the educational advances by debtor for his children, the bankruptcy court noted that “[w]hile the Pennsylvania legislature has not yet enacted a statute that requires parents to pay for their children’s post-secondary education, this Court holds that such expenses are reasonable and necessary for the maintenance of the [d]ebtor’s family.” However, the court limited its holding to payments by debtors for his children’s undergraduate education, reasoning such children enrolled in “graduate school are well into adulthood.” Thus, the court found payments to be a transfer in exchange for reasonably equivalent value, but tuition payments for graduate-level education were not for reasonably equivalent value was an avoidable transfer under state fraudulent conveyance law.

**v. Payments made while the children were minors.**

In *Geltzer v. Xavarian High Sch. (In re Akanmu)*, the chapter 7 trustee commenced an adversary proceeding against two independent schools (“Schools”) to avoid and recover $46,562 in tuition payments made by the debtors, for their minor children’s education as constructively fraudulent transfers or unjust enrichment. The trustee alleged that the debtors were not “direct beneficiaries” of the tuition payments, and private schooling for their children was “not reasonably necessary.” The Schools then moved to dismiss. The Schools’ motion to dismiss focused on the element of “reasonably equivalent value” and “fair consideration,” contending that, as a matter of law, the value provided in the form of

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education for the debtors’ children constitutes “reasonably equivalent value” and “fair consideration” to the debtors.

The Bankruptcy Court, Carla E, Craig, C.J., granted the Schools’ motion to dismiss and the chapter 7 trustee was not allowed under 11 U.S.C. §§ 544(b) or 548(a)(1)(B), N.Y. Debt. & Cred. Law § 273, or the concept of unjust enrichment, to recover tuition payments made for the debtors’ minor children’s education. The court concluded that the debtors “received reasonably equivalent value and fair consideration, directly and indirectly, in exchange for the tuition payments, in the form of the education provided for their children.” The court found that, by sending the children to school, the debtors “satisf[ied] their legal obligation [as parents] to educate their [minor] children, thereby receiving reasonably equivalent value and fair consideration.” The fact that cheaper modes of education (i.e., public school) may have been available was “irrelevant.” Therefore, the Schools’ motion to dismiss the adversary proceeding was granted.

In Geltzer v. Lawrence Woodmere Academy (In re Michel), the chapter 7 trustee brought an adversary proceeding against Lawrence Woodmere Academy (“Academy”) to avoid, as constructively fraudulent transfers, tuition payments that the debtor made prepetition to the Academy (a private school) on behalf of her minor children.63 The trustee alleged that the debtor made transfers in the form of tuition payments to the Academy totaling $69,240.00. The Academy then moved to dismiss.

The Bankruptcy Court, Elizabeth S. Stong, J., held that the debtor’s transfers to the Academy were supported by reasonably equivalent value and thus, not avoidable under a constructively fraudulent transfer theory. The court concluded that payments made by the

debtor to educate her minor children conferred reasonably equivalent value on the debtor because “parents have an obligation to provide for their children’s necessities, including their education and care, and it is not necessary for a family to meet that obligation, and all of its other pre-petition daily needs ... at the lowest possible cost, or no cost at all.” The court also noted such educational expenses “confer reasonably equivalent value on the parent because [the] parent and their minor children form a single economic unit . . . so that the value received in . . . education . . . of the minor child provides a tangible benefit to the parent.” The Academy’s motion to dismiss the trustee’s avoidance action was granted.

In McClarty v. University Liggett Sch. (In re Karolak),64 the chapter 7 trustee filed a complaint against University Liggett School (“Liggett”), a private school, to recover $16,960.00 of payments made for tuition by debtor for her three minor children. The debtor was an employee of Liggett, and as an employment benefit, she sent her minor children to Liggett for a reduced cost of attendance. Tuition payments were made by regular deduction from the debtor’s paycheck. Liggett moved for summary judgment.

The Bankruptcy Court, Phillip J. Shefferly, J., concluded that the debtor had received reasonably equivalent value in exchange for tuition payments made for her three minor children because the tuition payments to Liggett provided education for the debtor’s minor children and “enabled [the debtor] to fulfill her statutory duty” under Michigan state law.65 Even if tuition payment is viewed as an indirect benefit to the parent, the court “found the value to be sufficiently economic, concrete and quantifiable.” Thus, the court found Liggett to be entitled to summary judgment and dismissed the trustee’s complaint to

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recover $16,960.00 in payments made by a chapter 7 debtor to Liggett for tuition for her three children.

Some bankruptcy courts find an intermediate position in the discord among bankruptcy courts. In *Geltzer v. Oberlin College*, the chapter 7 trustee brought an adversary proceeding against Oberlin College (“Oberlin”), to avoid and recover tuition payments as constructively fraudulent transfers that debtors made on behalf of their daughters. Specifically, the trustee sought to recover $15,675.00 in payments made by the debtors for child A while she was of majority age, and $9,952.00 for child B ($2,276.00 in payments while child B was a minor and $7,676.00 while she was of majority age). The parties then cross-moved for summary judgment. The parties limited their cross motions to a request that the court rule whether the debtors received reasonably equivalent value for the transfers to Oberlin on behalf of their children, which presented two issues. First, did debtors receive reasonably equivalent value for payments made to Oberlin on behalf of their daughters? Second, is it relevant whether the daughters were younger or older than the age of majority (which is 21 in New York) when the transfers were made?

The Bankruptcy Court, Martin Glenn, J., granted the trustee’s motion for summary judgment in part and denied in part with respect to the transfer to child B while she was of minority age. Pursuant to 11 U.S.C. § 548(d)(2)(A) and N.Y. Debt. & Cred. Law § 272, the term “value” and “fair consideration” required either the transfer of property or the satisfaction of an antecedent debt in return for an insolvent debtors’ payments. Here, the debtors received neither with respect to transfers for the benefit of the daughters after they reached the age of majority. But the court found “reasonably equivalent value” and “fair consideration” for prepetition tuition payments made by debtors for child B to attend a
private liberal arts college when she was minor. Consequently, the court found $23,351.00 in transfers for the benefit of both of debtors' adult children, made while of majority age, avoidable as constructive fraudulent transfers but held that debtors' $2,276.00 in transfers for child B while she was of minority age were not avoidable as the debtors received reasonably equivalent value in exchange for those transfers.

E. Is the “mere conduit” defense available to avoid recovery of otherwise avoidable transfers?

In Mangan v. University of Connecticut (In re Hamadi), the chapter 7 trustee sought to recover, as constructively fraudulent transfers, payments made by the debtors to the University of Connecticut (“UConn”) for college tuition paid on behalf of their adult son. The debtors made four pre-petition payments to UConn that totaled $20,228.25. UConn then filed a motion for summary judgment to dismiss the chapter 7 trustee avoidance action.

The Bankruptcy Court, James J. Tancredi, J., granted UConn’s motion for summary judgment in part with respect to the refundable payments and postpetition payments, and denied in part with respect to the nonrefundable payments. As to the refundable payments, the court found that the University was a “mere conduit” and thus not an initial transferee from which trustee could recover alleged fraudulent transfers. The court reasoned that the debtors’ adult child was the initial transferee as to the refundable payments because “they were ultimately [the] property of [debtors’ adult child], and UConn did not immediately have the right to use the refundable payments for its own purpose.” UConn was merely acting as a financial institution or intermediary by maintaining the online portal, which is akin to a financial institution maintaining a bank account. When UConn “no longer had any obligation to refund the payment to [debtors’ adult child], [UConn] exercised complete dominion and control over the nonrefundable portion of the debtors’ payment.” Therefore,
the court found that, as to the nonrefundable payments, UConn was the initial transferee. Consequently, the court found that payment timing (and UConn’s refund obligations) distinguish UConn’s status as an initial transferee or immediate transferee of such initial transferee.

In *Pergament v. Hofstra Univ. (In re Adamo)*, a case converted from chapter 11 to chapter 7, the trustee sought to recover tuition payments made by the debtor to two undergraduate universities and a law school for the education of the debtor’s adult children as an avoidable transfer under 11 U.S.C §§ 544, 548(a)(1)(B) and 549, and N.Y. Debt. & Cred. Law § 273, 273-a, and 275. The parties’ cross-moved for summary judgment.

The Bankruptcy Court, Carla E. Craig, C.J., held that the two undergraduate universities and the law school that received tuition payment from the debtor to pay tuition costs for his children were entitled to summary judgment on the trustee’s claim that tuition payments were avoidable because they were “mere conduits” for the transfers. The court determined that the debtor’s children were the initial transferees because both universities and the law school placed payments they received from the debtor into account they established for his children, and all three schools were entitled to the good-faith for-value defense provided by 11 U.S.C. § 550(b).

In *Bonded Financial Services, Inc v. European American Bank*,66 the Seventh Circuit Court of Appeals held that a recipient of a transfer is not a transferee for purposes of § 550 of the Bankruptcy Code, unless it has dominion over the transferred funds. The bank was a subsequent transferee because it “acted as a financial intermediary” and “received no benefit” from the initial transfer.

66 838 F.2d 890 (7th Cir. 1988).
F. Are tuition pre-payments an interest of the debtor in property?

In Roumeliotis v. Johnson & Wales Univ. (In re DeMauro), the chapter 7 trustee brought an adversary proceeding against Johnson & Wales University (“University”), seeking to avoid and recover as constructive fraudulent transfer certain Federal Direct Parent PLUS loan proceeds disbursed to the University for the tuition of the debtors’ adult daughter, pursuant to 11 U.S.C. §§ 544(b)(1), 548 and 550(a), and the Connecticut Uniform Fraudulent Transfer Act (“UFTA”).

The Bankruptcy Court, Ann M. Nevins, J., granted summary judgment in favor of the University because the Parent PLUS loan proceeds do not constitute an interest of the debtors in property subject to avoidance under 11 U.S.C. §§ 544 and 548. Additionally, the federal Direct Parent PLUS loan proceeds paid prepetition by the U.S. Department of Education (“D.O.E.”) to the University for tuition of the debtors’ adult daughter, which were never possessed or held by the debtors prior to their bankruptcy, proceeds paid directly to the University and which debtors lacked any control over how the D.O.E. would disburse the proceeds, and which could not lawfully have been used to pay for any purpose other than financing the debtors’ adult daughters’ education, did not constitute property in which debtors had any interest, as required for trustee to recover loan proceeds on constructive fraudulent transfer theory.

Turning back to an aforementioned case, the court in Eisenberg v. Pennsylvania State Univ. also addressed whether Parent PLUS were an interest of the debtor in property. In Eisenberg, before the debtor filed a chapter 7 bankruptcy petition, the debtor had applied and was approved for several Parent Plus loans to pay for the educational expenses of his two

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68 See 20 U.S.C. § 1001 et seq.
children to attend Pennsylvania State University ("PSU"). Proceeds from the Parent Plus
loans were paid directly from the Department of Education ("D.O.E.") to PSU without
passing through the debtor or his children. The balance owed by the debtor on the Parent
PLUS loans totaled $142,990.45. The chapter 7 trustee then brought an adversary
proceeding to avoid, as constructively fraudulent transfers, the Parent PLUS loan proceeds
paid by the D.O.E. to PSU under the Bankruptcy Code and Pennsylvania's Uniform
Fraudulent Transfer Act. PSU then moved to dismiss the trustee's avoidance action.

The Bankruptcy Court, Richard E. Fehling, J., agreed with the College's argument
that Parent PLUS loans were not of an interest of the debtors in property and thus, the court
granted PSU's motion to dismiss complaints brought by the trustee alleging the tuition
payments were constructively fraudulent transfers. The court held that proceeds of Parent
PLUS loans the debtor obtained prepetition to pay for their children's college education,
which were paid by the D.O.E. directly to PSU, and which could not lawfully have been
used to pay the debtor's creditors or for any purpose other than financing their children's
education, did not constitute property in which debtor had any interest.

Another above-mentioned case questioned the debtor's interest in their child's
tuition-related funds, but this time, in the context of qualified tuition savings plans. In Roach
v. Skidmore College (In re Dunston), Skidmore argued that the particular funds it received
consisted of the funds withdrawn from the debtor's 529 Plans; and had the transfers not
occurred, the funds would have remained in the 529 Plans and would have been excluded
from the debtor's bankruptcy estate under § 541(b)(6) of the Bankruptcy Code. Pursuant to
26 U.S.C. § 529 and the express language of 11 U.S.C. § 541(b)(6), the court found the fact
that the debtor commingled the funds withdrawn from the 529 Plans with the funds in her
checking account was not determinative of whether the funds transferred to Skidmore would have been excluded from "property of the estate" under § 541(b)(6) had the transfers not occurred. Instead, whether the funds transferred to Skidmore would have been excluded from "property of the estate" depends on whether such funds can be adequately traced to the debtor's 529 Plans.\textsuperscript{69} The court determined that the trustee failed to show that no genuine issue of material fact existed regarding whether the funds transferred could be traced to debtor's 529 plans and thus were not transfers of interest of the debtor in property. The court was unable to sufficiently "trace" the funds withdrawn from the 529 Plans to the funds transferred to Skidmore.

\textbf{VII. TRIANGULAR PREFERENCES (TOUSA AND GM)}

The Eleventh Circuit in \textit{In re Tousa, Inc.}\textsuperscript{70} was faced with a serpentine transfer of liens by subsidiaries of a parent company to secure the payment of a debt owed to the parent. On appeal, the court was asked whether the bankruptcy court erred in finding that the subsidiaries did not receive reasonably equivalent value in exchange for the liens to secure loans used to pay a debt owed only by the subsidiaries' parent company.\textsuperscript{71}

The appeal stemmed from the Official Committee of Unsecured Creditors filing an adversary proceeding to avoid the obligations incurred by subsidiaries of Tousa, a homebuilder, stemming from a $421 million settlement from one of Tousa's joint venture partners. The funds used to pay this settlement were obtained by Tousa through two

\textsuperscript{69} Section 541(b)(6) excludes 529 Plan funds on a “sliding scale” based on the proximity in time of the contributions to the filing of the bankruptcy. Here, the debtor stopped making contributions on or before January 1, 2012. Thus, all of the funds in the debtor’s 529 Plans would have been excluded from “property of the estate” had they not been withdrawn.

\textsuperscript{70} 680 F.3d 1298 (11th Cir. 2012).

\textsuperscript{71} \textit{Id.} at 1301.
syndicated term loans: the first being secured by first-priority liens on the assets of Tousa’s subsidiaries, and the second secured by second-priority liens. The lenders required that the funds be used to pay the joint venture settlement. Six months after the settlement was paid, Tousa and the subsidiaries filed petitions for bankruptcy under chapter 11.

In the initial adversary proceeding and on appeal, the lenders argued that the conveying subsidiaries received reasonably equivalent value by attempting to thwart their parent company’s inevitable bankruptcy. Although declining to address whether a transaction intended to prevent bankruptcy constitutes reasonably equivalent value, the court found that the value received by the conveying subsidiaries was negligible compared to the costs of the transaction. The Eleventh Circuit avoided explicitly defining “value,” and merely held that, under the clearly erroneous standard, the bankruptcy court’s findings regarding value were supported by the record. Ultimately, the Eleventh Circuit found that the bankruptcy court did not clearly err in finding that the conveying subsidiaries did not receive reasonably equivalent value in exchange for the liens used to procure the settlement proceeds for their parent company.

Although the Eleventh Circuit avoided defining value in the context of consideration received by a parent company’s debtor subsidiary in Tousa, the court came closer to squarely addressed the term\textsuperscript{72} in PSN Liquidating Trust v. Intelsat International Systems, LLC (In re PSN

\textsuperscript{72} Other courts have also addressed the definition of value post-\textit{Tousa}. See, e.g., Janvey v. The Golf Channel, Inc., 780 F.3d 64 (5th Cir. 2015) (reversing district court, held that defendant’s “services furthering a debtor’s Ponzi scheme provided no value to the debtor’s creditors”); In re Positive Health Management, 769 F.3d 899, 904–05, 909 (5th Cir. 2014) (reversing lower courts, Fifth Circuit narrowed their holding that debtor had “received reasonably equivalent value in exchange for [its] cash transfers”; in effect, Fifth Circuit disregarded value of indirect economic benefits that had been provided to debtor by good faith lender, instead focusing on “the value that the transferee [defendant] gave up as its side of the bargain”).
USA, Inc.). 73 In PSN, the corporate parent—not the subsidiary—was the only party to a contract with the defendant for satellite services. 74 Pursuant to the debtor-subsidiary’s policy, it paid the defendant-satellite provider for its production expenses, including the contractual obligations of its nondebtor parent when the expenses related to production. 75 The liquidating trust sought to avoid the payments made to the satellite company, arguing that the debtor did not receive reasonable equivalent value in exchange for the payments. 76 On the defendant-satellite provider’s motion for summary judgment, the bankruptcy court concluded that the debtor derived an economic benefit from the transfers because it utilized the services that were the subject of the contract between the satellite provider and the debtor’s parent company. 77

On appeal, the Eleventh Circuit indicated that “[c]ourts generally use the term ‘value’ broadly for purposes of the Bankruptcy Code.” 78 The court chose to maintain its broad understanding of value, stating that “the test courts have applied to determine ‘reasonably equivalent value’ is whether the transfer ‘confers an economic benefit upon the debtor, either directly or indirectly,’ not whether the debtor received property rights by virtue of a transfer or whether the debtor was a party to the contract at issue.” 79 The court

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73 615 F. App’x 925 (11th Cir. 2015).
74 Id. at 926.
75 Id.
76 Id. at 925–26.
77 Id. at 926.
78 Id. at 930 (citing Templeton v. O’Cheskey (In re Am. Hous. Found.), 785 F.3d 143, 163 (5th Cir. 2015)); see also Pension Transfer Corp. v. Beneficiaries Under the Third Amendment to Fruehauf Trailer Corp. Ret. Plan No. 003 (In re Fruehauf Trailer Corp.), 444 F.3d 203, 212 (3d Cir. 2006) (“We have interpreted ‘value’ to include any benefit, . . . whether direct or indirect . . . . [T]he mere opportunity to receive an economic benefit in the future constitutes ‘value’ under the [Bankruptcy] Code.” (internal citation, quotation marks, and brackets omitted)).
79 Id. (citing In re Rodriguez, 895 F.2d 725, 727 (11th Cir. 1990)).
noted that the debtor used the services it paid the defendant-satellite provider for, notwithstanding the fact that it was not obligated under the contracts its parent company was a party to. In conclusion, the court addressed the liquidation trusts ancillary argument that, by making payments on the satellite contract when it wasn’t obligated to, it deepened the debtor’s insolvency and made its creditors worse off. The court stated that “the concept of reasonably equivalent value does not require a dollar-for-dollar transaction,” this concept only requires that the value received is “reasonably equivalent” in value to what was transferred. Solidifying its conclusion, the court stated that “the fact the [d]ebtor ultimately landed in bankruptcy does not preclude a finding that value was not given, even if the value increased the debtor’s insolvency.” Ultimately, the court held that an indirect benefit received by a debtor is reasonably equivalent consideration for payments it made on behalf of its nondebtor-parent company and affirmed the bankruptcy court’s grant of summary judgment in favor of the defendant-satellite provider.

VIII. USE OF EXPERTS ON ORDINARY COURSE AND SATISFACTION OF DAUBERT.

Even with the “ordinary course of business” defense being the most commonly-asserted affirmative defense to a preference adversary, it remains as one of the most difficult and costly to prove. In 2005, with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)§ 547(c)(2) was amended to lighten the load on creditors asserting the ordinary course exception by making the elements for the

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80 Id. at 931.
81 Id. at 932.
82 Id. (citing In re Northlake Foods, Inc., 715 F.3d 1251, 1257 (11th Cir. 2013).
83 Id.
84 Id. at 933.
ordinary course of business defense in the disjunctive. This allows the defendant to prove either that the transfer was either made in the ordinary course of financial affairs of the debtor and the transferee (the subjective element) or that the transfer was made according to ordinary business terms (the objective element).

A. The Subjective Test

While the subjective element may seem easier and less costly to prove, a defendant seeking to prove this element must still establish an ordinary pattern of transfers for an adequate historical period. Courts often look at the following factors when applying the subjective test: (i) the timing of the transaction; (ii) the length of time the parties engaged in the type of dealing at issue; (iii) whether the payments were tendered in a manner different from previous payments or whether the amount paid is higher than the amount usually paid; (iv) whether there is any unusual collection activity; and (v) whether the creditor did anything to gain an advantage in light of the debtor's deteriorating financial condition.

The timing of the transactions or payments between the parties is typically a central consideration for courts applying the subjective test. While late payments are presumptively unordinary, preference defendants can rebut this presumption by showing that late payments are consistent with the standard course of dealing between the parties.

Additionally, most courts agree that first-time transactions are not excepted from using the ordinary course of business defense.90

Responding to a motion for summary judgment brought by a preference defendant, in Stanziale v. Superior Technical Resources, Inc. (In re Powerwave Technologies, Inc.) the Bankruptcy Court for the District of Delaware gave a cogent analysis on the ordinary course defense.91 The court focused its review on the subjective element of the defense, noting that “whether a given transaction was within the subjective ordinary course of business that had developed between the parties is a broad, fact-based inquiry requiring historic examination of the parties’ pre-preference period relations.”92 The court stated that the historical period for establishing the subjective ordinary course should be inclusive of the period when the debtor was still financially sound.93 The court ultimately denied summary judgment due to the still-existent factual dispute over the relevant period for the ordinary course between the two parties.

B. The Objective Test

The objective test compares the nature of each transfer with the industry norms for the parties’ respective industries. The objective element is often more a more costly, fact-

90 See, e.g., First Citizens Bank and Trust Company v. Wilson, 711 F. App’x 374, 375 (9th Cir. 2017) (“[W]e have … recognized that even a first-time transaction may be in the ordinary course: Obviously every borrower who does something in the ordinary course of her affairs must, at some point, have done it for the first time.” (internal quotation and citation omitted)); In re C.W. Min. Co., 798 F.3d 983 (10th Cir. 2015) (stating that a first-time transaction can qualify for ordinary course of business exception); Kleven v. Household Bank F.S.B., 334 F.3d 638 (7th Cir. 2003) (stating that most courts agree that a first time transaction is not per se ineligible for protection from avoidance under § 547(c)(2)).
92 Id. at *4 (quoting Moltech Power Sys., Inc. v. Tooh Dineh Indus., Inc. (In re Moltech Power Sys., Inc.), 327 B.R. 675, 680 (Bankr. N.D. Fla. 2005)).
93 Id.
intensive element to prove.\textsuperscript{94} Although expert testimony is not required to successfully establish the objective element, the objective test can often turn into a “battle” of the experts. A preference defendant seeking to establish the objective element of the ordinary course of business defense must: (i) define the appropriate industry; (ii) demonstrate the norms for that industry; and (iii) show that the preferential payment is consistent with the norms in that industry.\textsuperscript{95}

To define the appropriate industry, courts often look to the debtor’s industry, the creditor’s industry, and general business standards.\textsuperscript{96} Defining the norms for a particular industry is generally best-accomplished by expert testimony. However, this can prove to be quite costly. Therefore, employees with first-hand knowledge of industry norms\textsuperscript{97} or

\textsuperscript{94} See Stanziale v. S. Steel & Supply, LLC (In re Conex Holdings, LLC), 518 B.R. 269, 285–87 (Bankr. D. Del. 2014) (explaining that, although expert testimony is not mandatory, there should be sufficient statistical data or supporting basis for the evidence related to the objective standard).


\textsuperscript{96} See Hutson v. Branch Banking & Trust Co. (In re National Gas Distribs., LLC), 346 B.R. 394, 404 (Bankr. E.D.N.C. 2006) (stating that, under BAPCPA, analyzing the ordinary business terms of two parties requires examination of both the debtor’s and creditor’s industry standards along with “general business standards”); \textit{but see} Simon v. Gerdau MacSteel (In re Am. Camshaft Specialties, Inc.), 444 B.R. 347, 364 (Bankr. E.D. Mich. 2011) (citing the Sixth Circuit standard that the transactions at issue must only resemble a majority of an industry’s transactions, rather than a significant percentage, the court found that the transfers were made in accordance with ordinary business terms); Pereira v. United Parcel Service of Am., Inc. (In re Waterford Wedgwood USA, Inc.), 508 B.R. 821, 831 (Bankr. S.D.N.Y. 2014) (citing the Second Circuit standard that a creditor only needs to prove that the business terms of the transaction in question were “within the outer limits of normal industry practices”)

\textsuperscript{97} See, e.g., Rice v. Hydro Temp Corp. (In re GS Inc.), 352 B.R. 858, 866 (Bankr. E.D. Ark. 2006) (the testimony of the president of a company that had been in the relevant industry for 30 years was acceptable to prove the industry standard).
evidence of a competitors’ practices\textsuperscript{98} may be used to support an ordinary course of business defense when the rules of evidence are satisfied.\textsuperscript{99}

\textsuperscript{98} See, e.g., Maxwell v. IDC (In re marchFirst, Inc.), 381 B.R. 689, 697 (Bankr. N.D. Ill. 2008).

\textsuperscript{99} Federal Rule of Evidence 701 states that “if the witness is not testifying as an expert, the witness’ testimony in the form of opinions or inferences is limited to those opinions or inferences which are (a) rationally based on the perception of the witness, and (b) helpful to a clear understanding of the witness’s testimony or the determination of a fact in issue, and (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702.”
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Chapter 13 Trustee (E.D. Ky.); Lexington

Neil C. Gordon
Arnall Golden Gregory LLP; Atlanta

Ronald R. Peterson
Jenner & Block LLP; Chicago
Direct-Pay Mortgages and the Chapter 13 Discharge

Prepared by Beverly M. Burden, Chapter 13 Trustee (Lexington, KY)

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Section 1322(b)(5): A chapter 13 plan may “provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.”

Maintenance of payments on the debtor’s principal residential mortgage: In some jurisdictions, a debtor’s ongoing contractual mortgage payments are made through the trustee’s office (“conduit payments”). In other jurisdictions, debtors are permitted to make contractual payments directly to the creditor (“direct pay” or “outside the plan”).

Relevant parts of section 1328(a): “As soon as practicable after completion by the debtor of all payments under the plan . . . the court shall grant the debtor a discharge of all debts provided for by the plan . . . except any debt - (1) provided for under section 1322(b)(5).”

Two Issues:

- Is a debtor’s direct payment of a mortgage a “payment under the plan” that must be completed in order for the debtor to get a discharge at all?

- Is a direct-pay mortgage a debt that is “provided for by the plan” and thus subject to discharge (absent other exceptions)?

Discharge Upon Completion of All Payments Under the Plan

Majority rule: If the debtor is not current on direct-pay mortgage payments at the end of the case, the debtor has not completed “all payments under the plan” and thus is not entitled to receive a discharge of any debts, even though the debtor may have made all required plan payments to the trustee. Payments on direct-pay mortgages are considered “payments under the plan.”

Seminal case: In re Heinzle, 511 B.R. 69 (Bankr. W.D. Tex. 2014) (Gargotta, J.), followed by:

   In re Kessler, 655 Fed. Appx. 242 (5th Cir. 2016), aff’g 2015 WL 4726794 (Bankr. N.D. Tex. 2015) (Jones, J);
In re Mrdutt, 600 B.R. 72 (9th Cir. BAP 2019) (Brand, J.), rev’g on other grounds In re Mrdutt, No. 11-61029 (Bankr. N.D. Cal., Aug. 16, 2017) (Blumenstiel, J);

Evans v. Stackhouse, 564 B.R. 513 (E.D. Va. 2017), aff’g In re Evans, 543 B.R. 213 (Bankr. E.D. Va. 2015) (St. John, J);

In re Finney, 2018 WL 4172599 (Bankr. S.D. Ill. 2018) (Grandy, J);

In re Dowey, 580 B.R. 168 (Bankr. D. S.C. 2017) (Waites, J);

In re Thornton, 572 B.R. 738 (Bankr. W.D. Mo. 2017) (Federman, J);

In re Gonzales, 570 B.R. 788 (Bankr. S.D. Tex. 2017) (Rodriguez, J);

In re Coughlin, 568 B.R. 461 (Bankr. E.D.N.Y. 2017 (Trust, J);

In re Young, 2017 WL 4174363 (Bankr. M.D. La. 2017) (Dodd, J);

In re Hoyt-Kieckhaben, 546 B.R. 868 (Bankr. D. Colo. 2016) (Brown, J);

In re Abila, 2016 WL 5389266 (Bankr. D. Colo. 2016 (Tallman, J);

In re Tumblson, 2016 WL 889772 (Bankr. E.D. Okla. 2016) (Veith, J);

In re Ramos, 540 B.R. 580 (Bankr. N.D. Tex. 2015) (Jernigan, J);

In re Formaneck, 534 B.R. 29 (Bankr. D. Colo. 2015) (Romero, J);

In re Gonzales, 532 B.R. 828 (Bankr. D. Colo. 2015) (Tallman, J);

In re Doggett, 2015 WL 4099806 (Bankr. D. Colo. 2015) (Tallman, J);

**Minority Rule:** “Payments under the plan” means payments to the trustee; debtor who is delinquent in postpetition direct-pay mortgage payments may still receive a discharge of all other debts; the mortgage debt itself is not discharged under § 1328(a)(1).

In re Gibson, 582 B.R. 15 (Bankr. C.D. Ill. 2018) (Perkins, J);

In re Rivera, 599 B.R. 335 (Bankr. D. Ariz. 2019) (Wanslee, J) (disagreed with by In re Mrdutt, 600 B.R. 72 (9th Cir. BAP 2019)).

**The Role of Rule 3002.1 - Notice of Final Cure and Creditor’s Response:** Bankruptcy Rule 3002.1 “applies in a chapter 13 case to claims that are (1) secured by a security interest in the debtor’s principal residence, and (2) for which the plan provides that either the trustee or the debtor will make contractual installment payments.” Fed. R. Bankr. P. 3002.1(a).
Rule 3002.1(f) requires the trustee, “within 30 days after the debtor completes all payments under the plan,” to file a Notice of Final Cure Payment stating that the debtor has paid in full the amount required to cure the default.

Rule 3002.1(g) requires the creditor to file a response to the Notice of Final Cure, stating (1) whether the creditor agrees that the debtor has cured defaults, and (2) “whether the debtor is otherwise current on all payments consistent with § 1322(b)(5) of the Code.” The creditor must itemize the amounts the creditor contends remain unpaid.

The rule, which was intended to protect and assist debtors, is now used as a sword against debtors. The creditor’s response provides evidence that the debtor has not made postpetition mortgage payments as required, which triggers the trustee’s or the court’s action to deny the debtor a discharge for failure to complete all payments under the plan.

**Debtor’s Failure to Make Postpetition Mortgage Payments:** There is a legitimate argument that a debtor who has not complied with all obligations under a confirmed plan should not receive a discharge.

However, using section 1328(a) as a basis for denying a discharge for failure to complete all payments under the plan creates a *per se* rule: if the debtor is delinquent on a direct-pay claim by any amount (regardless of materiality), s/he may not receive a discharge of any debts. That result is amplified in jurisdictions that will not permit the debtor to cure a small delinquency or modify the plan after month 60, even if the plan modification is to surrender the property.

Moreover, if mortgage direct-pay claims are “payments under the plan,” what about direct-pay student loans? Or direct-pay car payments on 6-, 7-, and 8-year car loans? Should trustees and the court determine whether the debtor has made those payments before granting a discharge?

The opinions in *Gibson*, *Rivera*, and *Mrdutt* are particularly thought-provoking. In addition, the Final Report of the ABI Commission on Consumer Bankruptcy provides insight and solutions ([https://consumercommission.abi.org/commission-report](https://consumercommission.abi.org/commission-report)).

**Recommendations of the ABI Consumer Commission:** The ABI Commission on Consumer Bankruptcy has made three recommendations that have a bearing on this issue:

- Require conduit payments for mortgages.
- Amend Rule 3002.1 to provide for a mid-case status review and to ensure compliance with the rule.
- Don’t automatically dismiss case at month 60.

Relevant excerpts of the report are attached.
**Discharge of Debts Provided For By the Plan**

If the debtor completes all payments under the plan and otherwise is entitled to a discharge, are long-term mortgage debts discharged?

Any debt “provided for by the plan” is discharged, except that “any debt provided for under section 1322(b)(5)” is not discharged. 11 U.S.C. §§ 1328(a)(1) and (c)(1).

Is a direct-pay mortgage debt provided for by the plan? No, according to the Eleventh Circuit Court of Appeals in the case of *In re Dukes (Dukes v. Suncoast Credit Union)*, 909 F.3d 1306 (2018).

**In re Dukes:** In *Dukes*, the confirmed plan and subsequent court orders provided that the first and second mortgage claims of Suncoast Credit Union would be “paid directly to the creditor” “rather than through the Chapter 13 Trustee.” The debtor was current in mortgage payments at the time of the petition, so there were no arrearage claims to be cured through the plan.

At some point during case, the debtor stopped making mortgage payments. Nevertheless, the debtor received a discharge under section 1328(a) when she completed plan payments to the trustee.

After discharge, the credit union foreclosed on the debtor’s house under the second mortgage and sought a personal judgment against the debtor for the unpaid balance on the first mortgage. The bankruptcy court held that the credit union’s debt was not discharged because: (1) the debt was not “provided for” by the plan; (2) the antimodification provision of 11 U.S.C. § 1322(b)(2) prohibited the discharge from modifying the creditor’s right to a deficiency claim; and (3) the debt was a long-term debt provided for under section 1322(b)(5) and thus was not discharged pursuant to 11 U.S.C. § 1328(a)(1).

The Eleventh Circuit held that the direct-pay mortgage was not “provided for” by the plan, stating:

> [B]y doing nothing more than mentioning that the Credit Union’s mortgage would be paid outside the plan, the plan did not “provide for” the mortgage. . . . [T]he plan did not set a repayment schedule for the mortgage and did not establish any repayment terms. The plan simply stated that Debtor would make any payments directly to the Credit Union. . . . By neither stipulating to nor making provisions for the Credit Union’s mortgage, the plan did not “provide for” it, and the mortgage was not included in the discharge under § 1328(a).

*Dukes*, 909 F.3d at 1315. The court went on to say that even if the plan “provided for” the credit union’s mortgage, the debt was still not discharged because to do so would violate the
antimodification clause of section 1322(b)(2) (the debtor may not modify a claim that is secured only by a security interest in real property that is the debtor’s principal residence). The court found that:

Removal of the Credit Union’s right to pursue in personam liability against Debtor, however, would necessarily modify the Credit Union’s rights because it strips the Credit Union of a right provided by the original loan instruments.

*Dukes*, 909 F.3d at 1321.

**Section 1322(b)(5):** The Eleventh Circuit did not address the question of whether the credit union’s mortgage was excepted from discharge under section 1328(a)(1) as a debt provided for under section 1322(b)(5). That leaves a more fundamental question unanswered: If a debtor is current on mortgage payments at the time of the petition and has no defaults to cure, is the debt provided for under section 1322(b)(5)? *Compare In re Rogers,* 494 B.R. 664 (Bankr. E.D.N.C. 2013) (Leonard, J.) (section 1322(b)(5) is not implicated if there are no defaults to be cured; statute says cure AND maintain, and both elements must exist for section 1322(b)(5) to apply; therefore, the mortgage debt is discharged) *with In re Hunt,* 2015 WL 128048 (Bankr. E.D. N.C. 2015) (Warren, J.) (the cure and maintain language of section 1322(b)(5) means cure defaults, if applicable, and maintain payments; any long-term debt can be provided for under 1322(b)(5) regardless of whether there is a prepetition default or not; therefore, the mortgage debt is not discharged under 1328(a)(1)).

“Completion of All Payments Under the Plan” Revisited: The *Dukes* holding seems to negate the *Heinzle* issue discussed previously. Under *Dukes*, if the direct-pay mortgage is not provided for by the plan, the debtor’s mortgage payments cannot be considered “payments under the plan.” Therefore, applying the *Dukes* analysis, a debtor who is delinquent in direct-pay mortgage payments is entitled to receive a discharge of all other debts upon completion of payments to the trustee under the plan. The mortgage debt, however, is not discharged.
Loan Modifications and Payment Change Notices (PCNs). The plan-modification process will provide detailed information about any mortgage payment change produced by the loan-modification process. As recommended above, a new official bankruptcy form should include specific information about how the loan modification changed the original mortgage payment. If the Commission’s recommendation is adopted, approval of the mortgage modification in the judicial order should substitute for any PCN that Federal Rule of Bankruptcy Procedure 3002.1 otherwise would require.

Transparency in the Loan-Modification Process. Throughout the Commission’s recommendations on loan modifications is the theme of transparency to all parties in the bankruptcy process. Indeed, the Commission’s recommendation to use the plan-modification process rests largely on providing notice and the ability to be heard to all parties. Participation not only allows all parties in the bankruptcy to protect their own interests but also to help resolve problems that have arisen in the loan-modification process. The rules process that the Commission recommends should consider how to promote transparency in loan modifications through existing online portals and who can access them. The rules process also should consider changes to which documents should be made available through the case management/electronic case filing (CM/ECF) system or through other processes.

§ 4.06 Conduit Mortgage Payments

(a) The Commission supports conduit payment of mortgage claims. The Commission takes no position on whether conduit payment is beneficial for nonmortgage claims.

(b) Congress should amend the Bankruptcy Code to clarify that conduit payment of mortgage claims is required unless there are compelling reasons for the debtor to make direct payments to the mortgage holder. Examples of compelling reasons include:

(1) The commission a trustee would charge on conduit mortgage payments would cause an unreasonable burden on debtors in that district.

(2) In a particular case, the debtor would not be able to make plan payments because of the trustee commission.

(3) A nonfiling co-debtor is making the payment.

(c) The USTP and bankruptcy administrators should facilitate the adoption and use of conduit payment of mortgage claims, including allowing bifurcated commission rates.

(d) Congress should adopt a clarifying amendment to 28 U.S.C. § 586(e) to allow bifurcated commission rates on mortgage payments and other payments in the plan.

Background. Section 1326(c) requires that the chapter 13 trustee serve as the disbursement agent, making payments to creditors under the plan unless the plan or confirmation order provides otherwise. Courts have long understood the statutory language as giving the court discretion whether to allow a
debtor to propose a plan where the debtor makes certain payments directly to creditors.79 Such a plan is known as a “direct payment plan” and most often arises in the context of payments to mortgage holders. In contrast, a “conduit plan” is a chapter 13 plan where the debtor’s mortgage obligation is part of the debtor’s monthly chapter 13 plan payment, and the trustee passes through to the mortgage holder that portion of the chapter 13 payment that represents the amount the debtor owes on the mortgage.

A little less than half of chapter 13 trustees appear to be primarily administering plans providing for conduit mortgage payments. In the 2017 government fiscal year, 45.7% of chapter 13 trustees reported making ongoing mortgage payments that were 10% or more of their total disbursements.80 In many jurisdictions, the use of conduit payments is simply implemented through the practices of the local chapter 13 trustee, subject to the customary judicial oversight. In some places, local rules enforce the statutory presumption, requiring conduit mortgage payments unless the court orders otherwise.81 Other districts require a conduit payment only when a prepetition arrearage exists,82 although arrearages obviously are common in bankruptcy cases. It is also possible that a local plan form might require a debtor to disclose ongoing direct payments outside the plan’s distribution, effectively allowing the chapter 13 trustee to assess whether to demand conduit payments as a condition for not objecting to the plan.83

Three published studies have examined whether conduit payments contribute to the successful completion of a case, and none have found a relationship. Norbert and Schreiber looked at chapter 13 cases closed from 1994-2000 in six judicial districts. The discharge/completion rate (33.3%) was identical for conduit and direct-payment plans.84 Examining the 1999 annual reports to the USTP, Bermant and Flynn reported that the data did not “support the conclusion that moving the ongoing mortgage payments through the trustee operation increases the rate of successful terminations” of chapter 13 cases.85 Greene, Patel, and Porter ran a regression analysis on a national random sample of 770 chapter 13 cases filed in 2007. In a regression model that accounted for the length of the plan, the number of prior bankruptcies, pro se status, a court order requiring the debtor’s wages be paid directly to the trustee (known as a “wage order”), and whether there were conduit payments, only the number

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79 See, e.g., In re Aberegg, 961 F.3d 1307, 1309 (7th Cir. 1992); Foster v. Heitkamp (In re Foster), 670 F.2d 478, 486-88 (5th Cir. 1982); see also Wagner v. Armstrong (In re Wagner), 36 F.3d 723, 726-28 (8th Cir. 1994) (reaching the same conclusion for chapter 12 plans based on identical statutory language); In re Sanford, 380 B.R. 873 (Bankr. E.D. Tex. 2008); In re Vigil, 344 B.R. 624 (Bankr. D.N.M. 2006); In re Tartaglia, 61 B.R. 439, 442 (Bankr. D. R.I. 1986); see also Gordon Bermant & Jean Braucher, Making Post-petition Mortgage Payments Inside Chapter 13 Plans: Facts, Law & Policy, 80 Am. Bankr. L.J. 261, 263 (2006) (noting the statutory language “has been read to give bankruptcy courts discretion to permit or not permit direct payments by debtors”).

80 The figure in the text is based on a calculation from the U.S. Department of Justice, United States Trustee Program, FY-2017 Chapter 13 Trustee Audited Annual Reports, available at https://www.justice.gov/ust/private-trustee-data-statistics/chapter-13-trustee-data-and-statistics (last visited Nov. 20, 2018). The spreadsheet available at this webpage identifies mortgage payments being 10% of total disbursements as the cutoff to identify trustees who regularly make mortgage payments through the plan.

Using 2005 data, a paper concluded that 47% of trustees used conduit payments “almost exclusively.” Bermant & Braucher, supra note 79, at 696. This figure is very similar to the current data. The use of conduit plans thus appears to be fairly consistent through time.


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of prior bankruptcies had a relationship with plan completion, and a negative one at that. Conduit payments did not affect plan-completion rates for better or worse.86

The Commission has based its recommendations for conduit mortgage payments on reasons other than improving plan-completion rates. Conduit payments allow chapter 13 trustees to have accurate recordkeeping regarding the postpetition payments for what is almost certainly the debtor’s largest obligation. The chapter 13 trustee’s records are likely to be more accurate than the debtor’s records or recall without records. The oversight from a chapter 13 trustee means fewer motions for relief from stay and greater scrutiny of postpetition fees, costs, and charges assessed by mortgage servicers.

Those benefits can come with a price. In a conduit plan, debtors must pay the trustee’s statutory percentage fee on the monthly mortgage payment. Most trustees who administer conduit plans can reduce their percentage fees due to the increase in receipts realized from the mortgage payments.87 Examining 2005 data from the USTP, Bermant and Braucher found that trustees making conduit payments “charge a lower percentage fee and less in dollars per case” than nonconduit trustees.88 But these effects are effects that will occur on average. In an individual case or a district with few cases, conduit plans could increase costs.

Recommendation. Considering all of the evidence as well as the professional experience of the commissioners with conduit plans, the Commission supports the use of conduit payment in the context of mortgages only. The Commission does not take a position on whether conduit payment is desirable for other types of secured debt. In the Commission discussion about conduit payments, commissioners observed that further evidence about its effectiveness and cost would be welcome, especially in the context of nonmortgage conduit payments. The Commission encourages academic researchers to study these issues.

Although the Commission endorses conduit plans in the mortgage context, it is aware that the circumstances in which conduit payments are used vary considerably across the country. The Commission believes Congress should amend the Bankruptcy Code to create a uniform rule that requires conduit payment of consumer mortgages but allows a court to permit a direct payment if compelling circumstances existed. A compelling circumstance would include a case where payment of the chapter 13 trustee percentage fee would mean the debtor would not be able to complete the plan. Congress also should except judicial districts with few cases where the increase in trustee receipts would not substantially lower the percentage fee such that conduit payments would work a hardship on all

87 Chapter 13 trustee compensation is sometimes misunderstood. “Unlike chapter 7 trustees, chapter 13 trustees do not ‘eat what they kill.” Henry E. Hildebrand, III, Behind the Curtain: The Chapter 13 Percentage Fee, Am. Bankr. Inst. J., Dec. 2014, at 24, 24. Instead, chapter 13 trustees are paid a fixed compensation that comes out of the percentage fee. See 28 U.S.C. § 586(e). The percentage fee also covers the chapter 13 trustee’s office expenses. The percentage fee is set in an amount in each judicial district to cover the chapter 13 trustee’s salary and office expenses. See id.; Hildebrand, supra, at 24. As receipts on which the fee is charged go up — perhaps because the trustee is running conduit plans — the percentage fee will go down.
88 Bermant & Braucher, supra note 79, at 277.
debtors in the district. Cases where a codebtor pays the mortgage also should be excepted from the requirement of a conduit plan.

Also, a two-tiered fee structure, with a lower percentage fee charged against conduit payments, would lower the costs of those payments. The Commission understands that currently no trustees have different commission rates on conduit mortgage payments versus regular plan payments. The USTP has only allowed “bifurcated commissions” to the extent that a chapter 13 trustee takes a 0% fee on ongoing mortgage payments or child support payments. The USTP has not taken a legal position on whether the current statutes authorize a bifurcated fee structure. The Commission believes the USTP has the authority under the existing statute99 to authorize a two-tiered fee structure but also that Congress should pass a clarifying amendment expressly authorizing it.

Missed Direct Payments and the Chapter 13 Discharge. Section 1328 provides that the court is to order a discharge upon (among other things) “completion of all payments under the plan.” Courts have grappled with whether direct payments occur “under the plan” such that a chapter 13 debtor who has missed direct payments can still receive a discharge. The seminal case is In re Heinzle,90 which held that direct payments are “under the plan” for purposes of section 1328(a) and denied discharge. Most other courts have agreed.91

The contrary position is cogently articulated by In re Gibson.92 The Gibson court points out that Federal Rule of Bankruptcy Procedure 3002.1 now requires the mortgage holder, in response to the trustee’s notice of final cure, to state whether the debtor is current on postpetition mortgage payments. Before the adoption of rule 3002.1, the chapter 13 trustee would not have known that the debtor had missed direct postpetition mortgage payments, and courts routinely ordered a discharge when trustee payments were completed. There had been no long-standing interpretation of direct payments as payments “under the plan,” so a payment by the debtor could be understood not to occur “under the plan.” At least one commentator has agreed.93

The Commission debated whether to express an opinion on this interpretive debate. The Commission decided the better approach was a more comprehensive solution that would move most debtor payments to conduit plans. When debtors use conduit plans, there will not be a surprise at the end of the case with missed direct payments to a mortgage creditor. Any missed payments will be dealt with during the case. The Commission’s recommendations for improvements to Federal Rule of Bankruptcy Procedure

89 See 28 U.S.C. § 586(e). The Commission’s recommendation applies to bankruptcy administrator districts as well.
302.1 also will minimize the possibility of uncertainty on whether the debtor is current on a mortgage. Together, these proposed solutions will help to minimize the possibility that legal issues will arise in the first place and thus will lower costs.

§ 4.07 No Automatic Dismissal When Chapter 13 Plan Payments Are Not Completed Within Sixty Months

If a debtor is making monthly chapter 13 plan payments routinely and the remaining balance to be paid under the plan is nominal or an amount that could be paid by the debtor within a reasonable period of time, a bankruptcy court should not dismiss a chapter 13 case because the debtor has not completed making plan payments within sixty months.

Background. It is a commonplace shorthand to state that a chapter 13 plan can last for no more than sixty months or five years. This shorthand reflects the rule of some courts that sixty months is the absolute maximum time that a chapter 13 plan can last. At the end of sixty months, these courts have found that they must dismiss the case if the debtor has not completed the chapter 13 plan payments.

Congress intended the sixty-month cap as a protection against unfairness to the debtor. Because chapter 13 requires that a debtor devote his or her disposable income to repayment under the plan, a reasonable time limit on plan length balances the policy goals of maximizing creditor repayment with the debtor’s fresh start. But a strict application of the sixty-month rule does not balance these goals. When a debtor has missed a few plan payments and could complete payments soon after the deadline, dismissal and denial of discharge only deprives a debtor of a fresh start without any material improvement in creditor repayment.

Recommendation. Although describing chapter 13 plans as having a sixty-month cap is generally correct, this description does not track the precise statutory law. Section 1322 provides what may be in a chapter 13 plan and is the origin of the idea that plans cannot last for more than sixty months. Subsection (d) states that “the plan may not provide for payments over a period that is longer than 5 years.” The same provision provides the general rule for a debtor below the state-median income, specifying that the plan cannot last longer than three years unless the court, for cause, approves a longer period capped at five years. But, section 1322 delineates only
what can be in a chapter 13 plan that a bankruptcy court may confirm. Nowhere does section 1322 provide the consequences for the failure to follow the terms of a plan or the circumstances under which the court can dismiss a chapter 13 case.

Rather, the dismissal rules are in section 1307.99 None of these rules expressly state that a court can dismiss a case for failure to finish the plan within sixty months. Instead, section 1307(c)(6) provides that the court “may dismiss” a chapter 13 case “for cause, including . . . material default by the debtor with respect to a term of a confirmed plan.” Failing to make plan payments would be a default under the plan. Thus, it is true that a court has the power to dismiss a chapter 13 case where the debtor’s missed payments cause the plan to stretch beyond 60 months.

Packed within that power, however, is a substantial amount of court discretion. First, to constitute grounds supporting dismissal a default must be material. Not all defaults are material.100 More significantly, section 1307(c) provides that a court “may” dismiss a case even if it finds cause. The word “may” suggests courts should exercise discretion in dismissing a case, even if the court finds that one of the factors in section 1307(c) is present. The Supreme Court has cautioned that a statute’s use of the word “may” is not alone conclusive of discretion but must be read in the context of the statute as a whole.101 That test is easily met in the context of the Bankruptcy Code. The dismissal provisions for chapters 7, 9, and 12 all use the word “may” in describing the court’s power to dismiss a bankruptcy case.102 In contrast, section 1112 uses the mandatory “shall” to specify when a court must dismiss a case versus circumstances when a court “may” dismiss a case.103 In the context of its dismissal provisions, the Bankruptcy Code draws a distinction between “may” and “shall,” with the former being a permissive power.

Some courts find significance in section 1329(c), which expressly prohibits modification of a chapter 13 plan that extends payments beyond sixty months, reasoning that section 1307(c) cannot grant discretion to do what section 1329(c) expressly prohibits.104 But, the two sections can live comfortably together. Sections 1322 and 1329 prohibit a debtor from proposing an initial plan or a subsequent modification that lasts more than sixty months, but neither section addresses what happens when later circumstances prevent the debtor from following through on the debtor’s intentions, which is the function of section 1307.

99 Section 1307 also applies to the conversion of chapter 13 cases to other chapters of the Bankruptcy Code. For ease of exposition, the text only refers to dismissal of chapter 13 cases. The analysis would be the same if the question was whether the case should be converted.

100 See Shovlin v. Klaas, 539 B.R. 465 (W.D. Pa. 2015) (allowing cure beyond 60 months for default that was less than one-half of a monthly payment under the plan); In re White, 126 B.R. 542 (Bankr. N.D. Ill. 1991) (default that arises from beyond the debtor’s control is not “material”); In re Durben, 70 B.R. 14 (Bankr. S.D. Ohio 1986) (finding two missed payments that occurred because of repairs to debtor’s commercial truck that the debtor was prepared to cure were not a “material” default).


102 See 11 U.S.C. §§ 707(a)-(b), 921(c), 1208(c).

103 Compare id. § 1112(b)(1) (court “shall” dismiss a case unless the court determines the appointment of a trustee or examiner is in the best interest of creditors) with § 1112(e) (court “may” dismiss if the debtor does not file the information required by section 521).

104 E.g., In re Humes, 579 B.R. 557, 564 (Bankr. D. Colo. 2018) (“[Section] 1329 reinforces the five-year limitation by forbidding a debtor from doing through modification what it could not do at plan confirmation.”).
The Commission believes the best interpretation of section 1307 is that failure to complete plan payments within sixty months is not automatically grounds for dismissal, as several courts have held.\textsuperscript{105} Courts should not dismiss a chapter 13 case where missed payments are nominal or in an amount the debtor could pay within a reasonable time.

At the same time, the original reasons for the sixty-month rule remain important. Chapter 13 plans should not last indefinitely. The Commission debated and rejected the idea of fixing a set maximum amount of time for the debtor to cure missed payments and complete the plan. A reasonableness standard is most consistent with the judicial discretion Congress has embedded in section 1307. Also, it was impossible to set a fixed time that would account for the varied circumstances in all cases. Finally, there would be the danger that any fixed period would become a new de facto rule for how long chapter 13 plans could last.

The Commission discussed the amount of time a debtor typically would need to cure and believes it would be rare that a reasonable time would exceed six months. Of course, in many cases a reasonable amount of time might be less than six months. In considering what is a reasonable amount of time, the case law suggests that courts should consider the reasons for the default, whether those reasons will persist, and whether the debtor is or soon will be able to cure the default.

The Commission's recommendation reflects what it believes is the best interpretation of the existing statutory language. As such, the Commission does not believe congressional action is necessary to implement this recommendation, but the Commission would support clarifying amendments to section 1307 consistent with the recommendation.

\textsuperscript{105} See \textit{In re} Klaas, 858 F.3d 820 (3d Cir. 2017); \textit{Marshall v. Henry (In re Henry)}, 368 B.R. 696 (N.D. Ill. 2007); \textit{In re Hill}, 374 B.R. 745 (Bankr. S.D. Cal. 2007); \textit{In re Brown}, 296 B.R. 20 (Bankr. N.D. Cal. 2003); \textit{In re Black}, 78 B.R. 840 (Bankr. S.D. Ohio 1987); see also \textit{In re Grant}, 428 B.R. 504 (Bankr. N.D. Ill. 2010) (refusing to allow 12- to 18-month extension beyond 60-month rule but suggesting dismissal was discretionary).
case is converted to chapter 11 or chapter 12 but not if the case is converted to a chapter 7. Congress added this section in 2005 to overrule “a line of cases holding that plan confirmation constitutes an implied valuation that applies in the Chapter 7 case upon conversion.”\(^\text{108}\) Section 348(f)(1)(B) allows the chapter 7 trustee to “be heard on the accuracy of the values scheduled in Chapter 13.”\(^\text{109}\) As provided in section 348(f)(1)(B), a chapter 7 trustee who believes there is substantial equity in property is not bound by any valuations that might have been made in the chapter 13 case prior to conversion. Under the Commission’s recommendation, if the debtor disputes the chapter 7 trustee’s valuation of the property, the court will make a new valuation of the property for the chapter 7 but decide the question of fact regarding valuation as of the petition date.

Finally, the Commission discussed cases in which a mortgage on the debtor’s principal residence includes other collateral. This situation occurs if the debtor has incurred debt secured by a multi-unit building in which the debtor resides in one of the units.\(^\text{110}\) *Collier on Bankruptcy* gives other examples: the security interest includes personal property, other real property, or incidental property such as easements or mineral rights.\(^\text{111}\) Because section 1322(b)(2) prevents modification of a claim secured “only by a security interest in real property that is the debtor’s principal residence” (emphasis added), the question has arisen as to whether antimodification applies where the security interest includes the debtor’s residence and other property.\(^\text{112}\) The Commission takes no position on this issue and believes it should continue to develop through the usual appellate process.

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**§ 2.07 Improvements to Federal Rule of Bankruptcy Procedure 3002.1 — Payment Change Notices and Notices of Final Cure**

(a) Payment Change Notices. Federal Rule of Bankruptcy Procedure 3002.1(b) should be amended to:

1. specify the effective date of any payment change when the creditor fails to timely file the required notice of payment change, and
2. require that payment change notices for home equity lines of credit (HELOCs) be filed and served annually rather than monthly, provided that the monthly payment amount does not increase or decrease by more than $10 in any single month.

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110 Compare, e.g., Scarborough v. Chase Manhattan Corp. (*In re Scarborough*), 461 F.3d 406 (3d Cir. 2006) ( antimodification rule does not apply to a multi-unit building that also contains the debtor’s principal residence) with, e.g., Wages v. J.P. Morgan Chase Bank (*In re Wages*), 508 B.R. 161, 165-66 (B.A.P. 9th Cir. 2014) (rejecting *Scarborough* and applying antimodification rule to real estate the debtor occupied as a principal residence, although it also included a home office and parking for commercial vehicles used in the debtor’s business).

111 8 *Collier on Bankruptcy*, *supra* note 27, at ¶ 1322.06.

112 See, e.g., *In re Lister*, 593 B.R. 587 (Bankr. S.D. Ohio 2018) (concluding that mortgage on mixed-use property could not be modified, court identified three approaches: 1) “bright-line only” approach, protecting against modification only if the property is debtor’s principal residence; 2) “bright-line includes” approach, preventing modification if property includes use as principal residence; and 3) case-by-case approach, considering factors such as parties’ intentions for use).
(b) Reverse Mortgages. FRBP 3002.1 should be amended to clarify that reverse mortgages are subject to the requirements of FRBP 3002.1 except for the payment change notice requirements in FRBP 3002.1(b).

(c) Notices of Final Cure.

1. The requirement of a notice of final cure payment under Federal Rule of Bankruptcy Procedure 3002.1(f) should be amended to:
   - (A) change the current notice process to a motion practice under Federal Rules of Bankruptcy Procedure 9013 and 9014,
   - (B) require the motions to include a warning that a creditor may be sanctioned for failing to respond, and
   - (C) add a midcase status review.

2. Federal Rule of Bankruptcy Procedure 3002.1(g) should be amended to:
   - (A) indicate clearly that the creditor’s statement is mandatory and must include (i) the principal balance owed; (ii) the date when the next installment payment is due; (iii) the amount of the next installment payment, separately identifying the amount due for principal, interest, mortgage insurance and escrow, as applicable; and (iv) the amount, if any, held in a suspense account, unapplied-funds account or any similar account;
   - (B) add a means for the debtor or trustee to object to the creditor’s statement and request a hearing; and
   - (C) provide that an objection commences a contested matter.

3. Federal Rule of Bankruptcy Procedure 3002.1(h) should be amended to allow the court to enter an order determining the status of the mortgage claim that includes all of the same information as in the proposed amendment to subsection (g).

4. Federal Rule of Bankruptcy Procedure 3001.1(i) should be amended to allow the debtor or trustee to file a motion to compel a creditor’s statement and for appropriate sanctions. If the motion is granted, the court should be required to order the mortgage creditor to pay the movant’s reasonable expenses incurred in making the motion, including attorney’s fees, unless the circumstances make such an award unjust. The failure of the mortgage creditor to obey a motion to compel a statement should be treated as contempt of court.

Background — Payment Change Notices. Federal Rule of Bankruptcy Procedure 3002.1(b) requires that mortgage creditors file and serve “a notice of any change in the payment amount, including any change that results from an interest rate or escrow account adjustment, no later than twenty-one days before a payment in the new amount is due.” Notice must be given on Official Form 410S1, the Notice of Mortgage Payment Change.
Form 410S1 requires the creditor to state the basis for the changed payment amount, the current and new payment amounts, and the date when the change will take effect. The two most common payment changes on mortgage accounts result from interest rate and escrow account adjustments. These changes are subject to disclosure requirements under the Truth in Lending Act (TILA) for adjustable-rate mortgages and the Real Estate Settlement Procedures Act (RESPA) for escrow accounts, and Form 410S1 instructs the creditor to attach to the form a rate-change notice or escrow account statement that is prepared under nonbankruptcy law (TILA and RESPA) with respect to the payment change.

The Advisory Committee Note indicates that rule 3002.1(b) is intended to assist the debtor and trustee in complying with the requirement under section 1322(b)(5) to maintain current mortgage payments:

[The Rule] is added to aid in the implementation of § 1322(b)(5), which permits a chapter 13 debtor to cure a default and maintain payments on a home mortgage over the course of the debtor's plan. . . . In order to be able to fulfill the obligations of § 1322(b)(5), a debtor and the trustee have to be informed of the exact amount needed to cure any pre-petition arrearage, see Rule 3001(c)(2), and the amount of the postpetition payment obligations. If the latter amount changes over time, due to the adjustment of the interest rate, escrow account adjustments, or the assessment of fees, expenses, or other charges, notice of any change in payment amount needs to be conveyed to the debtor and trustee. Timely notice of these changes will permit the debtor or trustee to challenge the validity of any such charges, if appropriate, and to adjust post-petition mortgage payments to cover any undisputed claimed adjustment.

Over time, three distinct problems have arisen that the Commission believes can be resolved by amendments to rule 3002.1(b): (1) payment change notices that fail to give at least twenty-one days' notice; (2) frequent payment changes of small amounts in home equity lines of credit (HELOCs); and (3) the extent to which the rule applies to reverse mortgages.

Recommendation — Untimely Notices of Payment Changes. At times, creditors file payment change notices that give less than twenty-one days' notice of the date the new payment amount will be due. If the payment increases, it is unfair to debtors and trustees to make the payment change effective when the parties have not been given the required notice. Conversely, if the payment decreases but the creditor gave less than twenty-one days' notice, it is unfair to make the debtor or trustee wait at least twenty-one days before the change becomes effective.

Therefore, rule 3002.1(b) should be amended to provide a special effective date for payment changes when the creditor fails to timely file the notice. If the payment is scheduled to increase and the creditor fails to give at least twenty-one days' notice of the new payment amount, the payment change will be effective on the first payment due date that is at least twenty-one days from the filing date of the notice. For example, if the due date for mortgage payments falls on the first day of the month and the creditor files a notice of payment change on January 29th purporting to be effective on February 1, the payment...
increase would not be effective until March 1, which is the first due date that is at least twenty-one days after January 29.

If the notice of payment change reflects a payment decrease and is filed and served without providing the required twenty-one days' notice, the effective date of the changed payment would be the later of the date of the filing of the notice or the date specified in the notice. This gives the debtor the benefit of the reduced payment as soon as possible.

Through its proposed amendments, the Commission does not intend any changes in the power of the court to take any of the actions permitted under subdivision (i) of rule 3002.1 for the creditor's failure to timely file the payment-change notice. Establishing an effective date of late payment-change notices offers certainty and uniformity for all parties while preserving the power to sanction the creditor's failure to file the notice when appropriate.

**Recommendation — HELOC Payment Changes.** Mortgage servicers have suggested that compliance with the payment-change notice requirements is burdensome with respect to a home equity line of credit (HELOC), because the payments on such mortgages may change monthly and in small amounts. Servicers have in some cases requested that courts exempt such loans from rule 3002.1. One court refused to grant such a request, finding that compliance with the rule is mandatory and that the court lacks discretion to extend the time deadlines or excuse performance.113 Another court modified the payment-change notice requirement for a HELOC loan, requiring that notices be filed every six months until the last year of the debtor's plan, at which time quarterly filings were required.114

On September 19, 2012, the Advisory Committee on Rules of Bankruptcy Procedure conducted a roundtable discussion with representatives of the mortgage-servicing industry, consumer debtors, chapter 13 trustees and others to discuss ways to improve Federal Rule of Bankruptcy Procedure 3002.1. One of the discussion topics was the treatment of HELOCs, and various proposals for amending rule 3002.1(b) were considered. Following the roundtable and further consideration by the Advisory Committee, an amendment to rule 3002.1(b) was published for comment. This amendment was finalized and became effective on December 1, 2018. It adds the following sentence at the end of amended rule 3002.1(b)(1):

“If the claim arises from a home-equity line of credit, this requirement may be modified by court order.”

The Advisory Committee Note related to this change states:

Subdivision (b) is subdivided and amended in two respects. First, it is amended in what is now subdivision (b)(1) to authorize courts to modify its requirements for claims arising from home equity lines of credit (HELOCs). Because payments on HELOCs may adjust frequently and in small amounts, the rule provides flexibility for courts to specify alternative procedures for keeping the person who is maintaining payments on the loan

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apprised of the current payment amount. Courts may specify alternative requirements
for providing notice of changes in HELOC payment amounts by local rules or orders in
individual cases.

A uniform procedure for addressing HELOC payment change notices should be adopted. Bankruptcy
rules that establish uniform procedures for the treatment of claims secured by home mortgages generally
further the objective of economical and efficient administration of bankruptcy cases. The approach
permitted under the 2018 amendment will detract from this objective by making it difficult for mortgage
servicers to comply with myriad local rules or orders in individual cases.

The Commission believes that an annual notice should suffice with respect to HELOCs, provided that
the monthly changes are less than $10 and the annual notice explains the monthly changes and includes
a reconciliation amount to account for any overpayment or underpayment received during the prior
year. The monthly payment specified in the annual notice would be adjusted upward or downward to
account for the reconciliation amount.

Background and Recommendation — Reverse Mortgages. Reverse mortgage loans are a form of credit
secured by first mortgages on single-family residences and are available to borrowers 62 years of age and
older. Two types of reverse-mortgage products are generally available: reverse mortgages offered under
the home equity conversion mortgage (HECM) program insured by the Federal Housing Administration
(FHA), and proprietary reverse-mortgage products offered by lenders. Instead of borrowing a lump sum
and repaying it over time, borrowers may receive loan proceeds not only in the form of a lump sum, but
also as a line of credit or regular monthly advances. The loan proceeds are not required to be repaid until
the borrower (or survivor if joint loan) dies or moves, or there is a default on other obligations. Lenders
are repaid the loan proceeds and interest out of the proceeds from the sale of the home.

While there are no monthly loan payments required of the borrower, reverse mortgages are not
“payment-free.” Rather, the loan documents require reverse-mortgage borrowers, like traditional
mortgage borrowers, to pay for “property charges.” These charges include real estate taxes and hazard
insurance premiums and, if applicable, condominium association fees, ground rents, or other special
assessments. If sufficient funds are not set aside or the funds run out, then the borrower is responsible
for making these payments directly.

Default occurs when the borrower is responsible for, but fails to pay, the property charges. After giving
the borrower notice and an opportunity to cure the default, and after obtaining approval from HUD,
the creditor may accelerate the debt, making all sums due under the loan immediately payable. The
homeowner’s failure to pay the property charges is an event of default and can trigger a foreclosure.
Alternatively, and more commonly, the creditor will pay the outstanding property charges by withholding

115 The Commission believes nonuniform practices in the bankruptcy system generally are a problem and recommends that courts
adopt local rules, standing orders, and practices that promote uniformity. See § 4.02 Nonuniform Court Practices. The Commission’s
recommendation for a uniform procedure to address HELOC payment-change notices addresses these concerns.

amounts from monthly payments or by charging amounts to a line of credit. In this situation, the payment is considered a distribution of available loan proceeds and the borrower is not considered delinquent. This solution works so long as loan funds remain available to draw. When the available credit on the reverse mortgage is insufficient to cover the outstanding property charges (i.e., the principal limit has already been reached), HUD generally requires lenders to advance their own funds, known as “loan advances” or “corporate advances,” to pay the property charges. Once there are no longer sufficient funds in the available credit, the loan is then in default and servicers will submit a due-and-payable request to HUD, which will lead to acceleration of the debt and foreclosure.

When rule 3002.1 first went into effect on December 1, 2011, it applied to principal residence loans that were “provided for under Code section 1322(b)(5) in the debtor’s plan.” Based on this language, the debtor’s curing of a default on a reverse mortgage under section 1322(b)(5) was clearly covered by rule 3002.1. Thus, the holder of the mortgage claim was required to provide notice of postpetition fees under rule 3002.1(c).

The reference to section 1322(b)(5) led some courts to conclude that rule 3002.1 applied only if the debtor’s plan clearly “provided for” the claim under that section, and only if the debtor had a prepetition arrearage that was being cured under the plan. Responding in part to these decisions, the Rules Committee in 2016 deleted the reference to section 1322(b)(5) from rule 3002.1(a) and replaced it with: “for which the plan provides that either the trustee or the debtor will make contractual installment payments.” The Advisory Committee’s Note issued with the rule amendment states that the “reference to § 1322(b)(5) of the Code is deleted to make clear that the rule applies even if there is no prepetition arrearage to be cured.”

The 2016 amendment arguably makes reverse mortgages no longer subject to rule 3002.1 because the debtor does not make “contractual installment payments.” While payment of property charges is a contractual payment, the requirement that it be an “installment” payment could lead courts to conclude that a chapter 13 plan providing for the curing of past payment charges and the maintenance of future payment charges is not subject to rule 3002.1. The Commission believes that a simple fix would ensure that the 2016 amendment does not work an unintended change. Deleting the word “installment” would make clear that rule 3002.1 applies to reverse mortgages. The language would then provide: “This rule applies in a chapter 13 case to claims (1) that are secured by a security interest in the debtor’s principal residence, and (2) for which the plan provides that either the trustee or the debtor will make contractual payments.” An Advisory Committee’s Note should explain that the change is intended to make clear that reverse mortgages are covered by the rule and that there is an obligation to send notices of postpetition fees and notices, as well as motions and responses related to the status of the mortgage.

Because reverse mortgages do not require the debtor to make installment payments, the payment-change notice requirements under rule 3002.1(b) are generally not applicable, but the rule does apply to attorney fees and other charges under defaulted reverse mortgages being cured though the plan. It would be helpful if this distinction was also stated in the Advisory Committee’s Note.
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Background — Notices of Final Cure. Subsections (f), (g), (h) and (i) of Federal Rule of Bankruptcy Procedure 3002.1 provide the procedure for determining the status of a mortgage claim at the end of the case. This procedure, known as a notice of final cure, includes detailed requirements for the creditor's response to the notice filed by the trustee or the debtor. The provisions permit the debtor or trustee to file a motion for the court to determine whether the default has been cured and all required postpetition amounts have been paid. The consequences for failing to timely provide information are also established by these provisions.

The notice of final cure process needs expansion and improvement. The process should be familiar and streamlined, and it should produce the precise information needed by the parties. This process should occur midcase to give the debtor, trustee, and creditor an opportunity to address any issues while time remains in the case. The process should also occur at the end of the case to provide the information needed just prior to case closing so that the loan can be properly serviced and so that debtors can know exactly what obligations remain. The process needs to be effective in both conduit and nonconduit jurisdictions and also for both large and smaller servicers. Finally, any new rule needs to provide more robust consequences for failing either to respond or to provide the required data.

Under section 1322(b)(5), a debtor is permitted to cure any default and maintain home mortgage payments over the life of the bankruptcy plan. To be successful, the debtor and trustee must know the amount needed to cure the pre-petition default and must be informed about postpetition payment changes and postpetition fees, expenses and charges incurred during the plan. Federal Rule of Bankruptcy Procedure 3002.1 was enacted to require this information.

The intent was both for the trustee to file a notice of final cure in every case containing a mortgage on the debtor's principal residence and for the debtor to have the opportunity to file a notice of final cure if the trustee failed to do so. But, in the experience of the Commission, there are many cases in which neither the trustee nor the debtor files a notice of final cure. Although the rule mandates a response, there are also many cases in which the trustee files a notice of final cure, but the creditor does not file a response or makes an incomplete response. As a result, there are many cases in which the creditor does not report the status of the loan at the end of the case. In such cases, debtors with home mortgages complete their chapter 13 cases without certainty as to the status of their mortgages. Even when the notice and response procedure in rule 3002.1 works as intended, the end-of-case timing is often too late for plan modification to address postpetition payment changes, fees, expenses, charges and defaults. Conversely, there are some trustees and debtors who not only file a notice of final cure, but file additional motions or requests for information not provided for in rule 3002.1. These include “qualified written requests” under RESPA, requests for full payment histories, and motions to deem the account current. These

117 For a discussion of the concept of “conduit” plans and the Commission’s recommendations on the subject, see § 4.06 Conduit Mortgage Payments.
118 A “qualified written request” is written correspondence from a borrower to a loan servicer requesting information relating to the servicing of the loan and that meets certain criteria. Typically, a qualified written request will identify errors the borrower believes have been made in the servicing of the loan. If the borrower makes a qualified written request, the loan servicer must respond within thirty days either correcting the error (including crediting the borrower’s account, if appropriate) or stating the servicer has investigated and providing the reasons the servicer believes the account is correct. See 12 U.S.C. § 2605(e). A discussion of RESPA’s
additional requests fill some of the voids in rule 3002.1 practice, but cause uncertainty and expense for creditors needing to prepare multiple responses and to gather information in addition to that required by rule 3002.1. The absence of procedural uniformity has impaired efforts by creditors to reliably automate the management of rule 3002.1 notices in chapter 13 cases. The Commission determined that a single, mandatory, motion-driven process would be more efficient and effective for all parties.

Recommendations — Midcase Status Process and Motion Practice. The Commission recommends amending rule 3002.1 to add a midcase status process to complement the existing final cure process. Both procedures would include data points required to be included in the creditor’s response and in the resulting court orders. The proposed amendments also provide more robust consequences for failing to provide required information.

The current notice process should be replaced with the motion-and-order practice familiar under Federal Rules of Bankruptcy Procedure 9013 and 9014, with a standardized style for the motion to improve automation and to increase the efficiency of PACER/ECF searches. The motions should include an additional warning that a creditor may be sanctioned under rule 3012.1(i) for failing to respond.

Recommendation — Creditor’s Response and Amendments to Federal Rule of Bankruptcy Procedure 3002.1(g). The Commission recommends amending rule 3002.1(g) to emphasize and clarify that the creditor’s response to a notice of final cure is mandatory. The response must include the principal balance owed; the date when the next installment payment is due; the amount of the next installment payment, separately identifying the amounts due for principal, interest, mortgage insurance and escrow, as applicable; and the amount, if any, held in a suspense account, unapplied funds account, or any similar account. The rule as amended would add a means for the debtor or trustee to object and request a hearing and provide that an objection would commence a contested matter.

Recommendation — Court Action and Amendment to Federal Rule of Bankruptcy Procedure 3002.1(h). The Commission also recommends amending rule 3002.1(h) to provide for the court to enter an order determining the status of the mortgage claim. The order would include the same data points listed in the response in the proposed amendment to rule 3002.1(g).

Recommendation — Motion to Compel and Amendment to Federal Rule of Bankruptcy Procedure 3002.1(i). Finally, the Commission proposes adding a provision for the debtor or trustee to file a motion to compel a response and for appropriate sanctions. If the motion is granted, the court must require the mortgage creditor to pay the movant’s reasonable expenses incurred in making the motion, including attorney’s fees, unless the circumstances make such an award unjust. The failure of the mortgage creditor to file a response would be treated as contempt of court. These changes are modeled after similar provisions in

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119 The Commission has recommended a uniform set of naming conventions for pleadings, events, and party names generally; see § 5.07 Case Management (CM)/Electronic Case Filing (ECF) & Docketing Improvements.

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Federal Rule of Civil Procedure 37, including amendments to rule 37 that were made after the Advisory Committee on Rules of Bankruptcy Procedure first promulgated rule 3002.1(i).

Appendix to Section 2.07

Formally, the Commission voted to approve the recommendations that appear at the beginning of this section. At the time of the vote, the Commission had before it specific amendatory language to Federal Rule of Bankruptcy Procedure 3002.1 that would implement the Commission's recommendations. Because of the technical nature of these recommendations, the Commission decided that it would be helpful to include the amendatory language as an appendix to this discussion of the recommendations.

Rule 3002.1 Notice Relating to Claims Secured by Security Interest in the Debtor

* * * *

(b) Notice of Payment Changes; Objection

(1) Notice. Except as provided in paragraph (3), the holder of the claim shall file and serve on the debtor, debtor’s counsel, and the trustee a notice of any change in the payment amount, including any change that results from an interest-rate or escrow-account adjustment, no later than 21 days before a payment in the new amount is due.

(2) If the holder of the claim fails to timely file and serve the notice required by paragraph (1), the following shall apply:

(A) Payment Increase: In the event that the holder of a claim files and serves a Notice of Payment Change that reflects an increase in the total new payment amount without providing the required 21 days’ notice, then the payment change shall be effective on the first payment due date that is at least 21 days from the filing date of the Notice of Payment Change.

(B) Payment Decrease: In the event that the holder of a claim files and serves a Notice of Payment Change that reflects a decrease in the total new payment amount without providing the required 21 days’ notice, then the payment change shall be effective as of the later of the Date of the Notice or the date specified in the Notice.

(C) Nothing in subparagraph (A) or (B) shall limit the power of the court to take any of the actions permitted under subdivision (i) for any failure to timely file and serve the notice of payment change.
(3) If the claim arises from a home equity line of credit, the notice of any payment change shall be filed and served on the debtor, debtor’s counsel, and the trustee no later than one year after the entry of the order for relief, and not less frequently than annually thereafter.

(A) The annual notice shall state the monthly payment amount due for the month in which the notice is filed. The payment amount shall be effective on the first payment due date that is at least 21 days from the filing date of the annual notice and shall remain effective until a new notice is filed with the court. The holder shall also include in the annual notice a reconciliation amount to account for any over- or under-payment received during the prior year. This amount shall be accounted for in the first payment due to the holder after the effective date of the notice, and shall be adjusted upward or downward to account for the reconciliation amount.

(B) Notwithstanding subparagraph (A) above, should the monthly payment increase or decrease by more than $10 in any single month, the holder shall file a notice consistent with subdivision (b)(1), and this notice shall be filed and served in addition to the annual notice requirement.

(4) Objection. A party in interest who objects to the payment change may file a motion to determine whether the change is required to maintain payments in accordance with § 1322(b) (5) of the Code.

* * * *

(f) Motion to Determine Status of Mortgage Claim.

(1) Mandatory Motion to Determine Status of Mortgage Claim. Both during the period between 18 and 22 months after the petition date and no later than 45 days after the trustee receives all payments due the trustee under the plan, the trustee shall file and serve on the holder of the claim, the debtor, and debtor’s counsel a motion to determine status of mortgage claim. The motion shall be styled as prescribed by the appropriate Official Form. The motion shall inform the holder of its obligation to timely file and serve a response under subdivision (g) and warn that failure to timely respond may be sanctioned under subdivision (i).

(2) Permissive Motion to Determine Status of Mortgage Claim. The debtor may file the motion required under subdivision (f)(1) of this Rule.

(g) Mandatory Response to Motion to Determine Status of Mortgage Claim; Objection.

(1) Within 28 days after service of the motion under subdivision (f) of this rule, the holder of the claim shall file and serve on the debtor, debtor’s counsel, and the trustee a response indicating (i) that the debtor has paid all amounts required by the plan to be paid to the...
holder on account of its claim; or (ii) that the debtor is in default of an amount required by the plan to be paid to the holder on account of its claim. The response shall include the following information, current as of the date of the response: the principal balance owed; the date when the next installment payment from the debtor is due; the amount of the next installment payment that is due from the debtor, separately identifying the components of that payment, including the amounts due for principal, interest, mortgage insurance, and taxes, as applicable; and the amount, if any, held in a suspense account, unapplied funds account or any similar account. If the response states the debtor is in default under the plan, the response shall itemize the amount(s) that the holder contends is unpaid as of the date of the response.

(2) The debtor or the trustee shall have 14 days from the date of service of a timely response filed under subdivision (g)(1) within which to file an objection and request a hearing. The filing of an objection commences a contested matter for purposes of Fed. R. Bankr. P. 9014.

(h) **Order Determining Status of Mortgage Claim.**

(1) If the holder of the claim fails to timely respond under subdivision (g)(1), the trustee shall submit and, without further hearing, the court may enter an order declaring as of the date of the motion that the debtor is current on all payments required by the plan with respect to the debtor’s obligations to the holder, including all escrow amounts, and that all postpetition legal fees, expenses and charges imposed by the holder are satisfied in full.

(2) If the holder timely responds under subdivision (g)(1) and no objection is filed under subdivision (g)(2), the trustee shall submit and without further hearing the court may enter an order determining that the amounts stated in the holder’s response filed under subdivision (g)(1) reflect the status of the claim as of the date of the filing of the holder’s response.

(3) If an objection is filed under subdivision (g)(2), the court shall, after notice and a hearing, determine the status of the mortgage claim and enter an appropriate order.

(4)

(A) An order entered under subdivision (h)(2) or (h)(3) shall include the following information, current as of the date of the holder’s response under subdivision (h)(2) or such other date as the court may determine: the principal balance owed; the date when the next installment payment from the debtor is due; the amount of the next installment payment that is due from the debtor, separately identifying the components of that payment, including the amounts due for principal, interest, mortgage insurance, and taxes, as applicable; and the amount, if any, held in a suspense account, unapplied-funds account or any similar account.
(B) An order entered under subdivision (h)(1) may include any of the information described in paragraph (A) as may be appropriate.

(i) Failure to Notice or Respond.

(1) If the holder of a claim fails to provide any information as required by subdivision (b), (c), or (g) of this rule, the court may, after notice and a hearing, take either or both of the following actions:

(A) preclude the holder from presenting the omitted information, in any form, as evidence in any contested matter or adversary proceeding in the case, unless the court determines that the failure was substantially justified or harmless; or

(B) award other appropriate relief, including reasonable expenses and attorney’s fees caused by the failure.

(2) If the holder of the claim fails to timely respond under subdivision (g)(1), in addition to any action the court may take under subdivisions (h)(1) and (i)(1), the debtor or the trustee may move to compel a response and for appropriate sanctions.

(A) If the motion is granted—or if the response is provided after the motion was filed—the court must, after giving an opportunity to be heard, require the holder to pay the movant’s reasonable expenses incurred in making the motion, including attorney’s fees, unless the failure was substantially justified or other circumstances make an award of expenses unjust.

(B) If the court orders the holder to file a response under subdivision (g)(1) and the holder fails to obey, the failure may be treated as contempt of court. In addition to any order the court enters as a sanction for contempt, the court must order the holder to pay the reasonable expenses, including attorney’s fees, caused by the failure, unless the failure was substantially justified or other circumstances make an award of expenses unjust.
May a debtor deduct voluntary retirement contributions when calculating the debtor’s projected disposable income?

*In re Seafort:* 401(k) loan repayments are expressly excluded from disposable income in section 1322(f). The treatment of voluntary 401(k) or other retirement plan contributions, however, is not so clear, as the Sixth Circuit Court of Appeals explained in *In re Seafort (Seafort v. Burden)*, 669 F.3d 662 (6th Cir. 2012). The Sixth Circuit held that postpetition income that becomes available after 401(k) loans are repaid is projected disposable income and may not be used to fund voluntary 401(k) plans. 669 F.3d at 663.

The court did not answer the question of whether the debtor may continue to make 401(k) contributions postpetition if those contributions had been ongoing at the time of the petition. But with some foreshadowing, the Sixth Circuit noted:

> The Trustee “concedes” that if a debtor is making voluntary retirement contributions when the bankruptcy petition is filed, such continuing contributions may be excluded from disposable income. We do not agree with this assertion, for the reasons stated in *Prigge*. However, our view is not relevant here, because this issue is not presently before us.

*Seafort*, 669 F.3d at footnote 7 (emphasis added) (referring to *In re Prigge*, 441 B.R. 667 (Bankr. D. Mon. 2010)). Because of its comprehensive analysis, a copy of the *Seafort* opinion is attached.

**Pending Appeal in In re Davis:** The issue is now squarely before the Sixth Circuit in the case of *In re Camille T. Davis (Davis v. Helbling)*, No. 19-3117, a direct appeal from the Bankruptcy Court for the Northern District of Ohio. Oral argument is scheduled for August 8, 2019.

A copy of the Debtor Appellant’s brief in *Davis* is attached as a counterpoint to the *Seafort* opinion.
In re Seafort, 669 F. 3d 662 - Court of Appeals, 6th Circuit 2012

669 F.3d 662 (2012)

In re Deborah K. SEAFORT; Frederick C. Schuler; Carrie A. Schuler, Debtors.
Deborah K. Seafort; Frederick C. Schuler; Carrie A. Schuler, Appellants,
v.
Beverly M. Burden, Trustee, Appellee.

No. 10-6248.

United States Court of Appeals, Sixth Circuit.

Decided and Filed: February 15, 2012.


OPINION

SUHRHEINRICH, Circuit Judge.

Chapter 13 of the Bankruptcy Code permits "individual[s] with regular income" whose debt falls within statutory limits, see 11 U.S.C. §§ 101(30), 109(e), to keep their property if they agree to a court-approved plan to pay creditors out of their future "disposable income." See 11 U.S.C. §§ 1306(b), 1321, 1322(a)(1), 1328(a). However, if a trustee of the plan or an unsecured creditor objects, a Chapter 13 plan can be confirmed only if the debtor contributes "all ... projected disposable income" to the plan. 11 U.S.C. § 1325(b)(1)(B). The question presented in this consolidated appeal is whether the income that becomes available after the debtors have fully repaid their 401(k) loans (which is allowed by 11 U.S.C. § 1322(f)) is "projected disposable income" to be paid to the unsecured creditors or whether the income can be used to begin making voluntary contributions to the debtors' 401(k) plans and deemed excludable from both disposable income and property of the estate under 11 U.S.C. § 541(a)(1) and (b)(7).

We hold that post-petition income that becomes available to debtors after their 401(k) loans are fully repaid is "projected disposable income" that must be turned over to the trustee for distribution to unsecured creditors pursuant to § 1325(b)(1)(B) and may not be used to fund voluntary 401(k) plans.

I. Background

On November 20, 2008, Deborah K. Seafort filed a petition for relief under Chapter 13 of the Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Kentucky, Case No. 08-22380. On November 24, 2008, Frederick C. Schuler and Carrie Schuler also filed a joint petition for relief under Chapter 13 of the Bankruptcy Code in the same court, Case No. 08-22417. Both Seafort and Frederick Schuler (collectively "Debtors") were eligible to participate in their employers' ERISA 401(k) qualified retirement plans. Debtors were not making any contributions to their employers' 401(k) retirement plans at the time of the filing of their petitions. Both debtors were in the process of repaying a 401(k) loan to their employers' retirement plans. Schuler was repaying his 401(k) loan at the rate of $815.86 per month. Seafort was repaying her loan at the rate of $254.71 per month as of the petition dates.

Both debtors filed proposed Chapter 13 plans which called for a commitment period under 11 U.S.C. § 1325 of five years. Under the Chapter 13 plans Debtors were scheduled to repay their 401(k) loans in full prior to the completion of their commitment periods. Seafort was scheduled to repay her 401(k) loan by month 19. Schuler was scheduled to repay his 401(k) loan by month 48. Neither proposed Chapter 13 plan provided for an increase in plan payments to the Chapter 13 trustee once they had completed repayment of the 401(k) loans. Instead, both plans proposed that Debtors would begin making contributions to their 401(k) retirement plans.
post-petition after the 401(k) loans were paid in full. In other words, both Debtors proposed to use the income available after repayment of the 401(k) loans was completed to begin funding their retirement accounts, instead of using the freed-up income to pay unsecured creditors.

In both cases, the Chapter 13 trustee, Beverly Burden ("Trustee"), filed objections to confirmation of Debtors’ plans of reorganization. Specifically, the Trustee objected to Debtors’ attempts to exclude from estate property and projected disposable income proposed post-petition contributions to their 401(k) retirement plans, since Debtors were not contributing anything to their qualified retirement plans when their bankruptcy cases began.

The bankruptcy cases were consolidated to determine whether Debtors could exclude from estate property and projected disposable income post-petition earned income proposed to be used for future 401(k) retirement plan contributions. The Trustee argued that the contributions are only excludable from property of the estate and disposable income if they are being made at the time the petition is filed. The bankruptcy court disagreed, holding that “participation in a 401(k) plan is an ongoing endeavor, and while loan payments may take the place of contributions for the life of the 401(k) loan, the income stream that funds both loan payments and plan contributions is the same.” In re Seafort, 437 B.R. 204, 208-09, 211-12 (B.A.P. 6th Cir. 2010). The dissent would have held that the disposable income does not include any amount withheld as a qualified contribution based upon the plain language of § 541(b)(7); Seafort, 437 B.R. at 217 (Shea-Stonum, J., dissenting).

Debtors appeal.

665*665 II. Discussion

A. The Statutory Framework

We start with the language of the relevant statutory provisions. Ransom v. FIA Card Servs., N.A., ___ U.S. ___, 131 S.Ct. 716, 723-24, 178 L.Ed.2d 604 (2011) (citing United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989)). As noted, if the trustee or an unsecured creditor objects to confirmation of a Chapter 13 plan, “the court may not approve the plan unless ... the plan provides that all of the debtor's disposable income to be received in the applicable commitment period ... will be applied to make payments to unsecured creditors under the plan.” 11 U.S.C. § 1325(b)(1)(B); see also Hamilton v. Lanning, ___ U.S. ___ , 130 S.Ct. 2464, 2466, 177 L.Ed.2d 23 (2010). "Disposable income" is defined in relevant part as "current monthly income received by the debtor... less amounts reasonably necessary to be expended ... for the maintenance or support of the debtor." 11 U.S.C. § 1325(b)(2)(A)(i). For debtors whose income exceeds the state median, as in this case, the "amounts reasonably necessary to be expended" is determined by the "means test" set forth in § 707(b)(2). See 11 U.S.C. § 1325(b)(2); see also Baud v. Carroll, 654 F.3d 327, 329-34 (6th Cir. 2011) (explaining the appropriate method for calculating "amounts reasonably necessary to be expended") cert. denied, ___ U.S. ___ , 132 S.Ct. 197, 181 L.Ed.2d 732 (Jan. 9, 2012) (No. 10A1008, 11-27), 2012 WL 33293.

"Projected disposable income" is not defined in the Bankruptcy Code, but the Supreme Court recently explained that "when a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation." Lanning, 130 S.Ct. at 2478; Darrohn v. Hildebrand (In re Darrohn), 615 F.3d 470 (6th Cir. 2010) (applying Lanning to the debtors' monthly mortgages, an otherwise deductible expense, because they intended to surrender the properties securing the mortgages). Because the Trustee here objected to Debtors' proposed plans, the bankruptcy court appropriately took into account the post-petition income available upon repayment of the 401(k) loans. Thus, we must decide whether that income is "projected disposable income" that must be committed to the Chapter 13 plan and paid out to unsecured creditors or instead is otherwise excluded.

Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), both 401(k) loans and 401(k) contributions were considered "disposable income." See Behlke v. Eisen (In re Behlke), 398 F.3d 429, 435-36 (6th Cir.2004) (holding that voluntary contributions to a 401(k) plan from property of the estate and disposable income, Debtors were allowed to exclude their proposed plan contributions from disposable income. Id.
plan were "disposable income"); Harshbarger v. Pees (In re Harshbarger), 66 F.3d 775, 666*666 777-78 (6th Cir. 1995) (holding that the debtor's voluntary repayment of 401(k) loans should be treated as disposable income in the bankruptcy estate). However, the BAPCPA added two exclusionary sections of importance here. The first, § 1322(f), is clear: It states in relevant part that "any amounts required to repay such loan shall not constitute 'disposable income' under section 1325." 11 U.S.C. § 1322(f).

The second provision, § 541(b)(7), is less so. See In re Egan, 458 B.R. 836, 842-43 (Bankr.E.D.Pa.2011) (commenting that "like many provisions of the Bankruptcy Code added by BAPCPA, ... the text of § 541(b)(7) [is] less than clear"). It provides as follows:

(b) Property of the estate does not include —

... ...

(7) any amount —

(A) withheld by an employer from the wages of employees for payment as contributions —

(i) to —

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

... 
except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325(b)(2)[.

11 U.S.C. § 541(b)(7) (emphasis added).[4]

This exclusion is found outside the confines of Chapter 13, in § 541. Section 541(a)(1) provides the general rule that property of the bankruptcy estate consists of all legal and equitable interests of the debtor in property as of the commencement of the case, subject to certain exceptions, namely those found in subsection (b) and (c)(2). It reads as follows:

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 541(a)(1) (emphases added).[5]

By contrast, "Property of the estate" for purposes of Chapter 13 is defined as:

(a) Property of the estate includes, in addition to the property specified in section 541 of this title —

(1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first.

(b) Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

11 U.S.C. § 1306 (emphases added). Section 1306(a) expressly incorporates § 541. Read together, § 541 fixes property of the estate as of the date of filing, while § 1306 adds to the "property of the estate" property interests which arise post-petition.

B. Competing Views

Although no circuit has addressed the question presented here, several bankruptcy and district courts have,
with divergent results. See, e.g., In re Egan, 458 B.R. 836, 843-44 (Bankr. E.D.Pa. 2011) (listing various approaches); In re McCollers, 451 B.R. 498, 501 (Bankr. N.D.Cal. 2011) (same). The first view, adopted by the BAP majority in this case, reads §§ 541 and 547(b)(7) as limiting voluntary retirement contributions to those amounts being made as of the petition date (hereinafter referred to as the ”BAP majority” or ”Seafort majority”). The second view, typified by the Johnson decision [In re Johnson, 436 B.R. 266, 268 (Bankr. D.Ga. 2006)] holds that all voluntary retirement contributions, both pre- and post-petition, are permitted under § 541(b)(7), limited only by the good faith requirement of § 1325(a)(3). A third view, articulated in In re Prigge, 441 B.R. 667 (Bankr. D.Mont. 2010), holds that § 541(b)(7) does not permit post-petition voluntary retirement contributions in any amount regardless of whether the debtor was making pre-petition retirement contributions.

1. The Seafort Majority

As noted, the Seafort majority held that § 541(b)(7), within the context of § 541, fixes the amount of voluntary 401(k) contributions a debtor may make on the date 668*668 of filing for bankruptcy relief. In other words, the debtor may continue making voluntary contributions in the same amount he or she was contributing at the time of filing. The Seafort majority reasoned that:

[T]he language of § 541(a) is clear. Property of the estate under § 541(a)(1) and exclusions from property of the estate under § 541(b) must both be determined on the date of the filing of the case. As provided in the statute, § 541(a) specifically states that ”the commencement of a case ... creates an estate.” Section 541(b) excludes certain property from the definition of ”property of the estate.” Read together, § 541(a) and (b) establish a fixed point in time at which parties and the bankruptcy court can evaluate what assets are included or excluded from property of the estate. Section 541(a) clearly establishes this point as the commencement of the case. Therefore, only 401(k) contributions which are being made at the commencement of the case are excluded from property of the estate under § 541(b)(7).

Seafort, 437 B.R. at 209.

In further support, the Seafort majority noted that § 1306, which addresses property acquired after the petition date in Chapter 13 cases, does not exclude from disposable income post-petition voluntary retirement contributions. Seafort, 437 B.R. at 209. Third, the BAP majority stated that this result was also supported by the language in § 541(b)(7), which excludes ”disposable income” and not ”projected disposable income.” Id. Finally, the BAP majority found its conclusion was consistent with the legislative intent of ensuring that debtors repay creditors to the maximum extent possible and protecting debtors’ ability to save for retirement. Id. at 209-10 (citing H.R.Rep. No. 109-31, pt. 1, at 2 (2005), U.S.Code Cong. & Admin. News 2005, pp. 88, 89). Id. at 210.

The Seafort majority’s view has been followed by two lower courts. See In re Noll, No. 10-35209-svk, 2010 WL 5336916, at *2 (Bankr. E.D.Wis. Dec. 21, 2010); In re Fletcher, 469 B.R. 3, 12-14 (Bankr. E.D.Ky. 2011).

2. The Johnson Decisions

Several bankruptcy courts have held that the plain language of § 541(b)(7) allows a Chapter 13 debtor to make voluntary post-petition contributions to a qualified retirement plan up to the maximum amount permitted under nonbankruptcy law, regardless of whether the debtor was making such contributions at the time of filing, subject only to the good faith requirement imposed by § 1325(a)(3). Not all sources of income need be committed to a Chapter 13 plan....

Debtors are also permitted to shelter certain contributions to employee benefit plans (EBPs), “[A]ny amount” that is either ”withheld by” or ”received by” a debtor’s employer for qualifying EBPs, deferred compensation plans, tax-deferred annuities, or state-law-regulated health insurance plans ”shall not constitute 669*669 disposable income, as defined in section 1325(b)(2),” 11 U.S.C. § 541(b)(7)(A) & (B) (emphasis added).
Furthermore, in addition to sheltering EBP contributions, the Code also protects repayments of loans from EBPs, including loans from 401(k) plans. [See] 11 U.S.C. § 1322(f). Sections 541(b)(7) and 1322(f) both plainly state that these contributions "shall not constitute disposable income." Congress has placed retirement contributions outside the purview of a Chapter 13 plan.

Johnson, 346 B.R. at 262-63.

In this vein, some courts reason that:

Section 547(b)(7) instructs that contributions to a qualified plan do not constitute disposable income for purposes of § 1325(b)(2). As excluded income, the contributions are not a deduction because they were never included in the first instance.

Further, unlike the provisions of § 707(b)(2) and § 1325(b)(2) or (3), § 541(b)(7) does not modify excluded contributions based on reasonableness or necessity. The Code simply contains no requirement that contributions to a retirement account be "reasonable or necessary." Perhaps more accurately, Congress has determined that contributions to a qualified retirement account are, by their very nature, reasonable and necessary. By providing for a debtor's eventual retirement, retirement contributions become part of a debtor's fresh start.

Devilliers, 328 B.R. at 864-65. See also Shelton, 370 B.R. at 865 (adopting Devilliers' reasoning); Leahy, 370 B.R. at 625 (same).

Another court reached this result based on the following reasoning:

The preamble of § 1306 and subsection (a)(1) both make reference to the entirety of § 541, not just § 541(a). The text provides no basis to read the references in § 1306 to § 541 to incorporate only the inclusions provided under § 541(a) and not the exclusions provided under § 541(b). Moreover, § 1306(a)(2) does not provide, in and of itself, a textual basis to infer that § 541(b)'s exclusions, let alone § 541(b)(7) specifically, would not be applicable post-petition. To the extent § 1306(a)(2) includes in a chapter 13 estate "earnings from services performed by the debtor after the commencement of the case but before the case is closed," 11 U.S.C. § 1306(a)(2), this Court finds that the purpose of this text is to expand the scope of § 541(a)(6). Section 1306(a)(1) incorporates into a chapter 13 estate "all property of the kind specified in [§ 541] that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted." 11 U.S.C. § 1306(a)(1) (emphasis added). This language makes clear that property of the type specified by § 541 that is acquired post-petition by a chapter 13 debtor, and not just post-petition income, becomes part of that debtor's chapter 13 estate.... Based on the reference in § 1306 to the entirety of § 541, this Court finds a reading of § 1306 that incorporates on an ongoing basis the exclusions of § 541(b), inclusive of § 541(b)(7), to be more consistent with the dynamic nature of chapter 13 cases.


3. The Prigge View

Prigge held that § 541(b)(7) does not authorize a Chapter 13 debtor to make voluntary post-petition retirement contributions in any amount. Prigge, 441 B.R. 670*670 at 676-77. The Prigge court observed that Congress created an express exclusion from disposable income for amounts necessary to repay a loan from the debtor's retirement plan in § 1322(f), within the confines of Chapter 13 itself, but did not create a similar provision to exclude voluntary 401(k) contributions. The court found this omission deliberate: "If Congress had intended to exclude voluntary 401(k) contributions from disposable income it could have drafted § 1322(f) to provide for such an exclusion, or provided one elsewhere." Id. at 677. The Prigge court found further reinforcement in the fact the IRS guidelines, which supply the standardized expenditure figures used in calculating a debtor's reasonable and necessary expenses under the means test, provide that contributions to voluntary retirement plans are not a necessary expense. Id. The Prigge court therefore concluded that the function of § 541(b)(7) was simply to clarify that retirement contributions withheld pre-petition and still in the employer's possession on the petition date do not constitute property of the estate or post-petition disposable income. Id. & n. 5 (citing 5 Collier on Bankruptcy, ¶ 541.22(2)(C)(1) (15th ed. rev.) (stating that § 541(b)(7) "seems intended to protect amounts withheld by employers from employees that are in the employer's hands at the time of filing bankruptcy, prior to remission of the funds to the plan").

Another bankruptcy court recently examined the holdings in Johnson, Seafort, and Prigge. Although it found some of the reasoning of the Seafort majority attractive, it ultimately found the ruling in Prigge more persuasive. See McCullers, 341 B.R. at 504. The McCullers court rejected the Johnson line of cases:
Those decisions are not persuasive, because a close reading of section 541(b)(7) indicates that "such amount" excluded from disposable income refers to prepetition contributions. With minor exceptions not relevant here, section 541(a) defines as property of the estate only property that the debtor holds on the petition date: section 541(a)(1) provides that property of the estate includes the "legal or equitable interest of the debtor in property as of the commencement of the case." (emphasis added), and section 541(a)(6) states that section 541 does not bring into the estate "earnings from services performed by an individual debtor after the commencement of the case." FN 7 Section 541(b) creates exceptions to section 541(a). This structure suggests that section 541(b)(7) excludes from property of the estate only property that would otherwise be included in the estate under section 541(a). Thus, the most natural reading of section 541(b)(7) is that it excludes from property of the estate only those contributions made before the petition date. That Congress intended to exclude from disposable income only the same prepetition contributions excluded from property of the estate is indicated by its specifying the contributions excluded from property of the estate and then stating that "such amount" shall not constitute disposable income.

FN7. In a chapter 13 case, postpetition personal service income becomes property of the estate under section 1306(a)(2), not under section 541.

The Johnson decisions also fail to explain why Congress, if it intended to enact a categorical exclusion from disposable income for retirement contributions, did not use language similar to that of section 1322(f), which created a categorical exclusion for all postpetition retirement loan repayments, but instead adopted a provision that links the amount of the exclusion for retirement


The McCullers court found Seafort and Prigge more persuasive, because both "limit the amount excluded from disposable income to pre-petition contributions." Id. at 504. McCullers found Seafort superficially attractive because it adopts a "plausible policy[] that Congress intended to encourage chapter 13 debtors to continue making retirement contributions, but did not intend to permit debtors to increase their rate of contribution to the detriment of their creditors." Id. at 504 (citing Seafort, 437 B.R. at 210). Notwithstanding, the McCullers court concluded that "Congress actually intended the much more limited effect recognized in Prigge." Id. It found:

First, neither the statute itself nor the Seafort decision offers any mechanism by which the fixed amount withheld as of the petition date is converted into a monthly rate of contribution that the debtor may continue postpetition. Second, and more important, Seafort does not take into account the use of the words "except that" at the beginning of the statutory language excluding retirement contributions from disposable income.... Use of the term "except that" suggests that the purpose of the language is merely to counteract any suggestion that the exclusion of such contributions from property of the estate constitutes postpetition income to the debtor. If Congress had intended to exclude prepetition contributions from the calculation of disposable income more generally, it would have been much more natural for Congress to provide that such contributions are excluded from property of the estate "and" in the calculation of disposable income. Prigge's more limited interpretation is reinforced by the fact that Congress used much more direct language in excluding retirement loan repayments from disposable income. Section 1322(f) was placed within the confines of chapter 13 itself, and states explicitly "any amounts required to repay such loan shall not constitute 'disposable income' under section 1325."

Congress's use of the words "except that" is entirely consistent with the Prigge decision, which held that the purpose of the statute was merely to clarify that the exclusion of certain prepetition contributions from property of the estate did not give rise to disposable income to the debtor. Prigge, 441 B.R. at 677 n. 5. This court is mindful of its obligation to adopt an interpretation that accords some effect to the statutory language in question, and that Prigge gives that language a very limited effect[.]. In using the words "except that," Congress suggests that its only purpose was to negate any inference that the exclusion of such contributions from property of the estate gives rise to income to the debtor.


C. Analysis

As in Baud, we are faced with a statute that is "inelegantly drafted" and therefore we must adopt an interpretation from competing theories "that is not only more consistent with the language of the statute than the competing interpretation[s], but that also is consistent with the legislative history and the overriding
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purpose of BAPCPA. Baud, 634 F.3d at 357. Upon careful inspection, we think the view espoused by the

McCullers and McQuilkin courts is the correct interpretation.

672*672 We begin with the assumption, as we must, that Congress's placement of 401(k) loan repayments
within Chapter 13 itself and placement of the exclusion for voluntary retirement contributions elsewhere was
deliberate. See Keene Corp. v. United States, 508 U.S. 200, 208, 113 S Ct. 2075, 124 L.Ed.2d 118 (1993)
(Where Congress includes particular language in one section of a statute but omits it in another, it is generally
presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.) (internal quotation marks and alterations omitted); City of Chicago v. Envtl. Defense Fund, 511 U.S. 328, 338, 114 S Ct. 1588, 128 L.Ed.2d 302 (1994) ("It is generally presumed that Congress acts intentionally and purposely when it
includes particular language in one section of a statute but omits it in another.") (internal quotation marks
and citation omitted); Hildebrand v. Petro (In re Petro), 395 B.R. 369, 375 (6th Cir. BAP 2008) (same).

The easy inference is that Congress did not intend to treat voluntary 401(k) contributions like 401(k) loan
repayments, because it did not similarly exclude them from "disposable income" within Chapter 13 itself. See §
1322(d)(7) (stating that "any amounts required to repay such loan shall not constitute "disposable income" under
section 1325"). See McCullers, 441 B.R. at 609-04; Baud, 441 B.R. at 677. Congress also does not consider
voluntary contributions as "reasonable and necessary expense[s]" deductible from "disposable income," see §
1325(b)(3), because it did not list them in § 707(b)(2)(A) & (B). In fact, it expressly excluded them from the list
of "necessary expenses" in Official Form 22C, which provides the formula for calculating "reasonable and
necessary expenses" of above-median income debtors. See Official Form 22C, Chapter 13 Statement of Current
Monthly Income and Calculation of Commitment Period and Disposable Income, line 31 (Dec. 2010). See
generally Lanning, 130 S.Ct. at 2470 n. 2 ("The formula for above-median-income debtors is known as the
'means test' and is reflected in a schedule (Form 22C) that a Chapter 13 debtor must file."); Baud, 634 F.3d at
722-23. Expenses; involuntary deductions; "Other Necessary Expenses for Employment," unequivocally in¬
cludes in calculating "Deductions from Income" the above-means Chapter 13 debtor may
"[e]nter the total average monthly deductions that are required for your employment, such as mandatory
retirement contributions... Do not include discretionary amounts, such as voluntary 401(k) contributions."
Official Form 22C, line 31. See generally McCullers, 441 B.R. at 677 (observing that the IRS guidelines state
that voluntary retirement contributions are not a necessary expense).

Notwithstanding, § 541(b)(7) must provide some sort of protection for voluntary retirement contributions in
Chapter 13 cases, because it says that such contributions "shall not constitute disposable income as defined in
section 1325(b)(2)." § 541(b)(7) (the so-called "hanging paragraph."). But Congress said this in the larger
context of § 541(a)(1). As the McCullers court pointed out, “[t]his structure suggests that section 541(b)(7)
excludes from property of the estate only property that would otherwise be included in the estate under section
541(a). Thus, the most natural reading of section 541(b)(7) is that it excludes from property of the estate only
those contributions made before the petition date." McCullers, 441 B.R. at 609-04. To this extent, we think the
BAP majority properly read §§ 541(a)(1) and (b) together, as defining "property of the estate" by what is
included and excluded at a fixed point in time — as of commencement of the bankruptcy case. We agree with
McCullers that for 672*672 this reason, the Johnson line of cases is not persuasive because they do not read §
541(b)(7) within the larger context of § 541 as a whole.

We find it is also significant that Congress placed the "disposable income" exception for voluntary retirement
contributions within the confines of § 541(b)(7), rather than in Chapter 13 itself. Like the McCullers court, we
think that "the most natural reading of section 541(b)(7) is that it excludes from property of the estate only
those contributions made before the petition date" as "indicated by its specifying the contributions excluded
from property of the estate and then stating that "such amount" shall not constitute disposable income.
McCullers, 441 B.R. at 609-04. Furthermore, as the McCullers court observed, the term "except that in the
hanging paragraph was designed simply to clarify that the voluntary retirement contributions excluded from
property of the estate are not post-petition income to the debtor. McCullers, 441 B.R. at 604-05. Restated,
the function of § 541(b)(7) was merely to clarify that pre-petition retirement contributions do not constitute
property of the estate or post-petition disposable income. See Baud, 441 B.R. at 677 & n. 5 (citing Collier on
Bankruptcy). Here, the BAP majority's reasoning fell short because it did not take into account the words
"except that such amount" at the beginning of the hanging paragraph excluding retirement contributions from
disposable income.

Similar to the analysis in Egan, Debtors argue that voluntary 401(k) contributions are excluded from Chapter
13 plans because § 1306(a) incorporates § 541 in toto, including § 541's exclusions. However, as just stated, this
argument ignores § 541(b)(7)'s express relationship with § 541(a)(1), whereby only those interests in property
set forth in § 541(b)(7)(A) in existence as of the commencement of a debtor's case are excluded from property
of the estate. Only by reading § 541(a)(1) and § 541(b)(7)(A) together can sufficient meaning be given to both
sections of § 541. Furthermore, if Debtors' theory that contributions to a qualified retirement plan never
constitute property of a bankruptcy estate was correct, Congress would not have needed to include an
additional provision in § 541(b)(7)(A) stating that such contributions are excluded from disposable income.

This distinction — between qualified retirement plan contributions in effect as of the commencement of a
bankruptcy case and those cases where contributions are not in effect as of commencement — is further clarified by the phrase "under this subparagraph" found in the hanging paragraph of § 541(b)(7)(A). If all contributions to qualified retirement plans were excluded from disposable income, regardless of whether they were in effect as of the commencement of the bankruptcy case, the phrase "under this subparagraph" would be superfluous, and § 541(b)(7) would simply read "such amount [qualified retirement plan contributions] shall not constitute disposable income as defined in section 1325(b)(2)." As it is written though, Congress intentionally limited the type of contributions to qualified retirement plans that would be excluded from disposable income, namely those "under this subparagraph", § 541(b)(7)(A), which in turn governs only those contributions in effect as of the commencement of a debtor's bankruptcy case, per § 541(a)(1).

Ultimately then, we find that the Prigge/McCullers interpretation is the most persuasive because it gives effect to every word in the statute. See Penn. Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 562, 110 S.Ct. 2126, 100 L.Ed.2d 674*674 488 (1990) ("Our cases express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment."); Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825, 877 & n. 11, 108 S.Ct. 2192, 100 L.Ed.2d 836 (1988) (same). Although "awkward" perhaps, we conclude, based on the language and structure of Chapter 13, incorporating § 541, that Congress intended to exclude from disposable income and projected disposable income available for unsecured creditors only voluntary retirement contributions already in existence at the time the petition is filed. [21]

It is true, as Debtors assert, that BAPCPA added new protections for retirement funds that did not exist under pre-BAPCPA law, namely § 1222(f) and § 541(b)(7). There is legislative history to this effect. See H.R.Rep. No. 109-31, pt. 1, p. 2-3 (2005), 2005 U.S.C.C.A.N. 88, 89 ("S. 256 also includes various consumer protection reforms.... S. 256 allows debtors to shelter from the claims of creditors certain education IRA plans and retirement pension funds."). [20] (On the other hand, as we recognized in Baud, BAPCPA's "core purpose" is to ensure that debtors devote their full disposable income to repaying creditors and maximizing creditor recoveries. Baud, 634 F.3d at 357. The legislative history supports this reading too. See H.R.Rep. No. 109-31, pt. 1, p. 2-3 (2005), 2005 U.S.C.C.A.N. 88 at 89 ("The heart of the bill's consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism ("needs-based bankruptcy relief" or "means testing"), which is intended to ensure that debtors repay creditors the maximum they can afford."). Ransom, 331 S.Ct. at 724 (stating that Congress enacted the BAPCPA "to correct perceived "unutility" of the bankruptcy system, and enacted the "means test" of § 707(b) in particular, "to help ensure that debtors who can pay creditors do pay them.") Ransom, 331 S.Ct. at 724. Thus, as in Baud, "we adopt the interpretation of [§§ 541(a)(1), 541(b)(7), and 1325] that is not only more consistent with the language of the statute[s] than the competing interpretation, but that is also consistent with the legislative history and the overriding purpose of BAPCPA as recognized in Lanning and Ransom." Baud, 634 F.3d at 357.

In sum, for the foregoing reasons, we hold that the income made available once Debtors' 401(k) loan repayments are fully repaid is properly committed to the debtors' respective Chapter 13 plans for distribution to the unsecured creditors and may not be used to make voluntary retirement contributions.

III. Conclusion

Although for slightly different reasons than those provided by the BAP majority in this case, its judgment is AFFIRMED.

[1] Carrie Schuler did not seek to begin making contributions to a qualified retirement plan during the life of the joint Chapter 13 plan. Accordingly, only Frederick Schuler and Seafort are referred to as "Debtors."

[2] ERISA 401(k) qualified retirement plan refers to an employee benefit plan that is subject to Title I of the Employee Retirement Income Security Act of 1974, or an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986, as set forth in 11 U.S.C. § 541(b)(7)(A)(i)(i).

[3] Section 1325(b)(2) contains three exceptions to "disposable income":

(A)(i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and

(ii) for charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to a qualified religious or charitable entity or organization (as defined in section 548(d)(4)) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.


(7) any amount —

(A) withheld by an employer from the wages of employees for payment as contributions —
(i) to —

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986; except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325(b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title; or

(B) received by an employer from employees for payment as contributions —

(i) to —

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986; except that such amount under this subparagraph shall not constitute disposable income, as defined in section 1325(b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title[.]

Section 541(b) lists a number of exclusions, including, inter alia, any power that the debtor may exercise for the benefit of some other entity; any eligibility to participate in programs authorized under the Higher Education Act; any interest in liquid or gaseous hydrocarbons; and funds used to purchase a tuition credit. See 11 U.S.C. § 541(b).


Section 1325(a)(3) states that “the court shall confirm a plan if — ... (3) the plan has been proposed in good faith and not by any means forbidden by law.” 11 U.S.C. § 1325(a)(3). This is a mandatory requirement. See Shaw v. Aurgroup Fin. Credit Union, 552 F.3d 447, 455 (6th Cir.2009).

The Trustee “concedes” that if a debtor is making voluntary retirement contributions when the bankruptcy petition is filed, such continuing contributions may be excluded from disposable income. We do not agree with this assertion, for the reasons stated in Prigge. However, our view is not relevant here, because this issue is not presently before us.

Notwithstanding, as the dissent in the case sub judice points out: “It is an unfortunate fact that there exists virtually no real legislative history for the detailed provisions of BAPCPA.” 437 B.R. at 220 (citing Susan Jensen, A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 79 Am. Bankr. L.J. 485 (2005)).
No. 19-3117

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

In re: CAMILLE T. DAVIS

Debtor

CAMILLE T. DAVIS

Appellant

v.

LAUREN A. HELBLING

Appellee

Appeal from the United States Bankruptcy Court For the Northern District of Ohio Case No. 17-12965 The Honorable Arthur I. Harris, Judge Presiding

BRIEF OF DEBTOR-APPELLANT CAMILLE T. DAVIS

Eugene R. Wedoff
144 N. Elmwood Ave.
Oak Park, IL 60302
Phone: 312-285-5849
erwedoff@me.com

Joseph M. Romano
526 Superior Avenue E
333 Leader Building
Cleveland, OH 44114
Phone: 216-621-7777
jromanolaw@sbcglobal.net

Attorneys for Debtor-Appellant Camille T. Davis
Statement of Jurisdiction

This is a direct appeal of an order of the Bankruptcy Court for the Northern District of Ohio, entered on September 13, 2018, confirming a Chapter 13 plan. Bankruptcy Case No. 17-bk-12965, R. 63. An order of plan confirmation is a final and appealable order under 28 U.S.C. § 158(a)(1), (d). See Bullard v. Blue Hills Bank, 135 S. Ct. 1686, 1692 (2015). Although Camille Davis, the debtor in the bankruptcy case, proposed the plan, she has standing to object to its confirmation in order to assert that a plan she had previously proposed should have been confirmed. See Zahn v. Fink (In re Zahn), 526 F.3d 1140, 1143-44 (8th Cir. 2008); Lindsey v. Pinnacle National Bank (In re Lindsey), 726 F.3d 857, 860-61 (6th Cir. 2013) (recognizing the availability of the procedure set out in Zahn). Ms. Davis’s notice of appeal from the confirmation order was filed on September 15, within the time allowed by Fed. R. Bankr. P. 8002(a)(1). R. 66.

Ms. Davis’s Request for Certification of Direct Appeal was filed on October 5, within 60 days after entry of the order of confirmation, as required by Fed. R. Bankr. P. 8006(f)(1). R. 84. The Bankruptcy Court granted the request on October 25, certifying the order for direct appeal.
R. 88. A request for permission to take a direct appeal was filed with this Court on December 10, and the Court granted the request by order entered on February 14. Circuit Case No. 18-319, R. 1 and R. 6.

Statement of Issues

This appeal raises a single issue for determination: the extent, if any, to which 11 U.S.C. § 541(b)(7) reduces the disposable income that a Chapter 13 plan must pay on unsecured claims by the contributions that the debtor was making to an employer-sponsored retirement plan before the bankruptcy case was filed.

Statement of the Case

None of the facts relevant to this appeal are disputed. Camille Davis, the appellant, is the debtor in a voluntary bankruptcy case under Chapter 13 of the Bankruptcy Code. Bankruptcy Petition, R. 1. Before she filed her case, Ms. Davis had arranged with her employer to contribute to a 401(k) retirement account, through monthly deductions from her compensation in the amount of $226.96. R. 1, Page ID # 36, line 5c. Her contributions had been made over an extended time, and by the time of her bankruptcy filing, the retirement account had a balance of slightly more than $20,000. R. 1, PageID # 12, ¶ 21.
Ms. Davis sought to continue funding the retirement account during her bankruptcy case, and so, in completing the official form for calculating her “disposable income”—the amount that she could be required to pay to her unsecured creditors under § 1325(b)(2)(B) of the Bankruptcy Code—Ms. Davis deducted her $226.96 monthly contribution, resulting in disposable income of $323. Official Bankruptcy Form 122C-2, R. 34-1, Page ID # 10, lines 41, 45.

The Chapter 13 plan that Ms. Davis filed in connection with this form—her preferred plan—provided for payment of unsecured claims in the amount of $19,380, the sum of 60 monthly payments of $323 in disposable income. Amended Chapter 13 Plan, R. 32-1, Page ID # 5, ¶ 7.

The Chapter 13 trustee objected to confirmation of this plan, contending that Ms. Davis’s retirement contribution was not allowed to be deducted from disposable income. R. 43, Page ID # 1, ¶ 1. After receiving briefs from the parties, the bankruptcy judge sustained the trustee’s objection in an oral ruling, R. 140, excerpts of which are set out in the addendum to this brief, A2-A9. The judge explained that his ruling was made in deference to dicta in Seafort v. Burden (In re Seafort), 669 F.3d 662 (6th Cir. 2012). Id., A4-A5.

To obtain appellate review of the bankruptcy court’s ruling, Ms. Davis followed the procedure suggested in Zahn v. Fink (In re Zahn),
526 F.3d 1140, 1143-44 (8th Cir. 2008) and recognized by this Court in
Lindsey v. Pinnacle National Bank (In re Lindsey), 726 F.3d 857, 860-61
(6th Cir. 2013). She filed an amended Form 122C2 that both reflected
an increase in her earnings and—consistent with the bankruptcy court’s
ruling—made no deduction from disposable income for her retirement
contributions and so, as a result, provided for increased payments on
unsecured claims. R. 59-1, PageID # 10, lines 39, 41, 45. Consistent
with this calculation of disposable income, Ms. Davis filed an amended
plan—the appealable plan—that provided for the additional payment
on unsecured claims. R. 57-1, PageID # 5 ¶ 7. Because she believes
that this appealable plan improperly included the amount of her
proposed retirement contributions in the unsecured debt payments, Ms.
Davis objected to its confirmation. R. 60. The bankruptcy court
confirmed the plan over this objection, R. 63. Ms. Davis has appealed
the confirmation order. Notice of Appeal, R. 66.
Summary of the Argument

Under § 1325(b)(2) of the Bankruptcy Code, a Chapter 13 plan must be denied confirmation if it is subject to an objection by the trustee or an unsecured creditor and it fails to provide for unsecured claims either to be paid in full or to be paid with all of the debtor’s disposable income.\(^1\) The trustee objected to Ms. Davis’s preferred plan, which did not pay unsecured claims in full, on the ground that it also failed to pay these claims with all of her disposable income, since she had deducted from disposable income the amount of monthly contributions she was making to her retirement account.

Ms. Davis’s position is that these retirement contributions, which she had been making well before her bankruptcy filing, are excluded from disposable income by § 541(b)(7) of the Code. Section 541(b)(7) contains two subparagraphs, each providing that amounts contributed to specified employer-sponsored retirement accounts are excluded from

\(^1\) The full text of § 1325(b), is set out in the addendum to this brief at A11.
property of the estate. After setting out this provision, each subparagraph adds the following clause: “except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325(b)(2).”

The application of § 541(b)(7)’s disposable income clause has been addressed repeatedly in judicial decisions, both before and after this Court considered the issue in Seafort v. Burden (In re Seafort), 669 F.3d 662 (6th Cir. 2012).

In Seafort, the court identified three different approaches that courts had taken in determining whether and to what extent § 541(b)(7) allows a Chapter 13 debtor to reduce disposable income by proposed contributions to an employer-sponsored retirement account:

1. a “full-deduction” approach: that § 541(b)(7) allows a deduction from disposable income for the full amount of any future retirement contributions that the debtor proposes to make,

2. a “limited-deduction” approach: that § 541(b)(7) allows a deduction only in the amount of a retirement contribution that the debtor was making at the time of the bankruptcy filing, and

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2 The full text of § 541(b)(7) is set out in the addendum at A9.
(3) a “no-deduction” approach: that § 541(b)(7) allows no deduction from disposable income for any proposed retirement contributions. *Seafort*, 669 F.3d at 667.

The *Seafort* decision rejected the full-deduction approach, preferring the no-deduction approach. *Id.* at 672-74. But the debtors in *Seafort* had not been making retirement contributions at the time of their bankruptcy filing, and the opinion noted that the validity of the limited-deduction approach, which the BAP had adopted, was not before the Court. *Id.* at 674 n.7. After the *Seafort* opinion was issued, decisions have continued to be divided among the three approaches in applying § 541(b)(7). *See In re Melendez*, 2019 Bankr. LEXIS 547 at *15-16 (Bankr. D. Colo. 2019) (collecting authorities).

As reflected in the continuing judicial disagreement, each of the three interpretations of § 541(b)(7) presents difficulties. The full-deduction approach does not take account of the placement of the disposable income clause in § 541(b)(7), which otherwise deals only with property of the estate, not disposable income, and it gives no meaning to the words “except that” at the beginning of the clause. These problems were pointed out in *In re McCullers*, 451 B.R. 498, 503-05 (Bankr. N.D. Cal. 2011), in an
analysis that *Seafort* cited approvingly, 669 F.3d at 671-73. The limited-deduction approach also fails to give meaning to the words “except that,” and does not explain how § 541(b)(7) places any previous retirement contributions into an amount deductible from disposable income. *McCullers*, 451 B.R. at 504; *Seafort*, 669 F.3d at 671. But the no-deduction interpretation of the disposable income clause adopted in *McCullers* is also problematic. *McCullers* itself recognized “it is unlikely” that under this interpretation the clause would have any effect on disposable income. 451 B.R. at 504-05. Indeed, under the no-deduction approach the exception from disposable income set out in the clause “is really a meaningless one.” Pernell W. McGuire, Aubrey L. Thomas, *401(k) Contributions Under Post-BAPCPA Case Law*, 32-MAR Am. Bankr. Inst. J. 18, 20 (2013).

A fourth interpretation of § 541(b)(7), more reasonable than any of approaches considered in *Seafort*, was proposed only after *Seafort* was decided, in *In re Bruce*, 484 B.R. 387, 394 (Bankr. W.D. Wash. 2012), and in *401(k) Contributions Under Post-BAPCPA Case Law*, 32-MAR Am. Bankr. Inst. J. at 20. This approach applies the disposable income
clause of § 541(b)(7) to the calculation of current monthly income, defined in § 101(10A) of the Code, the starting point for calculating disposable income.² The definition of current monthly income has as its basis the average of monthly income that the debtor received in the six calendar months before the bankruptcy case was filed. If retirement contributions are excepted from this income by § 541(b)(7), then disposable income is reduced, and the debtor’s post-bankruptcy income will be, to that extent, available for continued retirement contributions. However, a debtor who did not make retirement contributions in the six months before filing will have no reduction in disposable income—the result reached in Seafort—and a debtor whose contributions began less than six months before filing will have a reduction in disposable income less than the full contribution amount, because of the six-month averaging.

This interpretation gives meaning to the language of the disposable income clause, provides a reason for its placement in § 541, and balances two aims of the 2005 amendments of the Bankruptcy Code that

² The full text of § 101(10A) is set out in the addendum to this brief at A9.
are in tension, protecting retirement savings and assuring payment of claims to the extent reasonably possible.

Because Ms. Davis made contributions to her 401(k) account throughout the six months before her bankruptcy filing, her current monthly income and disposable income should have been reduced by the amount of those contributions, her preferred bankruptcy plan should not have been denied confirmation due to a shortfall in payments of disposable income, and confirmation of her appealable plan, now in effect, should be reversed.

**Argument**

The interpretation of the disposable income clause in § 541(b)(7)—determining the extent to which its treatment of retirement contributions affects disposable income—requires a fairly extensive background in provisions of the Bankruptcy Code establishing the meaning of disposable income. The argument in this brief sets out that background and then addresses the best interpretation of § 541(b)(7).

*Statutory background: disposable income*

The full text of the provisions discussed below is set out in the addendum to this brief.
1. The trustee’s objection to Ms. Davis’s preferred plan was brought under § 1325(b)(1)(B), which provides that if the trustee objects to confirmation, and if the plan does not provide for all unsecured claims to be paid in full,

   the court may not approve the plan unless . . . the plan provides that all of the debtor’s projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors.

2. Because this definition requires the plan to make payments of disposable income “to be received” during a period beginning with the first payment due under the plan, disposable income is always income received after the bankruptcy filing, rather than any income received before filing. Ms. Davis has income above the state median, and so, under § 1325(b)(4), the period of her required payments of disposable income is five years.

3. “Disposable income,” for purposes of § 1325(b)(1)(B), is defined in § 1325(b)(2), and has “current monthly income” as its starting point: “[T]he term “disposable income” means current monthly income received by the debtor . . . .”
4. “Current monthly income” (CMI) is also a defined term, under § 101(10A):

The term “current monthly income” . . . means the average monthly income from all sources that the debtor receives . . . derived during the 6-month period ending on . . . the last day of the calendar month immediately preceding the date of the commencement of the case . . . .

Under this definition, CMI is a monthly average amount calculated on the basis of what the debtor received during the six-month period before the case is filed. This pre-bankruptcy average is then used as the first element in calculating how much of the debtor’s post-bankruptcy income is disposable income.

5. The remaining calculation of disposable income involves deductions from CMI. The definition of disposable income in § 1325(b)(2) states first that CMI excludes certain items of income—child support

4 The definition also specifies that if the debtor does not file a Schedule I income statement, the six-month period would end on the date that the court determines current monthly income. See In re Ingram, 2006 Bankr. LEXIS 4635, 2006 WL 6070518 (Bankr. E.D.N.C. 2006) (ordering an extension of time for filing Schedule I to permit a later six-month period for determining CMI). In the absence of such a court order, however, Schedule I must be timely filed or the debtor’s case is automatically dismissed under § 521(i)(1).
payments, foster care payments, and disability payments for a dependent child. The definition then provides for deductions from CMI for support and charitable donations. For debtors whose income is above the state median, the support deduction is further defined by § 1325(b)(3), which applies the provisions of § 702(b)(2), commonly called the “means test,” to determine allowed expense amounts.

6. Finally, because “disposable income” is required to be “projected” under § 1325(b)(1)(B), it may be altered by changes in either the defined income or expenses that are known or virtually certain to occur. *Hamilton v. Lanning*, 560 U.S. 505, 517, 524 (2010).

7. The result of these provisions is a three-step process for determining projected disposable income under § 1325(b)(1) for a debtor with above-median income:

- Calculate the debtor’s CMI amount as defined by § 101(10A), and for each month during the applicable commitment period increase or decrease this average by any changes in income known or virtually certain to occur.

- Calculate the debtor's expenses under § 707(b)(2), and again, for each month during the applicable commitment period, increase or
decrease these expenses by any changes known or virtually certain to occur.

- Subtract the expenses from the income for each month of the applicable commitment period.

**Retirement contributions**

Nothing in the Code’s treatment of disposable income discussed above provides for any reduction of disposable income based on the debtor’s contributions to an employer-sponsored retirement program, such as a plan under 26 U.S.C. § 401(k). However, the 2005 BAPCPA amendments added to the Code a new paragraph, § 541(b)(7), which does treat retirement contributions. *See In re Leahy*, 370 B.R. 620, 623-24 (Bankr. D. Vt. 2007) (discussing the scope of § 541(b)(7)).

The new paragraph is part of the list of items in § 541(b) excluded from property of the bankruptcy estate defined in § 541(a). The exclusion in paragraph (7) is for contributions to employee retirement accounts, specifically “any amount (A) withheld by an employer from the wages of employees for payment as [defined retirement] contributions . . . or (B) received by an employer from employees for payment as [defined retirement] contributions.” There is nothing in this exclusion of
retirement contributions from estate property that directly bears on a
debtor's disposable income. However, each of the subparagraphs of
§ 541(b)(7) ends with the following clause: “except that such amount under
this subparagraph shall not constitute disposable income as defined in
section 1325(b)(2).” 5

This disposable income clause has widely been recognized as
poorly placed. See, e.g., In re Vanlandingham, 516 B.R. 628, 632
(Bankr. D. Kan. 2014), citing decisions that describe the presence of the
clause in § 541(b)(7) as “oddly-worded,” “awkward,” and “a Gordian
knot.” Part of the problem, as Vanlandingham points out, is that the

5 The decisions interpreting § 541(b)(7) have not labeled this
clause uniformly. The BAP opinion in Seafort called it the “hanging
Cir. 2010), and several other opinions apply the term “hanging para-
graph” to § 541(b)(7) generally, as this Court noted in its Seafort opin-
ion, 669 F.3d at 672. But this use of “hanging” may be misleading.
Other provisions added to Bankruptcy Code by BAPCPA have been
called “hanging” because they are separate from the rest of the section
in which they appear, but are not introduced by a paragraph number.
See, e.g., Americredit Financial Services v. Moore, 517 F.3d 987, 989 n.2
(8th Cir. 2008) (“The ‘hanging paragraph’ is a term used to describe the
unnumbered paragraph in 11 U.S.C. § 1325, directly following
§ 1325 (a)(9).”) Because the clause beginning with “except that” in
§ 541(b)(7) is an integral part of a separately number paragraph, calling
it simply the “disposable income clause” may be clearer.
clause injects consideration of disposable income—what a debtor needs to pay to creditors after filing the bankruptcy case—into a section of the Bankruptcy Code that otherwise deals only with property of the estate, which focuses on what the debtor owns at the time of the filing. *Id.*

There is, however, a more fundamental problem caused by the introductory words of the clause. The words “except that” are used to point out an exception from a previously stated general rule. For example, the general rule of § 1221 of the Bankruptcy Code—that “[t]he debtor shall file a plan not later than 90 days after the order for relief under this chapter”—is followed by a clause starting with the words “except that” setting out circumstances under which the 90-day limit would not apply: “except that the court may extend such period if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable.” Similarly, § 726(b) of the Code generally provides that if the assets of a bankruptcy estate are insufficient to pay in full all of the claims at a given priority level, payment should be made pro rata among all of the claims at that level of priority. This general rule of pro rata distribution is then followed by a clause
setting out a circumstance in which administrative claims in a converted Chapter 7 case are paid at a higher rate than administrative claims incurred before the conversion: “except that in a case that has been converted to this chapter . . . a claim allowed under section 503(b) . . . incurred . . . after such conversion has priority over a claim allowed under section 503(b) of this title incurred under any other chapter of this title.” These examples show how the words “except that” introduce a limitation to a general rule stated just before the exception. If a clause beginning with “except that” follows a statement to which it cannot be an exception, a non sequitur results, for example: “All players must wear head protection during the game, except that the playing field may be marked in 10-yard increments.”

The disposable income clause in § 541(b)(7) produces this kind of non sequitur. The entirety of § 541, apart from the disposable income clause, deals only with property of the estate, and § 541(b)(7) itself is only an exception to the general definition of estate property in § 541(a).
The clause in § 541(b)(7), excepting retirement contributions from disposable income, does not identify the rule from which it is an exception.6

The interpretative challenge presented by the disposable income clause is to give meaning both to its language, including “except that,” and its placement in § 541. As this Court stated in Seafort, 669 F.3d at 667, courts considering the clause have come to three different interpretations, and the division has continued in decisions rendered in the seven years since the Seafort decision. See In re Melendez, 2019 Bankr. LEXIS 547 at *15-16 (Bankr. D. Colo. 2019) (collecting authorities). As reflected in the continuing disagreement, each of these interpretative approaches presents difficulties.

6 This problem with the disposable income clause is noted in Pernell W. McGuire, Aubrey L. Thomas, 401(k) Contributions Under Post-BAPCPA Case Law, 32-MAR Am. Bankr. Inst. J. 18, 19 (2013) (“[I]n drafting § 541(b)(7)(A), Congress jumped from point A to point C, conflating distinct and arguably unrelated concepts (i.e., property of the estate and disposable income) without explaining the logical connection between the two.”).
1. Full deduction of proposed retirement contributions from disposable income

The interpretative approach that has been applied most frequently reads the disposable income clause in § 541(b)(7) as allowing Chapter 13 plans to exclude from the disposable income paid to unsecured claims any retirement contribution that the debtor proposes to make, regardless of whether the debtor was making contributions before filing the bankruptcy case and subject only to the general requirement under § 1325(a)(3) that the plan be proposed in good faith. This approach was first applied in Baxter v. Johnson (In re Johnson), 346 B.R. 256, 263 (Bankr. S.D. Ga. 2006), and is sometimes called the Johnson interpretation. It is grounded in a consideration of plain language. See, e.g., In re Drapeau, 485 B.R. 29, 38 (Bankr. D. Mass. 2013) (“Because the plain language of § 541(b)(7) is clear, reliance on legislative history or the purpose of the BAPCPA amendments is unnecessary . . . .”) Indeed, if only the words following “except that” are considered, and its location in § 541 is ignored, the clause does provide plainly that retirement contributions “shall not constitute disposable income as defined in section 1325(b)(2).”
However, ignoring the introductory words of the phrase is contrary to the basic rule that all of the words in a statute should be given meaning. *Ohio Valley Environmental Coalition v. Aracoma Coal Co.*, 556 F.3d 177, 218 (4th Cir. 2009). One of the decisions allowing full deduction of retirement contributions recognized this difficulty and gives a response:

To be sure, the drafting of the “hanging paragraph,” is awkward, and courts have endeavored to understand and give meaning to the words “except that” which precede the statement that the contributions are not disposable income. But the awkwardness of the language does not warrant a strained reading of the otherwise clear pronouncement that voluntary retirement contributions are excluded from the § 1325(b) disposable income calculation. To the extent that the inclusion of the phrase “except that” is deemed surplusage, in the context of the otherwise plain meaning of the statute and absent any other indication to the contrary, this Court should follow the Supreme Court’s admonition in *Lamie v. U.S. Trustee* that a statute’s mere “awkwardness” must not be allowed to alter its plain meaning:

Where there are two ways to read the text — either [with] surplusage, in which case the text is plain; or [without surplusage] . . . in which case the text is ambiguous — applying the rule against surplusage is, absent other indications, inappropriate. We should prefer the plain meaning since that approach respects the words of Congress.


This response, however, is not persuasive. Lamie held that it was appropriate not to apply the rule against surplusage to words that had not been removed from the Bankruptcy Code by an amendment that otherwise eliminated estate compensation of a Chapter 7 debtor’s attorney. Here the words “except that” were part of the amendment itself. Moreover, as this Court held in Seafort, the context of the clause in § 541 should not be ignored. 669 F.3d at 673 (“[T]he Johnson line of cases are not persuasive because they do not read § 541(b)(7) within the larger context of § 541 as a whole.”)

Moreover, another problem with full-deduction is ignoring the placement of the disposable income clause in § 541. If full-deduction of retirement contributions had been intended, the appropriate place to have provided for it would have been in § 1325(b)(2)(A) following the allowance of charitable donations. The choice of § 541 as the location of the clause should have significance for its interpretation.

Finally, the full-deduction approach allows debtors, at the time of their bankruptcy filings, to arrange for potentially large amounts of income that would otherwise pay unsecured creditors to go instead to the debtors’ retirement account, a result that appears at odds with the

2. **Limited deduction of proposed retirement contributions from disposable income**

   The decision of the Bankruptcy Appellate Panel in Seafort set out an interpretation of the disposable income clause that addresses the problems of the full-deduction approach in two ways. First, it accounted for the placement of the clause in § 541 by holding that, consistent with § 541(a)’s definition of estate property, the clause applies to the situation in existence at the time of the bankruptcy filing, not to the debtor’s post-bankruptcy income. 437 B.R. at 209. Second, the decision addressed the problem of unlimited retirement contributions conflicting with debt repayment by using the filing date status of the debtor’s retirement contributions:

   Congress clearly intended to strike a balance between protecting debtors’ ability to save for their retirement and requiring that debtors pay their creditors the maximum amount they can afford to pay. This balance is best achieved by permitting debtors who are making contributions to a Qualified Plan at the time their case is filed to continue making contributions, while requiring debtors who are not making contributions at the time a case is filed to commit
post-petition income which becomes available to the repayment of creditors rather than their own retirement plan. 437 B.R. at 210.

Although this limited-deduction approach has been adopted by some courts, e.g., *In re Thompson*, 2018 Bankr. LEXIS 555 at *6, 2018 WL 1320171 (Bankr. S.D. Ala. 2018), the approach also has a serious problem: there is nothing in the statutory language suggesting any basis for making the deduction of future retirement contributions dependent on whether a debtor made a retirement contribution just before filing the case. *See In re McCullers*, 451 B.R. 498, 503 (Bankr. N.D. Cal. 2011) (“[N]either the statute itself nor the Seafort decision offers any mechanism by which the fixed amount withheld as of the petition date is converted into a monthly rate of contribution that the debtor may continue postpetition.”); *RESFL Five, LLC v. Ulysse*, 2017 U.S. Dist. LEXIS 161751 at *19, 2017 WL 4348897, at *7 (S.D. Fla. 2017) (“[T]he Code contains no provisions supporting Seafort’s conclusion that those debtors making pre-petition contributions to a retirement account may continue making them post-petition while debtors who made no such pre-petition contributions are barred from doing so post-petition.”); *In re Cantu*, 553 B.R. 565, 577 (Bankr. E.D. Va. 2016) (“The Sixth Circuit
B.A.P.’s requirement that post-petition contributions be comparable to the debtor’s historic, pre-petition contributions appears to be grounded more in policy concerns than in the text of Section 541(b)(7).”

3. No deduction of proposed retirement contributions from disposable income.

The last of the three interpretative approaches, set out most clearly in *In re McCullers*, 451 B.R. 498, 503 (Bankr. N.D. Cal. 2011), begins with the placing of the disposable income clause in § 541. It agrees with the BAP’s *Seafort* opinion that the disposable income clause of § 541(b)(7), like § 541(a), deals only with the situation at the time of the filing of the case, and holds that the clause therefore has no application to retirement contributions made after the bankruptcy filing.

With minor exceptions not relevant here, section 541(a) defines as property of the estate only property that the debtor holds on the petition date . . . . Section 541(b) creates exceptions to section 541(a). This structure suggests that section 541(b)(7) excludes from property of the estate only property that would otherwise be included in the estate under section 541(a). Thus, the most natural reading of section 541(b)(7) is that it excludes from property of the estate only those contributions made before the petition date. That Congress intended to exclude from disposable income only the same prepetition contributions excluded from property of the estate is indicated by its specifying the contributions excluded from property of the estate and then stating that “such amount” shall not constitute disposable income.

This approach gives meaning to the words “except that” in the disposable income clause. It assumes a general rule under which contributions to a retirement account made before the bankruptcy filing (“prepetition” contributions) could be disposable income; the clause then would be an exception to this rule. The problem with this reading is that there cannot be a rule that includes in disposable income retirement contributions made before a bankruptcy filing. Section 1325(b)(1) only requires that a plan propose to make payments of disposable income “to be received in the applicable commitment period beginning on the date that the first payment is due under the plan”—a future date later than the bankruptcy filing. There is no obligation for a plan to propose payment of any income arising from prepetition retirement contributions, and so nothing for the disposable income clause to eliminate. McCullers itself recognized this problem, stating that it is “unlikely” that postpetition disposable income could be generated by prepetition retirement contributions; it is actually impossible. See In re Bruce, 484 B.R. 387, 391 (Bankr. W.D. Wash. 2012) (“If one accepts the initial premise . . . that § 541(b)(7)(A) only excludes prepetition amounts withheld by any
employer for a 401(k) or similar plan from treatment as property of the estate, and ‘such amount’ could only be withheld from prepetition income of the debtor, it is unclear how those amounts could ever be characterized as postpetition income.”); 5 Collier on Bankruptcy ¶ 541.23[1] (16th 2018) (“[A]ny funds in the hands of the employer as of the chapter 13 petition date would never be considered to be disposable income, which only includes income received by the debtor after the petition is filed.”); 401(k) Contributions Under Post-BAPCPA Case Law, 32-MAR Am. Bankr. Inst. J. at 20. (“[T]he exclusion that McCullers asserts that the hanging paragraph creates is really a meaningless one.”).

The no-deduction approach also creates difficulty in implementing the intent of the BAPCPA amendments. In contrast to the all-deduction approach, which gives little weight to BAPCPA’s goal of assuring payment to creditors from the debtor’s disposable income, the no-deduction approach gives little weight to BAPCPA’s goal of protecting retirement savings.
4. The CMI-interpretation: deduction of the average retirement contributions made during the six months before the bankruptcy filing

Although it had not been proposed at the time that this Court decided *Seafort*, there is a fourth approach to the interpreting the disposable income clause in § 541(b)(7), set out in *In re Bruce*, 484 B.R. 387, 394 (Bankr. W.D. Wash. 2012), and suggested in *401(k) Contributions Under Post-BAPCPA Case Law*, 32-MAR Am. Bankr. Inst. J. at 20; *see also In re Anh-Thu Thi Vu*, 2015 Bankr. LEXIS 1967 at *8 (Bankr. W.D. Wash. 2015) (reapplying the analysis that the court adopted in *Bruce*). Under this interpretation, the disposable income clause creates an exception from the general rule for determining the amount of current monthly income, CMI, set out in the definition of CMI, § 101(10A) of the Bankruptcy Code. As noted above in the statutory discussion (*supra*, p. 12), § 101(10A) calculates CMI by averaging the monthly income that the debtor receives in the six calendar months before the bankruptcy filing. The CMI interpretation provides that retirement contributions specified in § 541(b)(7) made during that six-month period are not counted in calculating CMI, so that CMI is reduced, and because CMI is the basis for determining disposable income, disposable income is reduced.
This CMI interpretation reasonably applies the disposable income clause, avoiding the problems of the other interpretative approaches. Specifically:

- The CMI interpretation provides a rationale for placement of the disposable income clause in § 541. Paragraph (b)(7) sets out an exception from property of the estate for retirement contributions made before a bankruptcy case filing. Deductions of retirement contributions from CMI are also applied before bankruptcy, and the paragraph's definition of excluded retirement contributions affects both estate property and CMI.

- The CMI interpretation gives meaning to the words “except that” in § 541(b)(7)—the general rule of § 101(10A), basing CMI on all of the debtor’s income, is made subject to an exception for the defined retirement contributions.

- The CMI interpretation has a significant effect, reducing the amount that a Chapter 13 debtor may be required to pay on unsecured claims by the average retirement contribution that the debtor made in the six months before the bankruptcy filing, and
so permitting continued retirement contributions in that average amount during the bankruptcy case.

- The CMI interpretation balances the BAPCPA goals of debt payment and retirement protection. Only debtors who have been making retirement contributions for six months before their bankruptcy filing will obtain the full amount of their monthly contribution as a deduction from CMI. A debtor who has made no retirement contributions in the six-month period would have no reduction in disposable income, and joining an employer-sponsored retirement plan on the eve of bankruptcy would have a minimal effect in reducing disposable income.

The CMI interpretation, then, should be adopted by this Court as the most reasonable reading of § 541(b)(7). As applied in Ms. Davis’s bankruptcy case, this interpretation provides no basis for finding that her preferred plan failed to pay her disposable income as required by § 1325(b), since her disposable income would have been reduced by the amount of the retirement contributions she made in the six months before her bankruptcy filing. Her objection to the confirmed plan that is
now in effect in her case should have been sustained, on the ground that increased disposable income should not have been required.

**Conclusion**

For the reasons set out above, the decision of the Bankruptcy Court confirming the Chapter 13 plan now in effect should be reversed and this case should be remanded to the Bankruptcy Court with direction that a plan proposed by the debtor may be confirmed without including in disposable income the amount of the monthly retirement contributions she had been making before her case was filed.

Respectfully submitted,

/s/ Eugene R. Wedoff

Eugene R. Wedoff
144 N. Elmwood Ave.
Oak Park, IL 60302
Phone: 312-285-5849
erwedoff@me.com

Joseph M. Romano
526 Superior Avenue E
333 Leader Building
Cleveland, OH 44114
Phone: 216-621-7777
jromanolaw@sbcglobal.net
NCBJ: HOT TOPICS IN CONSUMER CASES
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Prepared By

Neil C. Gordon
Arnall Golden Gregory LLP
Atlanta, Georgia
Neil C. Gordon is a partner in the Atlanta office of Arnall Golden Gregory LLP. He served for two years as a law clerk in Atlanta for United States District Court Judge Robert L. Vining, Jr., followed by 38 years in private practice, with the last 35 years being exclusively in the areas of bankruptcy, business reorganization, fraud investigations, and creditors’ rights. Mr. Gordon represents trustees and receivers throughout the country, including in Delaware litigation that recently settled for approximately $40 million.

Mr. Gordon chaired the Bankruptcy Law Section of the Atlanta Bar Association from 1992 to 1993, and has been a panel trustee since 1994, and also serves as a SEC Receiver. Mr. Gordon was first elected to the Board of the National Association of Bankruptcy Trustees in 2000. He has held every office including President (2011-2012) and for eight years chaired its Amicus Committee. Mr. Gordon has authored or co-authored over 75 scholarly articles and book chapters on bankruptcy law related topics and made over 165 seminar presentations throughout the country. He served for three years ending in April 2015 as the Co-Chair of the ABI’s Legislation Committee. He is a Lifetime Member of the ABI and the NABT President’s Circle, a Master of the Bench in the W. Homer Drake, Jr., Georgia Bankruptcy American Inns of Court, a Full Member of the National Association of Federal Equity Receivers, and a Fellow of the American College of Bankruptcy.

**A. AVOIDANCE**
No Preference Exposure Results from Non-Collusive Pre-petition Foreclosure Sale


- D’s home sold at FC pre-petition
- 1st mortgagee Capital One conducts FC sale
- Fifth Third Bank holds the second mortgage and bids amount necessary to satisfy 1st mortgage ($90K)

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**Veltre**

- D files Ch.11 and then AP to avoid the purchase as a preference, asserting value was far greater
- B.Ct. dismisses – as a matter of law, non-collusive properly conducted sale could not be a preference
- D.Ct. affirms
- Circuit Ct. affirms, rejecting argument that bidder received more than under a hypothetical Ch.7
**NOTES:**

- *BFP v. Resolution Trust Corp.*, 511 US 531,547 (1994) was ambiguous as to a FC’d property, but under PA. law, it is presumed that the sale price constitutes the highest and best obtainable.
- So preference theory fails.

**Neil’s Comments:**

- BFP – FC sale price deemed reasonably equivalent value for the §548 purposes.
- BFP – Also applied to §549 “present fair equivalent value”.
- §547 is not based on value equivalence. It is based on what T would receive in a hypothetical sale versus what was actually paid.
- State law and extreme disparities can play a role.
COMPARE:

  (T cd. Have orchestrated an orderly sale to produce a far greater value than the FC sale credit bid)

  (Creditor credit bids against its claim of $2.855 MM a bid price of $1.22 MM for a property worth $3.3 MM. Held, potentially avoidable as a preference)
§ 544(b):

“the trustee may avoid any transfer of an interest of the debtor or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim....”

Can Trustee stand in the shoes of the IRS as the “golden creditor” and assert its 10-year reachback for avoidance of fraudulent transfers?

**No**

- (while “no time runs against the king,” it does against the trustee)
Yes


2. **In re Kipnis**, 555 B.R. 877 (Bankr. S.D. Fla. 2016) (Mark, J.)


and this case holds that trustee is allowed to use the 10-year look back period available to a federal environmental agency.


*In re Kipnis*, 555 B.R. 877 (Bankr. S.D. Fla. 2016) (Mark, J.)

- 2014 Chapter 11 case converted to Chapter 7
- IRS POC almost $2 MM
- Trustee sues to avoid transfers in 2005 made after IRS makes a determination of a $1 MM deficiency
Kipnis

- IRC §6502(a) allows IRS to collect by levy or court proceeding initiated within 10 years after the assessment of the tax
- IRC §6901(a)(1)(A) provides authority for the IRS to pursue avoidance actions against transferees of taxpayer’s property
- §544(b) allows Trustee to step into shoes of IRS and utilize its 10-year reachback
- Vaughn wrong. Language of statute is clear and could not be contradicted by policy arguments

Trustee entitled to use Federal Debt Collection Procedures Act to reachback 6 years

Gordon v. Harrison

- 28 U.S.C. § 3306(b) – 6 year reachback on fraudulent transfers
- Transfers occur 5 years out
- IRS large claimant – on both transfer and petition dates
- Motion to Dismiss denied – case settles for $950,000
- NOTE: §§ 3304(a)(2) and 3302(b)(3) – provides 2 year look-back on insider preferences

In re Kaiser, 525 B.R. 697, 713 (Bankr. N.D.Ill. Dec. 31, 2014) (treating the FDCPA as applicable law and allowing the trustee to use the IRS as the “golden creditor” under § 544(b))


In re Tronox Inc., 503 B.R. 239, 272-75 (Bankr. S.D.N.Y. 2013); In re Pfister, 2012 WL 1144540 (Bankr. D.S.C. 2012) (holding transfers were avoidable under §544(b)(1) and the FDCPA where the IRS was a creditor)

In re Walter, 462 B.R. 698, 704-706, 712 (Bankr. N.D.Iowa 2011) (holding trustee sufficiently plead a claim under §544(b)(1) and the FDCPA)

In re Porter, 2009 WL 902662 at *20-21 Bankr. D.S.D. 2009) (holding that a trustee could step into the shoes of the SBA and bring claims under the FDCPA and take advantage of the six year statute of limitations thereunder)
Trustee sues Rogich, Hackenberry, and Hackenberry’s wholly-owned business to avoid transfers made to them in repayment of antecedent debts > 1 year but < 2 years before Ch. 11 PD

Business also sued for unauthorized post-petition payments and preferences within and outside ninety days

IRS is a creditor so Trustee seeks to use FDCPA


Three elements to satisfy under §3304(a)(2):

1) “the transfer was made to an insider for an antecedent debt”

2) “the debtor was insolvent at the time of the transfer”

3) “the insider had reasonable cause to believe that the Debtor was insolvent”

§3302(b): Debtor presumed insolvent if it “is generally not paying its debts as they become due”

- Individual directors of the D advanced $110K and $100K, respectively, to cover different payrolls and were repaid a few weeks later, 13 and 14 months before the PD (the “Transfers”)

- Trustee demonstrates:
  
  1) BOA had frozen D’s operating account prior to the PD due to a garnishment on a $1.8 million judgment vs. D obtained before the Transfers

  2) IRS owed $170K for withholding taxes within 2 months of the Transfers and $420K more in additional taxes plus filed its POC for over $2.8 million (later amended to $3.7 million)

  3) The insiders had to advance $$ for substantial payrolls
1) Court grants partial summary judgment to trustee:
   (a) vs. the business on the 90-day preferences and unauthorized post-petition transfers totaling $62,000;
   (b) vs. the individuals on the first prong that they are insiders (being directors of the Debtor).

2) Court believed a trial was necessary on the other 2 prongs and denied summary judgment utilizing a “flexible – totality-of-the-circumstances test.” Court believed a complete balance sheet test was needed.

3) Court also required a trial to establish whether the business was an insider even though it was wholly owned by an insider.
Multi-day trial - Valdosta

Court finds defendants were insiders (being directors) and that D was insolvent on a balance sheet analysis

Court next focuses on whether they had reasonable cause to believe D was insolvent

They deny knowing anything about the IRS and other debts

Assert director meetings not regularly held, and when called, participated by telephone

Court finds no actual knowledge of the insolvency

Next turns to “inquiry notice” of the insolvency that could be imputed to them

Court finds D’s principal had failed to disclose that info. to them and lied to D’s own accountant
BANA extended $3 million LOC after a multi-day investigation of D’s finances

While far less than the $8 million sought, it was some objective evidence of how well D’s principal had hidden D’s true financial condition

Neil disagrees: BANA was interested in value of collateral and loan to value analysis

In re CVAH, Inc., 570 B.R. 816

(Bankr. D.Idaho 2017) (Pappas, J.)

4 consolidated APs
(one week after the preceding FDCPA cases)

- Tax debts of $1.5 million
- Debtor transfers $375K to pay the debts of other individuals or entities
CVAH

- Court denies MTD
- Enables trustee to proceed with extended reachbacks to avoid fraudulent transfers under FDCPA
- Follows majority of courts (better reasoned view)

CVAH

- Defendants first argue legislative history makes it inapplicable to bankruptcy
- Court rejects reliance on a single legislator/author that FDCPA not applicable to B.Code and relies on Sup. Ct. precedence

Trustee steps into shoes of IRS and employs its collection powers

Not about extended reachback, but other powers unique to the IRS

- Civil collection procedures were not exclusive to the United States and could be used by trustees
- No requirement of a prior assessment
- No necessity of exhausting collection remedies
- §3304(b) did not require the IRS to be a creditor at the time of the transfer
Gaither

- Debtors’ son dies in aviation accident
- Debtors appointed by probate court as personal representatives
- Debtors sue and settle for $1.3MM for a net recovery of $830,183
- Same day Ds disclaim their right to the settlement proceeds, so it would pass to their three surviving children ($276,727 each)

Gaither

- Children form an LLC and open an account in which the settlement proceeds are deposited
- Ds file Ch.7 < three years after the settlement
- IRS files total claim of $787,239 (s/c of $332,623, p/c of $102,873, u/c of $352,342)
Gaither

- Trustee sues under Section 544(b) to avoid the transfer to the children of the disclaimed settlement proceeds
- Defendants file MTD
- T asserts that she can employ FDCPA to avoid the transfer because IRS could have avoided the transfer “to satisfy the debt to the United States.” 28 U.S.C. §3306(a)(1)

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Gaither

- Such an action can be brought under §3304 where a debtor fraudulently transfers funds
- Defendants: (a) only the IRS could do so, and T lacked standing, and (b) FDCPA was not “applicable law under Section 544(b)”
- Bankruptcy Court rules for Trustee
**Gaither**

- *Moore v. Bay*, 284 U.S. 4 (1931) permits trustees to step into the shoes of actual creditors
- *Drye v. United States*, 528 U.S. 49, 59 (1999) S.Ct. held a disclaimer does not defeat a federal tax lien
- Trustee can step into shoes of IRS to avoid the transfer and collect the debt
- IRS has option to proceed under FDCPA or IRC
- Court traces history of Bank. Ct. holdings in support

What about Trustee using §548 (e)(1)?

New SOFA Forms
Part 7, Q.19

“Within 10 years before you filed for bankruptcy did you transfer any property to a self-settled trust or similar device of which you are a beneficiary?”

We may go 10 years before anyone actually checks that box!!
- Section 548(e)(1)—10-year reachback for Self-Settled Trust or Similar Device (with actual intent to hinder, delay or defraud)


**B. SUING UNIVERSITIES TO RECOVER TUITION PAID FOR ADULT CHILDREN**

Reasonably Equivalent Value

*In re Wierzbicki*, 830 F.3d 683 (*7th* Cir. 2016)

Intangible, non-economic benefits do not count as reasonably equivalent value in defense of a fraudulent transfer action.
While insolvent, debtor transfers (for $1 by QC deed) 40-acre farm in Wisconsin with $151K of equity

Chapter 7 fourteen months later

Trustee sues to avoid transfer

Only issue in dispute: was reasonably equivalent value exchanged for the transfer?

Purported consideration was stopping transferees endless litigation and appeals

Bankruptcy court – the “meritless appeals” had no value

Circuit Court agrees. Giving up the farm to eliminate the risk of losing the farm made little sense in terms of value

Circuit Court rejects transferee argument that available homestead exemptions eliminated the equity – not even relevant (nor is D even allowed an exemption in voluntarily transferred property)
Avoiding further family conflict too “nebulous” in a bankruptcy context, where the transfer put the debtor’s property beyond the reach of creditors

Creditors would be unwilling to volunteer to provide a financial subsidy to enhance the insolvent debtor’s family relationships by allowing the debtor to put valuable property beyond their reach

Other examples of what does not constitute reasonably equivalent value under §548:

- *In re Treadwell*, 699 F.2d 1050-1051 (11th Cir. 1983) (love and affection)

- *In re Bargfrede*, 117 F.3d 1078, 1080 (8th Cir 1997) (“non-economic benefits in the form of a release of a possible burden on the marital relationship and the preservation of the family relationship”)

- *In re Hinsley*, 201 F.3d 638, 643 (5th Cir. 2000) (intangible, non-economic benefits, such as preservation of marriage)
▪ Standard §548 defenses/issues apply such as solvency
▪ Real fight is over reasonably equivalent value
▪ Courts are divided on whether there is reasonably equivalent value in paying an adult child’s college tuition

Isn’t this just an intangible “nebulous,” speculative benefit?
Look at §548(d)(2) where “value” is defined as “property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor.” (emphasis added)

Is there reasonably equivalent value?

YES:  

NO:  
Dunston

Reasonably Equivalent Value

- Any moral obligation to pay for college and help daughter achieve financial independence did not:
  (i) provide an “economic” benefit to D,
  (ii) satisfy any legal duty or obligation to pay, and
  (iii) increase D’s assets in any way that could be used to pay her creditors

Knight

**NO:** Boscarino v. Board of Trustees of Conn. State Univ. System *(In re Knight)* 2017 WL 4410455 (Bankr. D.Conn. 9/29/17) (Tancredi, J.) (Conferred no value to D within meaning of §548(d)(2)(A). Expectation of future economic benefit is too speculative)
• Only issue is whether reasonably equivalent value was received in exchange for paying adult son’s tuition

• **Debtor**: enable son to move out of home and to achieve financial independence

• **University**: “value” received was discharge of familial obligation to pay tuition and expenses

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Court rejects:
“While such support is unquestionably admirable, it may have helped to fulfill her Expected Family Contribution under the federal financial aid regime, it is undisputed that the debtor had no legal obligation to pay for her adult son’s college education. The transfers did not, therefore, satisfy ‘a present or antecedent debt of the debtor’ or otherwise confer ‘value’ to the debtor within the meaning of 11 U.S.C. §548(d)(2)(A).” (emphasis added)
**No:** *Geltzer v. Oberlin College, et al (In re Sterman)*, WL 6333588 (Bankr. S.D.N.Y. Dec. 4, 2018) (Glenn, J.) (the purported economic “benefit” did not constitute “value” under either the B.Code or N.Y. law)

- This “is a culturally and socially charged issue.”

- Increasing likelihood of that children would be self-sufficient was not value under the B.Code or N.Y. law.

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**Geltzer**

- Moral obligation to pay is insufficient where there is no legal obligation

- Constructively fraudulent transfers that are recoverable only if made after children are legally adults (age 21 under N.Y. law) because parents require to support a non-adult child
In addition to the standard defenses, there are unique defenses to attempted clawbacks of tuition payments.

(A) POE (§529 Plans)

• 541(b)(6): POE excludes “funds … contributed to an account in accordance with §529(b)(1)(A) of the Internal Revenue Code … not later than 365 days before the [PD] ….”

• Must be able to adequately trace funds to D’s 529 plans

• May need evidence of D’s other income and expenses during relevant time periods
(B) Fed’l Direct Parent PLUS Loans ("FDPPL")

- Governed by Higher Education Act of 1965 (20 USC §1001 et seq.; 34 C.F.R. 685.100 et seq.)
- Parent can borrow to pay for tuition and other qualified educational expenses
- All loans are disbursed by either electronic transfer of funds directly from the lender to the eligible institution or
- a check co-payable to the eligible institution and the student or parent borrower


- Univ. receives transfers via FDPPL for adult child’s tuition
- T sues to recover $66,616
- Univ. moves to dismiss
- Motion granted. Transferred funds did not constitute an interest of the D in property
**Demitrus**

- Funds could never have been considered D’s property
- Funds never within the reach of creditors
- No diminishment of D’s bankruptcy estate
- Earmarked from lender to university

**Neil’s Comments**

- T could have successfully attacked this differently:
- T should have sought to avoid the obligation itself as fraudulently incurred because D likely did not receive reas. equiv. value for incurring the obligation
- Then sue to recover the loan repayments made by D to the lender
- T still would have no claim v. the university
(C) University as Mere Commercial Conduit


- T sues Hofstra Univ., Fairfield Univ. & Brooklyn Law School for approximately $278K total
- All 3 schools treated the funds similarly

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**Adamo**

- School accounts are created by the student with a unique user name and password
- Funds are placed in the account through an electronic portal and transferred to univ. general account only upon student’s registration for classes
- After D transfers the funds to those accounts, D cannot access the accounts absent account holder’s authorization. Nor can the schools utilize the funds
- If student withdraws from the programs, the student receives the refund of the account balance
- Any payments credited to student’s account are considered credits belonging to the student and not to any third party – such as D.
Adamo

- Ct. rules schools did not exercise dominion and control over the tuition payments
- Schools were mere commercial conduits
- Schools only gained dominion and control after student registered for classes that semester, whereupon funds would be applied to tuition
- If student withdrew, student would receive the funds and been under no obligation to return funds to D

Adamo

- Ct. equates the student portals to a bank account with the children/students as the initial transferees and the school as subsequent transferee
- Schools are then protected by asserting the good faith defense under §550(b) as value was given for the subsequent transfers to the school
- Bonded Finan. Svcs., Inc. v. European Amer. Bank, 838 F.2d 890 (7th Cir. 1988) is “exactly on point.” No different than a bank.
- The school’s electronic system was merely holding the funds for the student account holders. The schools/transferees were mere conduits.
Adamo

District Court vacates and remands
2018 WL 6182502 (E.D. N.Y. Nov. 27, 2018) (Ross, J.)
Amended 595 B.R. 6 (E.D.N.Y. 2019)

- B.Ct. failed to address a key factual question
- Transferee must lack dominion over the funds and not be able to use them for its own purposes to be a “mere conduit”
- A “mere conduit” is no more than a transmitter of the transfer

Adamo

- Here, tuition was not owed until a student had affirmatively registered for classes for the upcoming term
- If students withdrew without registering they would receive a refund of any prepaid tuition in their student accounts
- Payments made while D’s children were still eligible for a refund had to be treated differently from payments that children could not collect
- D.Ct. amends on motion for reconsideration to clarify that the court was not making a finding as to when a tuition payment would be refundable or not.
C. Carve-Out Sale Proceeds

Does a debtor’s unobjected-to homestead exemption trump the later “carve-out” proceeds?

NO

_In re Bunn-Rodemann_, 491 B.R. 132 (Bankr. E.D. Cal. 2013)

_In re Baldridge_, 2013 WL 1759365

_In re Reeves_, 2011 WL 841238
(Bankr. E.D. N.C. 2011 March 8, 2011)
aff’d, 546 Fed. Appx. 235 (4th Cir. 2013)

_In re Groben_, 2013 WL 5302798
(8th Cir. BAP 2013)

_In re Diener_, 2015 WL 4086154 (p. 31, #32)

Contra, _In re Wilson_, 494 B.R. 502
( Bankr. C.D.Cal. 2013)
(wild-card can be used)
Can D’s homestead exemption attach to the proceeds of a “short sale”?

Yes – NACBA Argued

No – Held Brown v. Ellman, 851 F.3d 619 (6th Cir. 2017)

Brown

Court authorized trustee’s sale of D’s homestead for $160K despite two mortgages with total payoffs of $219K

D initially proposed to surrender the home and claimed no exemption

D objected to sale motion and sought to amend schedules to claim home exempt

B.Ct. denied the exemption and granted the sale motion

D.Ct. affirmed
6th Cir. affirms

There was no equity so there was no applicable exemption

Court does not discuss the carve-out at all

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Jahn v. Burke (In re Burke)
863 F.3d 521 (6th Cir. 2017)

- T seeks to evict Ds, sell their home, and pay their homestead exemption (which Ds never claimed)
- Ds resist and seek to compel abandonment based on no equity
- Court agrees with Ds

No fees for trustee or his counsel for pursuing inappropriate carve-outs

---

**Bird**

- 2 separate cases
- T employs his law firm to pursue short sale carve-outs of homestead properties and objects to exemptions in homesteads
- T employs realtor
- Ds move to compel abandonment
Bird

- Days before hearing on abandonment, T moves for court to approve agreement with IRS to pay $10K per estate as a carve-out
- Court overrules OTE and T appeals
- Court sets evidentiary hearing on MT compel abandonment
- T moves to sell the homes (scheduled for one month after hearing on abandonment) for far more than scheduled values but only a minimal amount above total encumbrances (so no net equity after costs of sale are considered)

<table>
<thead>
<tr>
<th>Property</th>
<th>Liens</th>
<th>Exemptions</th>
<th>Value</th>
<th>Sales Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property 1:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage 1</td>
<td>$133,275</td>
<td>$30,000</td>
<td>$240,000</td>
<td>(+34%)</td>
</tr>
<tr>
<td>Mortgage 2</td>
<td>20,550</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IRS Lien</td>
<td>147,661</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jmt Liens</td>
<td>5,383</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>$306,869</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- $322,000
- $306,869
- $15,131
- realtor ($ 22,540)
- short ($ 7,409)
Bird

- Ds object to sale motions and move to vacate their discharges* and convert to Ch. 13
- Ct. hears and grants motion to convert mooting motions to sell and motion to compel abandonment

*Required by many courts that don’t allow two discharges in the same case

<table>
<thead>
<tr>
<th>Liens</th>
<th>Exemptions</th>
<th>Value</th>
<th>Sales Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>$51,000</td>
<td>$351,000</td>
<td>$425,000</td>
<td>$425,000</td>
</tr>
<tr>
<td>13677142</td>
<td>79</td>
<td>80</td>
<td>200</td>
</tr>
</tbody>
</table>
Bird

- T and counsel seek administrative expense claims of:

<table>
<thead>
<tr>
<th>T &amp; Counsel</th>
<th>Realtor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case 1: $3,634 + $31,110:</td>
<td>$34,744</td>
</tr>
<tr>
<td>Case 2: $2,765 + $28,998:</td>
<td>$31,763</td>
</tr>
<tr>
<td>$66,507</td>
<td>$52,290</td>
</tr>
<tr>
<td>TOTAL: $118,787</td>
<td></td>
</tr>
</tbody>
</table>

- B.Ct. denies all fees under §330(a)(4)(A)(ii)
  (a) not necessary to case administration
  (b) not likely to benefit the estates
  (c) no meaningful distribution will result

Bird

- Ct. goes on to wrongly state: Ds would be entitled to the carve-out proceeds to pay their homestead exemptions

- Otherwise, Ds would have:
  (a) no home
  (b) no homestead exemption
  (c) non-dischargeable tax claims
**Bird**

- T appeals: 10th Cir. BAP affirms
- Highlights T’s critical role in “performing the bankruptcy system’s required balancing act.”
- T should have abandoned the homes
- Sale of fully encumbered homes might be warranted in some situations – but not here

**Bird**

- Here, T violates Trustee Handbook directive not to sell POE “where the proceeds . . . will primarily benefit the Trustee or the professionals”
- T argued that B.Ct. made several erroneous conclusions, including that Ds would be entitled to homestead exemptions in the short-sale proceeds
- BAP doesn’t need to address those arguments because all of the fees sought “were in furtherance of trustee’s inappropriate scheme to sell the homesteads.” Refers to “token carve-outs.”
Inadequate carve-outs that deprive Ds of homes but do virtually nothing for creditors are leading to harmful rulings that prevent even the good carve-outs

RUINING THE ENTIRETY OF CARVE-OUTS AS BAD FACTS MAKE BAD LAW

Judges here were angry. NACBA is angry.

In re Scoggins, 517 B.R. 206 (Bankr. E.D.Cal. 2014) (en banc) (high volume of tiny carve-outs with questionable benefit to the estate beyond professionals) required Trustees to keep detailed time records whenever seeking to sell properties with a carve-out and plan on being subjected to closer scrutiny
All You Need to Know About Liquidating Chapter 11 Plans

This panel will provide an overview on pointers and pitfalls in obtaining confirmation of liquidating chapter 11 plans, implementing liquidating chapter 11 plans, and successfully operating post-confirmation liquidating and litigation trusts.

Andrew W. Caine, Moderator
Pachulski Stang Ziehl & Jones LLP; Los Angeles

Jason S. Brookner
Gray Reed & McGraw LLP; Dallas

Dana P. Kane
Kelley Drye & Warren LLP; New York

Bradley D. Sharp
Development Specialists, Inc.; Los Angeles
Why the Need for a Post-Confirmation Wind Down Entity?

- Modern chapter 11 trend – lender-driven quick sales
- BAPCPA limitations on exclusivity - §§ 1121(b), (d)

Result

- Short stay in chapter 11 means much of the heavy lifting is done post-confirmation
- Structure, personnel and preservation of information are critical to wind-down that is expeditious and preserves value for creditors
Structuring Post-Confirmation Entities

- Is there a difference between a Liquidating Trust and a Litigation Trust?
  - Many titles, same function and qualifications
  - Separate and distinct legal entities and are created for the benefit of a Debtor’s creditors to prosecute certain causes of action and/or liquidate assets that are transferred to the Trust, usually as a result of a Debtor’s confirmed Plan.
  - The ultimate goal is to make pro-rata distributions to the Trust beneficiaries (holders of claims against the pre-confirmation Debtor)

Structuring Post-Confirmation Entities

- Establishing a Trust helps speed up Confirmation by allowing reorganized debtors to emerge from Chapter 11 prior to the resolution of certain litigation, the liquidation of assets and distribution to creditors.
- In the case of liquidating plans, Trusts allow for Confirmation to proceed and distributions to begin before all assets have been liquidated, litigation concluded, and/or claims resolved.
- A mechanism by which the creditors can maximize their recovery by liquidating assets and causes of action, and minimize costs associated with Bankruptcy Court oversight approval of that process.
Creation of Liquidating Trusts

- Simple trusts generally created by contract, \textit{i.e.}, pursuant to a plan of reorganization or a plan of liquidation
  - Can also be created by settlement agreement, structured dismissal
  - The Trust is a separate and distinct legal entity
  - Created to prosecute causes of action/liquidate assets transferred to Trust under plan

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Creation of Liquidating Trusts: Generally

- Authorized by the Bankruptcy Code
  - Section 1123(b)(3)(B): “.. a plan may provide for the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest...”

- \textit{In re Acequia, Inc.}, 34 F.3d 800 (9th Cir. 1994)

  Section 1123(b)(3)(B) was designed to make possible the formation and consummation of a plan before completion of the investigation and prosecution of causes of action (e.g., insider misconduct, mismanagement): \textit{i.e.}, preserve assets of the estate while facilitating confirmation of a plan
Creation of Liquidating Trusts: Tax Issues

Characterization as a Liquidating Trust

- Treas. Reg. § 301.7702-4(d)
  “An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose.”

- Revenue Procedure 94-45
  Checklist of conditions that are necessary for classification as a liquidating trust. Some of these include:
  - The plan and disclosure statement must explain how the bankruptcy estate will treat the transfer of its assets to the trust for federal income tax purposes: a transfer of assets to beneficiaries/creditors and then from creditors to trust

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Creation of Liquidating Trusts: Tax Issues

- Rev. Proc. 94-45, cont’d
  - Express purpose of trust is for collecting, liquidating and distributing trust assets
  - No objective to continue or engage in the conduct of a trade or business other than as necessary to further above purpose
  - Trustee shall not act to unduly prolong the duration of the trust
  - Creditors treated as grantors and owners of trust, receive trust interests
  - 5-year termination date (can be extended)
  - Limited investment powers of the trustee
  - Consistent valuation of property transferred to trust

- Effective drafting of Plan/LTA will support the characterization and should include a recitation of these conditions, which should be followed.
Creation of Liquidating Trusts: Tax Issues

- Tax implications of a Liquidating Trust
  - Liquidating trust normally treated as grantor trusts for the benefit of its beneficiaries
  - As creditors are owners/beneficiaries of the Trust, the Trust is a pass-through that does not generate its own tax liabilities

Cautionary tales

Some unfortunate errors that have appeared recently in the drafting of plans requiring grantor trusts include:

- Use of inappropriate entity – plan required trustee to use preexisting entity (previously an operating entity) with an existing balance sheet that had to be dealt with after the fact, without sufficient upfront tax and administrative planning
- Use of a non-pass-through entity - in another case, drafters used an LLC instead of a trust to disburse the assets to the creditors; when tax returns were late, result was significant penalties to IRS
- Inconsistency between structure of trust called for in plan/disclosure statement versus trust document
Creation of Liquidating Trusts: Other Key Structuring Issues

- Proper transfer of assets to the Trust is paramount
  - Blanket or general language may not preserve claims for the liquidating trust
  - Standalone claim descriptions that may not suffice
    - “any and all claims of Debtor”
    - “all avoidance actions”
    - “all state law claims”
  - Without preservation, the claim might be deemed resolved and settled

- Plan should specifically identify claims to ensure preservation
  - Most jurisdictions require some level of specific identification of claims for preservation; North Carolina and Michigan may be exceptions

- Rationale for specificity varies
  - Res Judicata – was the claim reserved or settled?
  - Notice – so creditors can make informed decisions re Plan
  - Estoppel – corollary of notice and res judicata rationale
  - Contract – Plan is a contract; interpreted in same manner

See In re Hart Oil & Gas, Inc., 534 B.R. 35, 47 (Bankr. D.N.M. 2015), collecting cases
Creation of Liquidating Trusts: Other Key Structuring Issues

- Proper transfer of assets to Trust: Degree of specificity required?
  - Varies by jurisdiction
  - Better to be “clear” and “specific and unequivocal”
  - Specific defendants and facts typically not required
  - Avoidance actions – state code section, reference to Chapter (e.g. Chapter 5 claims) may be insufficient
  - State law claims – more specificity needed; e.g., all “malpractice” or “lender liability” claims is sufficient
  - Larger the claim or creditor, more specificity is appropriate; but consider practical implications of detailing claim and defendant in Plan

Creation of Liquidating Trusts: Other Key Structuring Considerations

Many helpful provisions designed to foster efficient and cost-effective administration

- Funding
  - Effective-date cash transfer or initial liquidation of trust assets
  - Seed money loan from a reorganized debtor or senior creditor
  - Practical note: anticipating expenses, budgeting and creating reserves are important to bridge lulls between liquidation of assets that bring money into trust
Creation of Liquidating Trusts: Other Key Structuring Considerations

- Authority to retain professionals and independent contractors
  - Legal professionals – especially for substantive knowledge of bankruptcy code and rules for claims litigation, pursuit of causes of action
  - Tax professionals – compliance with conditions necessary to be considered a grantor trust
  - Independent Contractors – Historical background, knowledge and contacts, especially where documentation is sparse

Oversight Committee?

- Layer of approval above trustee can add some delay and cost
- However, oversight committee members are key representatives of the beneficiaries and bolster legitimacy of actions taken by trustee
- Balance these competing concerns by
  - Limiting size of OC and setting thresholds for OC approvals, both as appropriate given circumstances of case
  - Implementing negative notice mechanisms
Creation of Liquidating Trusts: Other Key Structuring Considerations

Limitation of Trustee and OC member liability

Important to getting qualified persons interested to serve in those roles and keeping costs down

- Indemnification provisions
- Insulation from liability to the extent of action taken on advice of professionals
- Recoveries limited to trust assets
- Purchase of insurance policy (E&O, crime) tail coverage
- Provide that the Trustee’s obligations are limited to those enumerated in LTA – no implied duties

Creation of Liquidating Trusts: Other Key Structuring Considerations

Other Practical Notes

- Preservation of applicable privileges as to information flowing from pre-confirmation debtor to trustee should be included in Plan/LTA/Confirmation order
- Information necessary to evaluating and contesting disputed claims should be gathered upfront
  - A/P records, bills of lading, contracts
  - Payment runs after first days (CV orders) and sales (cure payments)
- Information to assist in pursuing avoidance actions should be gathered upfront
  - 90-day data, pre-preference period historical data
  - Cancelled checks
  - Communications re: collection efforts
- Maintain contact information for people who can help later
Administration of Trust Assets: Tangible Assets

- Liquidation of Tangible Assets
  - Trustee should be empowered to sell assets without court approval – minimizes costs and speeds up timing
  - Trustee should have ability to pursue tax refunds
  - Trustee should be able to abandon assets deemed to be of inconsequential value to the trust
  - Consider remnant asset sales – found assets, uncashed checks

Administration of Trust Assets: Intangible

- Liquidation of intangible assets and litigation claims
  - Trustee should be empowered to determine terms for retaining counsel (hourly, contingent, mixed fee)

- Engage special litigation counsel early, preferably before plan confirmation
  - Can advise on collection and preservation of relevant evidence
  - Can participate in gathering evidence for claims through R.2004 examinations in advance of filing claims; more knowledge of claims assists in determining terms for engaging litigation counsel
  - Helps to avoid limitations and laches as barriers to recovery
  - Can identify which claims are not suitable for assignment to a trust (e.g., where assignment may serve to ratify or otherwise defeat claims)
Administration of Trust Assets: Intangible

- Consider whether a Private Actions Trust is appropriate
  - Allows creditors of debtor to assign private claims to a trust
  - Should be incorporated into the plan preparation and confirmation process
  - Appropriate for “mass action” litigation when large groups of creditors have viable claims against third parties
  - Helps to make economically viable smaller, individual claims
  - Use of single counsel for prosecution of claims
    - Increases opportunities for pre-suit resolutions → can offer “global peace” to potential defendants
    - Streamlines discovery efforts

Administration of Trust Liabilities: Claims Reconciliation

- Matching scheduled claims to filed POC
  - Bankruptcy Rule 3003(c)(4) – scheduled claim automatically superseded by filed POC for same liability
  - Claims agent will make obvious matches upfront; can direct claims agent to “merge” others
  - Comfort orders/public filings
    - Object to scheduled claims as amended and superseded by POC (Jurisdiction dependent – e.g., not permitted in Delaware (Del. Bankr. L.R. 3007-1(c))
    - Amend schedules – but new bar date must be set
    - Notice of superseded scheduled claim
Administration of Trust Liabilities: Claims Reconciliation

- Identify POCs and unmatched scheduled claims that have been satisfied
  - First Day relief
    - Employee wage and benefit claims
    - Sales & use tax claims
    - Insurance premiums
    - Customer claims
    - Critical vendors
  - Assumed contracts and leases – cures
  - Secured lender claims satisfied by sale proceeds
  - Objection versus notice of satisfied claim

Administration of Trust Liabilities: Claims Reconciliation

- Identify waived or released claims
  - Pre-confirmation settlements pursuant to Bankruptcy Rule 9019
  - Estate-retained professionals
  - Critical vendor programs – release of residual claims in exchange for partial payment in 100-cent dollars
  - Contingent/unliquidated/disputed scheduled claims as to which no POC is filed (Bankruptcy Rule 3003(c)(2))
Administration of Trust Liabilities: Claims Reconciliation

Non-substantive Objections

- Typically can be done without reference to historical records (Exception: Insufficient documentation claims)
- Types - non-exhaustive list
  
  * E.g. Del. Bankr. L.R. 3007-1(d)
    * Duplicative vs. redundant claims – but redundant claims not non-sub objection unless cases substantively consolidated
    * Amended/superseded claims – however, be sure to distinguish disguised late claims from amendments

  “While most courts have adopted [a] liberal approach toward allowing the amendment to timely filed proofs of claim, purported amendments will not be permitted if they actually constitute ‘new claims.’”

Administration of Trust Liabilities: Claims Reconciliation

Non-substantive Objections, cont’d

- Late-filed – keep in mind multiple bar dates (rejection, gov’t)
- Equity interests – *i.e.*, claims seeking the value of the stock
  - Objections to damages claims that are subordinated pursuant to Bankruptcy Code § 510(b) more fairly considered substantive
- Insufficient documentation – does not include sufficient information to meet *prima facie* validity standards of Bankruptcy Rule 3001(f)
- Contingent claims of co-debtors for reimbursement or contribution – Bankruptcy Code 502(e)(1)

  In re Carribean Petroleum Corp., 566 Fed.Appx. 169 (3d Cir. 2014) – Third Circuit overruled a claimant’s argument that 502(e)(1) was not applicable in the context of a post-confirmation liquidation trust; Notable as this Code provision is useful in avoiding the need to establish large reserves for claims that may never materialize
Administration of Trust Liabilities – Claims Reconciliation

■ Substantive Objections
  ➢ Efficacy often depends on access to, and quality of, historical information/books and records
    • Overstated claims
    • “No liability” objections
    • Some “misclassified claims” objections – e.g., outside the 20-day window for 503(b)(9) treatment;
  ➢ Still can raise these objections even with limited records. Examples:
    • Misclassified “check the box” priority claims
    • Secured claims (mechanics’ liens) on leased locations

Administration of Trust Liabilities: Claims Reconciliation

■ Limitations

■ Estimation as a tool – § 502(c)
  Bankruptcy court “shall” estimate “contingent or unliquidated claim(s), the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case”
Administration of Trust Liabilities: Distributions

Distributions are on Allowed claims
- Establish a DOF for disputed claims – pending or anticipated objections, or claims under review
- The Trustee must establish sufficient reserves to pay those claims at face value (or as provided under plan/court order) if objection sustained

Administration of Trust Liabilities: Distributions

Claimants must comply with tax reporting requirements
- Plan and LTA should provide that creditors must provide IRS Form W-9/W8-BEN etc. to trustee to be eligible to receive any distribution
- Enables trustee to file proper grantor letters with IRS (maintain status as grantor trust/avoid penalties)
- Could also be solicited after Trust is formed but time limits to comply should be clearly established
- Consider solicitation and need for OFAC (Office of Foreign Assets Control) Certification
Administration of Trust Liabilities: Distributions

- Single (lump-sum) vs. interim distributions
  - Usually dictated by Plan and Trust Agreement
  - If Plan/LTA requires interim distributions, available funds for distribution are calculated based on available funds net of reasonable reserves
    - Again, smart budgeting and anticipation of expenses is key

- Expenses and Reserves
  - Consider how long Trust will need to function
  - Must apportion expenses to different debtors in a non-consolidation situation

Administration of Trust Liabilities: Distributions

- Expenses and Reserves, cont’d
  - Types of expenses for which to reserve:
    - Trustee’s own fees; Oversight Committee member expenses
    - “Professional” fees (legal, tax, claims agent, disbursing agent)
    - Insurance (including tail coverage) if applicable
    - Bank fees
    - U.S. Trustee Fees
    - Employer portion of taxes for wage-related claims
    - Costs of debtor entity dissolution
    - Office overhead: PO Box maintenance, postage, document storage, document destruction, data servers, licensing fees (e.g., software)
    - Contingency reserve – for the unknown (important!)
Administration of Trust Liabilities: Distributions

- Unclaimed or undeliverable distributions
  - Invariably will occur with any trust; frequency increases as trust ages
  - Customary to include a provision that distributions that have not been claimed within a certain period (often a year) are forfeited to the Trust for the benefit of, and \textit{pro-rata} redistribution to, other Trust beneficiaries
  - Reduces administrative expenses and eliminates the need to maintain records necessary to comply with any applicable escheat laws
Energy – PG&E Panel

The panelists will discuss cutting-edge issues in energy cases, including the PG&E case, competitive generation, renewables, power purchase agreement rejection issues and other issues.

Camisha L. Simmons, Moderator
Simmons Legal PLLC; Dallas

Lee Jason Goldberg
GLC Advisors & Co.; New York

Charles M. Moore
Alvarez & Marsal; Southfield, Mich.

David R. Seligman
Kirkland & Ellis LLP; Chicago

Risa Lynn Wolf-Smith
Holland & Hart LLP; Denver
NCBJ CONFERENCE 2019
ENERGY: PG&E PANEL

November 1, 2019: 10:30-11:30 a.m.

Camisha L. Simmons, Moderator
Simmons Legal PLLC; Dallas

David R. Seligman
Kirkland & Ellis LLP; Chicago

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Alvarez & Marsal; Detroit

Lee Jason Goldberg
GLC Advisors & Co., LLC.; New York

Risa Wolf-Smith
Holland & Hart LLP; Denver

Agenda

• Legal Landscape
  o Rejection of Executory Contracts v. Filed Rate Doctrine

• A Tale of Two Cases
  o FirstEnergy
  o PG&E
Legal Landscape: Rejection of Executory Contracts v. Filed Rate Doctrine

- Rejection of Executory Contracts is a Core Matter Over Which Bankruptcy Courts Have Exclusive Jurisdiction.
  - Section 365(a) of the Bankruptcy Code provides: “...the trustee [or debtor-in-possession], subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.”
  - Bankruptcy courts have broad discretion to authorize rejection, and rejection is vital to reorganization to relieve severe financial burdens.
  - Bankruptcy courts have “original and exclusive” jurisdiction of all cases under Title 11, 28 U.S.C. § 1334(a).
- Rejection of contracts under Section 365 is a core matter as a proceeding that “arises under title 11” and invokes a substantive right provided by title 11 and could arise only in the context of a bankruptcy case. 28 U.S.C. § 157(b)(1).
- Rejection Constitutes Breach, Not Termination.
  - Rejection creates a contract “breach,” not modification or termination.
  - The non-breaching party to the rejected contract receives an unsecured claim against the debtor’s estate. 11 U.S.C. § 365(g).
- The Business Judgment Standard Applies to a Debtor’s Decision to Reject.
  - Rejection is appropriate where it would benefit the estate—cost/benefit.
Legal Landscape: Rejection of Executory Contracts v. Filed Rate Doctrine

  - Under the Federal Power Act, FERC has exclusive authority to regulate the provision of electric energy in interstate commerce and must approve of any modifications or abrogation of a "filed rate." 16 U.S.C. § 824.
  - FERC is vested with exclusive authority to regulate rates for wholesale sales of electric energy.
  - Filed rates for wholesale sales of electric energy carry the force of law.
  - A party may not unilaterally modify a FERC contract without a showing that continuation of the contract would harm the public interest.
  - FERC has expertise in ensuring the reliable provision of energy at just and reasonable rates that serve the public interest.

Legal Landscape: Rejection of Executory Contracts v. Filed Rate Doctrine

- The Bankruptcy Code Contains Provisions Which Affirm That Debtors Remain Subject to Regulatory Supervision and Authority.
  - Under Section 362(b)(4) of the Bankruptcy Code, the automatic stay does not stay any “action or proceeding by a governmental unit…to enforce such governmental unit’s…regulatory power.”
  - Section 1129(a)(6) requires that as a condition to confirmation of a plan of reorganization “[a]ny governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change.”
  - A debtor-in-possession must also manage its estate in accordance with all applicable state and federal law regulations. 28 U.S.C. § 959(b).
The Legal Landscape: Rejection of Executory Contracts v. Filed Rate Doctrine

Courts are split on the question of whether a debtor may be relieved of its obligations under power purchase agreements without FERC approval.

**FirstEnergy** (Bankr. N.D. Ohio 2018)
- Permits a debtor to reject a PPA without FERC approval, applying business judgment standard.

**PG&E** (Bankr. N.D. Cal. 2019)
- Permits a debtor to reject a PPA without FERC approval, applying a heightened public interest standard.

**Mirant** (5th Circuit 2004)
- Permits a debtor to reject a PPA without FERC approval, but applies a heightened public interest standard that allows FERC to provide its input.

**Boston Generating** (S.D.N.Y. 2010)
- Requires approval of both FERC and the bankruptcy court to reject a PPA.

**Calpine** (S.D.N.Y. 2006)
- Requires FERC approval to reject a PPA, finding bankruptcy court lacks jurisdiction over such matter.
Legal Landscape: Rejection of Executory Contracts v. Filed Rate Doctrine

- In bankruptcy, parties (including contract counterparties and FERC) typically argue that debtors cannot reject Power Purchase Agreements without FERC’s approval, on the basis that rejection constitutes a modification of a filed rate contract.

- Courts ruling on the issue have reached opposite conclusions.
  - The Fifth Circuit in *Mirant* held that a bankruptcy court may authorize the rejection of a PPA without independent FERC approval. However, the Fifth Circuit directed the District Court to apply a heightened standard of review to the proposed rejection in light of the Federal Power Act, instructing the court to allow FERC's participation to assist in balancing the equities. *In re Mirant Corp.*, 378 F.3d 511, 525–26 (5th Cir. 2004).
    - On remand, the district court noted that prior to authorizing a rejection it would “afford the FERC an opportunity . . . to evaluate the effect that such a rejection would have on the public interest.” *In re Mirant Corp.*, 318 B.R. 100, 108 (N.D. Tex. 2004).
  - Conversely, in *Calpine*, the bankruptcy court held that it lacked jurisdiction to authorize the rejection of a PPA because doing so “would directly interfere with FERC’s jurisdiction over the rates, terms, conditions and durations of wholesale energy contracts.” *In re Calpine Corp.*, 337 B.R. 27, 35–36 (S.D.N.Y. 2006).
  - Recently, the FirstEnergy and PG&E bankruptcy courts have weighed in on the FERC issue.

A Tale of Two Cases: FirstEnergy and PG&E
A Tale of Two Cases: FirstEnergy

- On March 26, 2018, in anticipation of a potential filing, Ohio Valley Electric Cooperative ("OVEC") filed a complaint against FirstEnergy Solutions, Corp. ("FES") with FERC.
  - OVEC requested that FERC either enter an order (i) finding that FES's anticipated rejection of the PPA would constitute a violation of that agreement's terms and would not satisfy the Federal Power Act's "public interest" standard, or, (ii) declaring that FERC has exclusive jurisdiction over the proposed rejection of the PPA.
- On March 31, 2018 FES filed for chapter 11 protection, seeking to reject a multi-party wholesale power purchase agreement (the "ICPA") that was regulated by FERC. FES also sought to enjoin FERC from reviewing FES's requested rejection of the ICPA under the public interest standard.
  - OVEC and FERC objected to FES’s rejection on several grounds, including on the grounds that the rejection constitutes a modification of a filed rate contract and is therefore subject to independent FERC review under the public interest standard.
- The Bankruptcy Court held that the rejection of the ICPA does not constitute a modification or abrogation of a filed rate contract, so it enjoined FERC from reviewing the requested rejection. Separately, the Bankruptcy Court authorized the rejection, applying the "business judgment" standard.
  - Debtors also filed an adversary proceeding to enjoin FERC.
  - Creditors assumed the risk of uncertainty regarding the treatment of post-petition administrative claims for electricity supplied.

- Some creditors joined forces to reach settlements with the Debtors. Stipulations monetized claims and included:
  - Immediate payment of administrative priority claims at the contract rates, including payment for renewable energy credits and capacity obligations.
  - Substantial security deposits (cash deposits, letters of credit, guaranties) monetized.
  - Covenants to allow unsecured claim amounts enabled claimants to sell claims in active trading markets.
  - Some rejection damages creditors which did not stipulate to claim amounts joined forces to negotiate for a greater claim distribution percentage.

- Next Steps: OVEC and FERC (along with other parties) appealed the Bankruptcy Court’s decision to the Sixth Circuit. Oral arguments were held June 26, 2019 and the parties are awaiting the Sixth Circuit’s decision.
A Tale of Two Cases: PG&E

Pacific Gas and Electric Co. (together with PG&E Corporation, “PG&E”) is a regulated, investor-owned utility, which provides natural gas and electricity to northern California.

—On January 14, 2019, PG&E provided the public 15-days notice of their intent to file for bankruptcy protection (as mandated by California law).

—In late January, in anticipation of PG&E filing, various counterparties to wholesale PPAs (the “PPA Counterparties”) initiated proceedings before FERC, requesting an order that PG&E may not reject PPAs in bankruptcy without FERC approval.

—On January 25, 2019 and January 28, 2019, FERC issued orders in favor of the PPA Counterparties, concluding that FERC and the bankruptcy courts have concurrent jurisdiction to review and address the disposition of PPAs sought to be rejected through bankruptcy (the “FERC Orders”).

—On January 29, 2019, the Debtors filed chapter 11. Along with their petitions, PG&E filed an adversary proceeding seeking: (1) declaratory relief confirming the bankruptcy court’s exclusive jurisdiction to reject PPAs under section 365; (2) enforcement of the automatic stay under section 362; and (3) an injunction barring FERC from taking any action that would harm the Debtors’ right to reject any of the PPAs.

—The PPA Counterparties joined forces on Day 1 and intervened in the adversary proceeding against FERC.

—On February 25, 2019 the Debtors sought a rehearing of the FERC Orders. On May 1, 2019, FERC denied the rehearing motion.

—To date, no motions to reject PPAs have been filed in the bankruptcy proceedings.
A Tale of Two Cases: PG&E

- On June 7, 2019, the Bankruptcy Court granted the Debtors’ motion for declaratory relief, finding that the Bankruptcy Court had original and exclusive jurisdiction over the rejection of PPAs in bankruptcy.

- After laying out examples in the Bankruptcy Code where congress delineated that a bankruptcy court does not have exclusive jurisdiction over executory contracts (i.e. intellectual property rights under section 365(n)), the court stated that “if an executory contract does not fall into the exceptions set forth by Congress in the Bankruptcy Code, only the Bankruptcy Court can issue a ruling on rejection.”

- The court described the FERC Orders as “unauthorized acts of [FERC] executing a power play (to use a hockey term) to curtail the role of the court acting within its authorized and exclusive role in these bankruptcy cases.”

- “Despite FERC’s lip service to what it describes as ‘concurrent jurisdiction’ to carry out differing and perhaps competing policies, the effect of its decision guts and renders meaningless the bankruptcy court’s responsibilities in this area of the law. For this reason, FERC must be stopped and the division and balance of power and authority of the two branches of government restored.”

- In *dicta*, the court suggested it would adopt the *Mirant* approach that a bankruptcy court may take into account the public interest when deciding if a court can reject a PPA contract. However, no contract has yet been rejected, so this issue was not before the court.

- Shortly after, the court certified a direct appeal to the Ninth Circuit Court of Appeals.

- **Next Steps:** The PPA Counterparties are awaiting whether the Ninth Circuit will hear the appeal.
Power Industry Overview

National Conference of Bankruptcy Judges - November 2019

Contents

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2  Market Regions and Structures  7
3  Trends Impacting Energy Prices  10
Power Market Overview

OVERVIEW

The Power Industry includes the generation, transmission and distribution, and retail sale of electricity from electric power generating units to consumers.

- **Generation** includes the production of electricity at electric generating units fueled by coal, natural gas, oil, nuclear, water, wind, solar, or other sources
- **Transmission** represents the process of moving the power from the generating unit to major load centers (such as cities)
- **Distribution** represents the final delivery of electricity to consumers. After transmission, the distribution system “steps-down” high voltage electricity to lower voltages that are useful for consumers (such as 120 volts in homes)
- **Retail** electricity sales are conducted by local utilities or energy retailers

- Transmission of electricity becomes inefficient over longer distances (hundreds or thousands of miles), and therefore the national electric grid in the U.S. is operated in smaller, regional grids
- Within each region, system operators forecast the electric demand and designate generators to operate to meet this base level of demand (baseload facilities)
- On a real-time basis, actual electric system demand fluctuates, and therefore “peaking” generators (those generators that are able to respond to changes in demand rapidly) operate to fill in the gap between actual demand levels and the amount of generation available from the baseload facilities

- Historically, the retail sale of electricity was managed by vertically integrated utilities (companies that owned all of the generation, transmission and distribution systems)
- In some regions of the country, the retail market has been deregulated, allowing independent energy retailers to manage the procurement of wholesale energy and sale of electricity to consumers without actually owning the infrastructure
Power Generation Market Overview

**Key Observations**

- Total US power generation has remained relatively flat since 2005, with annual growth of approximately 0.1%
  - Generation has declined marginally since 2010, with annual declines of approximately (0.2)%
- Revenue from retail sales of electricity to ultimate customers have increased over the same period, with annual growth of approximately 2.8%
  - However, the US power generation industry has experienced substantial power price declines in the past 2+ years, primarily correlated with reductions in natural gas and coal prices
  - Surplus of supply coupled with slowing demand driven by warmer than normal winters has kept prices down

**US Electricity Generation**

**US Electricity Ultimate Customer Price**

**OVERVIEW**

Electricity production in the United States has historically been dominated by coal- and natural gas-fired power plants. Recently, development of renewable wind and solar generation has accelerated.
OVERVIEW

Many states have shifted from coal-fired generation to natural gas and nuclear generation as natural gas prices have shifted and environmental regulations have pressured coal facilities.

As coal facilities have suffered with the decline of power prices and the increase in environmental regulations and resulting capital requirements, natural gas, nuclear and hydroelectric sources have become the primary source of electricity for many states in the southeastern and northeastern United States.


Market Regions and Structures
Market Structures

The United States power system includes three electrically-isolated interconnections (Eastern, Western, and ERCOT).

Regional Transmission Organizations

The regional transmission organizations and independent system operators set the market structures and operational policies within their respective regions. In this way, economics and market prices between different regions can vary significantly.
The US power generation market experienced some pricing improvement in 2018, due in part to increased weather-driven demand. However, pricing pressure remains throughout the country and is likely to continue in the foreseeable future.

Monthly average wholesale electricity prices at selected trading hubs, 2017-2018

Source: EIA
Shale gas production rapidly increased over the past 10 years, lowering natural gas costs...

In a five year period, US shale gas production growth has quadrupled which has depressed the price of natural gas by 75%

US shale gas production growth over time

NYMEX gas prices

$/MMBtu

- 75%
('08-'18)

- 45% to
- 60%
('08-'17)

Simulated PJM supply stack(1), 2018

Dispatch cost ($/MWh) by Capacity (GW)

Weighted average wholesale power price $/MWh

- Gas generation heavily influences the price of power as the assets sit at a critical part of the current supply stack
- Decreased natural gas costs have contributed to decreases in power prices of ~45-60% in major markets

Source: Ventyx, Energy Velocity, McKinsey PowerIQ; EIA/ICE wholesale power market historical data, PUCT for ERCOT pre 2014

(1) Showing only dispatchable assets, excludes loads from non-dispatchables, modeled under scenario $2.75/MMBtu gas at Henry Hub (real $).
Meanwhile, electricity demand has been flat, in large part due to efficiency.

Net growth in supply has dropped below GDP growth rate since 2000s, much of which is driven by energy efficiencies.

Deregulation has stalled, leading to further uncertainty in several regions of the US power markets...

While most of FES operations are in the Northeast where deregulation is underway, there are state-level limitations on retail that lead to further uncertainty.

- Michigan: Limited to 10% of each customer class
- Virginia: Limited to non-residential customers in certain service territories, and residential customers seeking electricity from 100% renewable energy sources
- Oregon: Limited to non-residential customers
- Nevada: Limited to non-residential customers
- California: Suspended in 2001; in 2009, reopened to allow limited switching
- Texas: Liberalized market being one of the most competitive US markets
- Georgia: Limited to non-residential customers > 900 kW

Source: EIA, team analysis
These market forces have dramatically reduced cash margins and made baseload generation a precarious business

Case example of cash margin and revenue changes for PJM W nuclear plant

- 74% decline in gas prices, coupled with increased supply from renewables and natural gas and flat demand, has led to a 44% decline in revenues for the average nuclear plant in the PJM west region
- Cash Margin levels declined by 83% over the same time period puts nuclear plant in danger of negative cash flow before financing costs

Source: Commodity Prices: SNL; GDP: US Bureau of Economic Analysis; Power Demand: EIA

Carbon Tax had the potential to give nuclear plants additional margin over coal plants
- E.g., a simple $25/ton tax would cost a coal plant $24/MWh
- However, with regulations stalling, nuclear is no longer in an advantageous position

<table>
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<th>Outcome</th>
<th>Commentary</th>
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Politically Difficult Issue
- Past efforts to enact a carbon price in Washington have failed largely because powerful fossil-fuel groups financed campaigns against lawmakers who supported a carbon tax. In 1994, dozens of Democratic lawmakers lost their jobs after Al Gore, who was vice president at the time, urged them to vote for a climate change bill that would have effectively taxed carbon pollution. In 2009, President Obama urged House Democrats to vote for a cap-and-trade bill that would have required companies whose carbon-dioxide emissions exceeded set levels to buy emissions rights from those who emitted less. The next year, Tea Party groups spent millions to successfully unseat members who voted for the bill. (1)

- Carbon tax had the potential to give nuclear plants additional margin over coal plants
- However, with regulations stalling, nuclear is no longer in an advantageous position

Source: NY Times; DoE report on Environment Baseline, V1, June 2016

(1) Coral Davenport, NY Times December 5, 2013.
(2) Basic calculations = coal CO2 emission of 0.96 metric ton/MWh and a carbon tax of $25/metric ton.

While Carbon Tax stalled, resulting in nuclear not receiving adequate compensation for carbon free electricity despite needed capex

In spite of some success at state and regional level (RGGI & Western Climate Initiative), US Federal Level Climate policy has stalled and is difficult to envision passing near term due to economic and policy complexity and partisan opinions on best path forward

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- Carbon tax had the potential to give nuclear plants additional margin over coal plants
  - E.g., a simple $25/ton tax would cost a coal plant $24/MWh (2)
- However, with regulations stalling, nuclear is no longer in an advantageous position

Source: NY Times; DoE report on Environment Baseline, V1, June 2016

(1) Coral Davenport, NY Times December 5, 2013.
(2) Basic calculations = coal CO2 emission of 0.96 metric ton/MWh and a carbon tax of $25/metric ton.
North America Half-Cycle Break-Even Price Curve\(^{(1)(2)}\)

Looking forward, natural gas prices are expected to remain at disruptively low levels for the foreseeable future. There is currently 50 years worth of natural gas supplies under $5/MMBtu.


(1) Includes 10% IRR and excludes finding and land costs (includes drilling & completion costs and all operating costs).
(2) Associated gas plays and predominantly oil basins excluded.

Energy Investment Landscape Expected to Shift Across Value Chain

<table>
<thead>
<tr>
<th>Overview</th>
<th>Regulated</th>
<th>Merchant</th>
</tr>
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<tbody>
<tr>
<td>Growth driven by renewables due to changing regulatory landscape</td>
<td>Solar(^{(1)}) +30%</td>
<td>Wind(^{(2)}) +6%</td>
</tr>
<tr>
<td>Flat demand will make market even tougher for coal and nuclear assets</td>
<td>Nuclear(^{(1)}) +1%</td>
<td>Coal(^{(2)}) -6%</td>
</tr>
<tr>
<td>Tight margins and flat growth based on overall kWh demand growth</td>
<td>Other(^{(1)}) +6%</td>
<td>Other(^{(2)}) +6%</td>
</tr>
<tr>
<td>Aging infrastructure will require replacement, and near-term growth</td>
<td>Wholesale Trading</td>
<td></td>
</tr>
<tr>
<td>Opportunity for merchant players nascent but limited</td>
<td>T&amp;D</td>
<td></td>
</tr>
<tr>
<td>Opportunity likely to remain limited, especially given pressures on</td>
<td>Retail</td>
<td></td>
</tr>
<tr>
<td>Sample 12% and 11%</td>
<td>&quot;New</td>
<td></td>
</tr>
</tbody>
</table>
| Significant growth is expected in solar and storage, with additional     | Downstream"
| value from demand response, energy efficiency                           |
| New business models and new value-creating technology will emerge across  |
| region containing 50 years worth of demand                              |

Source: McKinsey

(1) EBITDA basis, excluding upfront costs or maintenance capex.
(2) Merchant available margin growth.
Selected Historical Mean LCOE Values

While costs in renewable technologies are declining, traditional technologies can continue to remain competitive through the optimization of their assets.

- LCOE of renewables has decreased below that of traditional fuels, and the gap is expected to widen in the foreseeable future.
- Existing coal and nuclear generation operators that can adjust their cost structures to near breakeven levels will still be more profitable than new generation.

Source: 2017 Lazard Levelized Cost of Energy Analysis
(1) SunTrust equity research forecasts PJM ATC prices.
Rejecting Power-Purchase Agreements in Energy Cases
Do Bankruptcy Courts Have Exclusive Jurisdiction?

In a much-awaited and pivotal decision in the PG&E chapter 11 proceeding, the U.S. Bankruptcy Court for the Northern District of California held that it not only has exclusive jurisdiction over the rejection of wholesale power-purchase agreements, but that the Federal Energy Regulatory Commission (FERC) has no such jurisdiction and any determinations by FERC to the contrary would be void. While the decision might not be surprising to most bankruptcy practitioners, the proposition that FERC has no jurisdiction over the breach or modification of a power-purchase agreement is not only shocking to energy practitioners, but contrary to well-established authority in the energy arena.

Further, other courts have held otherwise, and the issue is percolating its way up on appeal to the Sixth and Ninth Circuits. There is a split of authority, and the collision between the regulation of energy sales in interstate commerce and bankruptcy policy is unsettled territory. This article explores the ever-changing legal landscape on the question of whether bankruptcy courts have sole authority to approve rejection of a power-agreement otherwise within FERC’s province.

Bankruptcy Basics: Rejection of Executory Contracts Is a Core Matter over Which Bankruptcy Courts Have Exclusive Jurisdiction

First, let’s review some basic bankruptcy principles. Section 365(a) of the Bankruptcy Code provides that “the trustee [or debtor-in-possession], subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.” This section allows debtors to be relieved of burdensome agreements, and bankruptcy courts have broad discretion to authorize rejection under this provision. The U.S. Supreme Court has recognized that the authority to reject an executory contract “is vital to the basic purpose of a Chapter 11 reorganization, because rejection can release the debtor’s estate from burdensome obligations that can impede a successful reorganization.”

Further, bankruptcy courts have “original and exclusive jurisdiction of all cases ‘under’ title 11.” There is no question that the rejection of contracts under § 365 is a core matter and a proceeding that “invokes a substantive right provided by title 11 or ... a proceeding that, by its nature, could arise only in the context of a bankruptcy case.” Courts have similarly held that “[t]he right of a debtor in possession to reject certain contracts is fundamental to the bankruptcy system because it provides a mechanism through which severe financial burdens [might] be lifted while the debtor attempts to reorganize.”

It is also clear that rejection of an executory contract under 11 U.S.C. § 365(a) constitutes a breach of the contract, not a modification or termination. Rejection creates a contract “breach,” and the non-party to the contract has the right to assert that the contract is null and void.

6 In re Gruntz, 202 F.3d 1074, 1081 (9th Cir. 2000) (quoting 11 U.S.C. § 365(a)).
8 See, e.g., In re Gruntz, 202 F.3d 1074, 1081 (9th Cir. 2000) (quoting 11 U.S.C. § 365(a)).
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breaching party to the rejected contract holds an unsecured claim against the debtor’s estate. The Bankruptcy Code thus permits debtors to breach burdensome contracts and transforms a debtor’s obligations to perform into a pre-petition claim for damages under § 365(g) of the Bankruptcy Code. In reviewing a debtor’s request, bankruptcy courts apply the “business judgment” standard to determine whether the rejection of an executory contract or unexpired lease should be authorized. Rejection is appropriate where it would benefit the estate.10 In other words, if a bankruptcy court finds that a debtor has exercised sound business judgment to determine that rejection of a contract is in the best interests of the debtor, its creditors and all parties-in-interest, the bankruptcy court should approve rejection.11 Generally speaking, bankruptcy courts approve a debtor’s decision to reject as a matter of course, and the business-judgment standard is fairly easily satisfied.

**FERC Has Exclusive Jurisdiction over Wholesale Energy Contracts: The “Filed Rate” Doctrine (Mobile-Sierra)**

However, there is also a well developed body of case law upholding the proposition that FERC has exclusive authority to regulate the provision of electric energy in interstate commerce. Furthermore, it exercises this authority for the “public interest.”12 FERC is vested with exclusive authority to regulate rates for wholesale sales of electric energy, and this exclusive authority extends to the terms and conditions of wholesale power agreements (including their duration and early termination), as well as changes to those agreements.13 Moreover, filed rates for wholesale sales of electric energy carry the force of law.14 Once approved by FERC, the duty to perform under a contract “springs from the Commission’s authority, not from the law of the private contracts.”15 If a party seeks to modify a filed rate contract, the Supreme Court has ruled that the Federal Power Act requires FERC to apply a rigorous standard, and a party may not unilaterally modify the contract without a showing that continuation of the contract would harm the public interest.16 This fundamental principle of energy law is known as the “Mobile-Sierra doctrine.”

Extremely important in this calculus and subsumed in its role as the agency vested with authority to oversee the sale of energy, FERC has unique expertise in ensuring the reliable provision of energy at “just and reasonable rates” that serve the public interest. Indeed, that is its primary purpose. It implements national energy policy to maintain economically efficient, safe, reliable and secure energy services at a reasonable cost for consumers. More succinctly, it safeguards the stability of the nation’s electric markets on the transmission grid. Undeniably, FERC has expertise that the bankruptcy court does not concerning the provision of electricity.

**Bankruptcy Code Contains Provisions That Affirm that Debtors Remain Subject to Regulatory Supervision and Authority**

There can be no doubt that Congress intended for debtors in bankruptcy to operate in compliance with regulatory oversight, and several Bankruptcy Code sections reveal this intent. Under § 362(b)(4), the automatic stay does not stay any “action or proceeding by a governmental unit…to enforce such governmental unit’s … regulatory power.”17 Certainly, FERC’s regulatory authority under the Federal Power Act to safeguard energy markets is an exercise of regulatory power under § 362(b)(4). Ironically, the U.S. Bankruptcy Court for the Northern District of California affirmed this authority with respect to the California Public Utilities Commission in the prior PG&E bankruptcy proceeding.18

Further, § 1129(a)(6) requires that as a condition to confirmation of a reorganization plan, “[a]ny governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.” A debtor in possession must manage its estate in accordance with all applicable state and federal laws.19

**Circuits Are Split on Whether a Debtor May Be Relieved of Its Obligations Without FERC Approval**

Given the two bodies of law, which authority should govern a debtor’s decision to reject a power-purchase agreement? Should it be the bankruptcy court or FERC, or should they have concurrent authority and perhaps work together harmoniously? Various courts have addressed the issue of jurisdiction over the rejection of power-purchase agreements, and the opinions are split. In the Mirant opinion, the Fifth Circuit Court of Appeals held that because the rejection of a FERC contract is a breach, the bankruptcy court may grant a debtor’s motion to reject such a contract and give full effect to the filed rate in determining contract damages resulting from the rejection. However, it also opined that the bankruptcy court should apply a heightened standard: “Use of the business-judgment standard would be inappropriate in this case because it would not account for the public interest inherent in the transmission and sale of electricity.”20 On remand, the district court held that the debtor:

*must prove that [the contract] burdens the bankruptcy estate ... that after careful scrutiny and giving significant weight to comments and findings of the FERC relative to the effect such a rejection would have on the public interest inherent in the transmis-

---

12 In re Hydro-Québec Gas Serv. Corp., 538 F.3d 83, 104 (3d Cir. 2008) (holding that absent extraordinary circumstances, court approval of debtor’s decision to assume or reject executory contract “should be granted as a matter of course”).
The question of whether bankruptcy courts should defer — or at least listen — to FERC in determining whether wholesale power-purchase agreements can be rejected is not only a fascinating one, but one that affects billions of dollars in damages to wholesale energy suppliers. We have not heard the last word on this thorny matter, as appeals are in the works and the circuits are split. However, we can only hope that bankruptcy courts will be sensitive to the consequences of their decisions on energy markets and investment in the provision of energy, particularly in delicate and evolving renewable energy markets. The saga continues, and we will see whether bankruptcy courts maintain sole authority to determine whether energy contracts may be rejected, and under what circumstances, or whether these contracts are so different that different laws must be applied.


The American Bankruptcy Institute is a multi-disciplinary, non-partisan organization devoted to bankruptcy issues. ABI has more than 12,000 members, representing all facets of the insolvency field. For more information, visit abi.org.
ABI Consumer Commission: Part I

Members of the Commission will report on its findings related to debt limits in chapter 13, the concept of a reserve fund, collateral and discharge violations.

Alane A. Becket
Becket & Lee LLP; Malvern, Pa.

Edward C. Boltz
The Law Offices of John T. Orcutt; Durham, N.C.

Henry E. Hildebrand, III
Chapter 13 Trustee; Nashville, Tenn.

Hon. Eugene R. Wedoff (ret.)
Oak Park, Ill.
An Introduction
to the Final Report and Recommendations
for Chapter 13 cases
National Conference of Bankruptcy Judges 2019
Washington DC

Consumer ABI Consumer Commission:
Part I

- Hon. Eugene R. Wedoff (ret.), Moderator Oak Park, Ill.

- Alane A. Becket Becket & Lee LLP; Malvern, Pa.

- Edward C. Boltz The Law Offices of John T. Orcutt; Durham, N.C.

- Henry E. Hildebrand, III Chapter 13 Trustee; Nashville, Tenn.
ABI Commission Final Report Topic Categories

- Effectuating the Fresh Start
- Improving Creditor Certainty
- Facilitating Effective Access
- Making Chapter 13 Work
- Systems Issues

Chapter 13 Debt Limits

- $3,000,000
- No secured/unsecured distinction
- Adjusted per §104
- Clarification for married persons
  - Non-filing spouse’s debts NOT to be aggregated with filing spouse
  - In a joint filing, both spouses have benefit of debt limit
Presumptively Reasonable Chapter 13 Fees

• Courts should adopt presumptively reasonable fees through confirmation, with regular reviews of fee amount

• Adoption of “a la carte” fee structure for post-confirmation work

• Consider higher fee for certification

Unbundling of Attorney Services

• Local Rules specifying services and addressing unbundling

• Rules consistent with professional responsibility
Stand-in Counsel

- **Adoption** of governing rules including best practices specific to bankruptcy
- Amend rule 9010 to require notice of appearance with any limitation on representation
- Encourage video and telephonic hearings
- Negative notice procedures

Student Loans – Payment in 13

- New 11th priority
  - Further goal of paying government loans (surplus 7)
  - Allows for separate classification and payment
- 1322(a)(4) should except student loans from payment in full requirement
- All subject to the best interests of creditors test
Reserve Fund in Chapter 13

- Chapter 13 debtors should be allowed and encouraged to maintain a reasonable reserve fund
  - to be held by the trustee
  - for unanticipated expenses of the debtor
- The reserve fund should be limited to one month of scheduled expenses
- The debtor would access the reserve fund after notice and an opportunity for interested parties to object
- The debtor should be allowed to replenish the reserve fund

Rule 3002.1 Changes

- Changes to payment change notices
- Notices of final cure, with mandatory response
- Add mid-case status review
Conduit payments

• Would be required unless:
  • Trustee commission would be an undue burden on debtors in the district
  • Trustee commission would be an undue burden on the debtor in the case
  • A non-filing co-debtor is making payments

• Bifurcated commission rates should be permitted

Underwater Mortgages

• Debtor may satisfy a claim subject to a mortgage by conveying property to lienholder or selling free and clear of liens:
  • Use of Rule 6004 procedure: notice of sale
  • Plan must give mortgage holder 60 days from confirmation to respond to plan provision
  • Holder accepts deed in lieu or if rejects transfer, Debtor serves motion to sell under § 363(f)
Other Chapter 13 Recommendations

• No automatic dismissal for reasonable extension past 60 months

• Preventing conflicts between proof of claim and plan

• Rule 1306 amendment

Application of Means Test in Converted Cases

• Means test should apply

• Applied as of original petition date
Business Debtor Reporting

- Amend Rule 2014 to require new official form for chapter 13 business debtors
- Quarterly reports
- Court may excuse or change requirements

Repeat Filers – §109(g)

- Amend 109(g): order of dismissal (first case) may include a restriction on a new filing – after notice and hearing – made by any party in interest:
  - Willful failure of debtor to abide by court orders or propose a plan in good faith
  - Willful and substantial default
  - Repetitive dismissed bankruptcies
  - Willful failure to appear
  - Any abuse of Title 11 other than 707(b)
  - Prohibition on refiling for (in most cases) 180 days
Repeat filers – §349

• Dismissal of a case
  • Does not bar discharge in a subsequent case of dischargeable debts except as expressly provided for by the Code

  • Does not prejudice the Debtor with regard to refiling except as set forth in 109(g)

Repeat filers - §362

• 362(c)(3) should be repealed*

*clarified
Mental Health issues in Bankruptcy

• Acknowledge and address the known link between debt and mental health issues

• Recommendations:
  • Encourage disclosure while protecting privacy
  • Education and evaluation services /pro bono and reduced fee services to court
  • ABI programming

Standardization of Credit Reporting after bankruptcy

• Problems: Proper reporting of discharged debt
  • Mortgage servicers not reporting during a case
  • Incorrect reporting after notice of final cure
  • Lack of standardization after dismissal
  • “Ride-through” reported as delinquent
  • Reporting of co-obligors

• ABI forum bringing experts together to develop best practices
You Can Use § 363 for That?

This panel will discuss uses of § 363 other than in connection with asset sales, such as first-day relief, entry into contracts, payment of fees of professionals of ad hoc groups and other uses.

Douglas M. Foley, Moderator
McGuireWoods LLP; Washington, D.C.

Eric W. Anderson
Parker, Hudson, Rainer & Dobbs LLP; Atlanta

Lisa G. Beckerman
Akin Gump Strauss Hauer & Feld LLP; New York

Hon. Robert D. Drain
U.S. Bankruptcy Court (S.D.N.Y.); White Plains

Rosa J. Evergreen
Arnold & Porter Kaye Scholer LLP; Washington, D.C.
“YOU CAN USE SECTION 363 FOR THAT?”

Moderator
Douglas M. Foley, McGuire Woods LLP

Panelists
Rosa J. Evergreen, Arnold & Porter Kaye Scholer LLP
Eric W. Anderson, Parker, Hudson, Rainer & Dobbs LLP
Lisa G. Beckerman, Akin Gump Strauss Hauer & Feld, LLP
Judge Robert D. Drain, United States Bankruptcy Judge, United States Bankruptcy Court for the Southern District of New York
A. Section 363(b) as the Basis for Approval of Post-Petition RSA

I. What is an RSA?

a. A restructuring support agreement (“RSA”) -- also sometimes referred to as a plan support agreement (“PSA”) when effectuated after a petition date -- is generally a pre- or postpetition agreement entered into by the debtor and certain significant stakeholders of the debtor pursuant to which the parties agree to support a proposed or pre-negotiated Chapter 11 plan.

b. The approval process for RSAs is not uniform. Different bankruptcy courts have treated RSAs differently -- and whether the agreement was entered into prepetition or postpetition can be a factor in the court approval process.

II. Approval of an RSA.

a. There are two primary methods to obtain judicial approval of an RSA:

i. RSA entered into Prepetition: A debtor may seek to assume the agreement as an executory contract under Section 365 of the Bankruptcy Code.

» A court reviewing the prepetition RSA may approve the assumption of the agreement under Section 365 upon a showing that the debtor’s decision to take such action will benefit the debtor’s estate and is an exercise of the debtor’s sound business judgment.

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1 This section was prepared by Rosa J. Evergreen and Gerardo Mijares-Shafai Arnold & Porter
ii. **RSA entered into Postpetition:** A debtor may seek bankruptcy court approval to enter into the agreement under Section 363 of the Bankruptcy Code.

> Section 363(b) provides, in relevant part, that a debtor, “after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” See 11 U.S.C. § 363(b)(1).

III. Court approval under Section 363(b) of the Bankruptcy Code.

a. The standard for review under Section 363(b) is the business judgment rule.

i. The business judgment rule applies when “the following elements are present:

> » (i) a business decision,
> » (ii) disinterestedness,
> » (iii) due care,
> » (iv) good faith, and
> » (v) according to some courts and commentators, no abuse of discretion or waste of corporate assets.”

_In re Innkeepers USA Trust_, 442 B.R. 227, 231 (Bankr. S.D.N.Y.2010); _see also In re Residential Capital, LLC_, No. 12-12020, 2013 WL 3286198, at *19 (Bankr. S.D.N.Y. June 27, 2013) (approving a postpetition RSA under Section 363 after determining that the elements of the business judgement standard had been satisfied).
b. Courts across several jurisdictions have held that a debtor may enter into a postpetition RSA pursuant to Section 363(b) of the Bankruptcy Code. See, e.g., In re 4 West Holdings, Inc., Case No. 18-30777 (HDH) (Bankr. N.D. Tx. June 4, 2018) (ECF Doc. # 506) (entering an order approving postpetition RSA pursuant to Section 363(b), over the unsecured creditors committee’s objection); In re Magnetation LLC, Case No. 15-50307 (GFK) (Bankr. D. Min. July 14, 2015) (ECF Doc. # 239) (entering an order approving entry into a postpetition RSA under Section 363(b) over the objection of the U.S. Trustee); In re Residential Capital, LLC, No. 12-12020, 2013 WL 3286198, at *19 (Bankr. S.D.N.Y. June 27, 2013).

B. Post-Petition Fees: How Does Section 363(b) Apply?

I. Compensation of ad hoc professionals generally:
   a. Professionals employed by statutory committees are generally compensated pursuant to Section 330 of the Bankruptcy Code, whereas ad hoc committee professionals or other types of professionals are sometimes treated differently.
   b. Section 503(b)(4) of the Bankruptcy Code provides a mechanism whereby some ad hoc committee members have sought reimbursement of fees and expenses. See In re Mirant Corp., 354 B.R. 113, 131 (Bankr. N.D. Tex. 2006), subsequently aff’d, 308 F. App’x 824 (5th Cir. 2009) (noting this concept).
i. More specifically, “section 503(b)(4) provides that payment of professional fees as an administrative expense of the estate requires that:

1. the compensation sought be ‘reasonable;’

2. the compensation be for services of an attorney or accountant;

3. the attorney or accountant be employed by an entity that is entitled to payment of expenses under Code § 503(b)(3); and

4. the compensation must be warranted by the time, nature, extent and value of the professional services.”

Id. at 132 (analyzing and citing Section 503(b)(4)).

ii. In order for professional fees to be payable under Section 503(b)(4), the entity that retained the professional must satisfy the requirements of Section 503(b)(3)(D) -- that it be “a creditor ..., an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of [the Bankruptcy Code], [that makes] a substantial contribution in a case under chapter 9 or 11 ...”

See 11 U.S. Code § 503.

iii. However, bankruptcy courts have also authorized certain fees under Section 363(b) (see the next section).
II. Payment of ad hoc professionals pursuant to Section 363(b) of the Bankruptcy Code:

a. As discussed above, under Section 363(b), the debtor “may use, sell, or lease, other than in the ordinary course of business, property of the estate” after notice and a hearing.

b. Courts have held that “[t]he authorization of certain types of payments under § 363(b) is not prohibited simply because there is another section of the Bankruptcy Code related to the same type of payment.” *In re Bethlehem Steel Corp.*, No. 02 CIV. 2854 (MBM), 2003 WL 21738964, at *11 (S.D.N.Y. July 28, 2003) (affirming the order of the bankruptcy court authorizing the debtor to reimburse its employees’ union for certain professional fees under Sections 105 and 363, and finding that subsections 503(b)(3)(D) and (b)(4) are not rendered meaningless simply because in certain unique circumstances a bankruptcy court approves a debtor’s motion to enter into an agreement to reimburse a creditor for professional fees); *see also In re Enron Corp.*, 335 B.R. 22 (Bankr. S.D.N.Y. 2005) (*citing Bethlehem Steel*, and stating that “authorization of certain types of payments under § 363(b) is not prohibited simply because there is another section of the Bankruptcy Code related to the same type of payment”); *In re Asarco, LLC*, 441 B.R. 813 (Bankr. S.D. Tex. 2010) (finding that Section 363(b), not Section 503(b), was more applicable for approval of reimbursement of expenses for bidders in asset sale, reasoning that “administrative expenses [under section 503(b)] are for routine operational costs”).
c. Some bankruptcy courts have permitted the compensation of ad hoc professionals under Section 363(b).

i. In In re Arch Coal, Inc., the debtors sought relief under Section 363(b) to pay “all reasonable and documented fees and expenses of [their] Consenting Lenders’ advisors incurred in connection with the RSA, the other Restructuring Documents and the transactions contemplated thereby.” In re Arch Coal, Inc., No. 16 40120 (CER) (Bankr. E.D. Mo. January 21, 2016) (ECF Doc. # 156).

» The bankruptcy court entered an order approving the prepetition RSA pursuant to Section 365 of the Bankruptcy Code, and approved the reimbursement of fees and expenses of the lenders’ professionals pursuant to Section 363(b) of the Bankruptcy Code. See Arch Coal, No. 16 40120 (CER) (Bankr. E.D. Mo. July 7, 2016) (ECF Doc. # 1098).

» Later in the Chapter 11 cases, the U.S. Trustee filed an objection to the confirmation of the debtors’ Chapter 11 plan on the basis that the plan provided for the payment of non-estate retained professionals without legal justification. See Arch Coal, No. 16 40120 (CER) (Bankr. E.D. Mo. September 7, 2016) (ECF Doc. # 1295) (arguing that the payment provisions were inconsistent with Section 503).

» Over the objections of the U.S. Trustee, the bankruptcy court entered an order confirming the debtors’ Chapter 11 plan,
which explicitly provided for the payment of fees to the RSA
parties’ professionals consistent with the terms of the RSA
and the RSA order. See Arch Coal, No. 16 40120 (CER)
(Bankr. E.D. Mo. September 15, 2016) (ECF Doc. # 1334).

ii. In In re Residential Capital, LLC, the debtors sought approval of
their entry into a postpetition PSA pursuant to Sections 105 and 363
of the Bankruptcy Code. No. 12-12020, 2013 WL 3286198, at *1
(Bankr. S.D.N.Y. June 27, 2013); see also id. at ECF Doc. # 3814.

The U.S. Trustee objected to the debtors’ motion seeking to
approve the PSA on several bases, one of which was that the
proposed treatment of professional fees and expenses of
certain of the plan support parties as administrative expenses
was impermissible. See id. at ECF Doc. # 4031.

The bankruptcy court overruled the objection of the U.S.
Trustee, approved the PSA in its entirety, and held that (i)
the PSA was not an impermissible solicitation of votes under
Section 1125 and (ii) the Debtors “met their burden of
showing that the business judgment rule applies and that
they exercised sound business judgment in reaching the
[PSA].” See Residential Capital, 2013 WL 3286198, at *20
(Bankr. S.D.N.Y. June 27, 2013); see also id. at ECF Doc. #
4098.

C. Payment of Fees to Independent Directors of the Debtor under Section 363.
I. Payment of fees to independent directors in a Chapter 11 proceeding.
   a. Chapter 11 debtors with employees usually will file a “first day” motion seeking authority to pay their employees’ prepetition wages, commissions, salaries, expenses and benefits. This is referred to generally as a “first day wage motion.”
   b. As part of this “first day” motion, some debtors have included a request for continued payment of its independent directors on the basis that such payments represent a sound exercise of the debtor’s business judgment, is necessary to avoid immediate and irreparable harm to the debtor’s estate, and is therefore justified under Section 363(b).

D. Payment of Professionals of Independent Directors Under Section 363.

I. Payment of a debtor’s independent directors’ professional fees.
In addition to seeking authority to continue paying the fees of and compensation to its independent directors, some debtors have also sought relief under Section 363(b) to pay for the fees and expenses of the directors’ counsel.

Courts in certain jurisdictions have approved payment of fees and expenses of counsel for a debtor’s independent directors pursuant to Section 363. See e.g., *In re PG&E Corporation*, No. 19-30088 (DM) (Bankr. N.D. Ca. May 10, 2019) (ECF Doc. # 1979) (authorizing payment of reasonable fees and reimbursement of reasonable and necessary expenses of counsel to certain current and former independent directors under Section 363(b)); *In re SunEdison, Inc.*, No. 16-10992 (SMB) (Bankr. S.D.N.Y. July 13, 2016) (ECF Doc. # 764) (authorizing payment of fees and expenses of counsel to independent directors); *In re Sabine Oil & Gas Corp.*, No. 15-11835 (SCC) (Bankr. S.D.N.Y. Nov. 5, 2015) (ECF Doc. # 485) (authorizing the debtor to advance legal fees to directors in connection with a postpetition investigation); *In re Residential Capital, LLC*, No. 12-12020 (MG) (Bankr. S.D.N.Y. Sept. 27, 2012) (ECF Doc. # 1610) (authorizing payment of fees and expense of counsel to independent directors); *In re Innkeepers USA Trust*, No. 10-13800 (SCC) (Bankr. S.D.N.Y. Nov. 10, 2010) (ECF Doc. # 701) (authorizing payment of fees and expenses of counsel to committee of independent trustees of a board of trustees).

**E. Retention of Professionals by Debtors Under Section 363.**
I. Retention of a debtor’s professionals in bankruptcy: Section 327 versus Section 363.

a. Chapter 11 cases typically involve various professionals -- attorneys, accountants, appraisers, auctioneers, and others -- assisting the debtor in carrying out its duties under the Bankruptcy Code. Many of these professionals must be retained under Section 327 of the Bankruptcy Code.

i. Section 327(a) imposes a number of requirements, including the submission of a retention application that includes a sworn affidavit from the professional disclosing, among other things, any connections to a party-in-interest or potential conflicts-of-interest, and attesting to the professional’s disinterestedness.

b. Attorneys, accountants, appraisers, and auctioneers are expressly listed in Section 327(a). Section 327(a) also refers to “other professional persons.” “Professional person,” however, is not a defined term in the Bankruptcy Code.

i. By its terms then, if “a professional” is not a “professional person” under Section 327(a), a debtor may be able to seek to retain/pay such professional under a different section of the Bankruptcy (e.g., Section 363(b)).

II. Who qualifies for retention and payment under Section 363(b) of the Bankruptcy Code:

a. While a debtor’s professional advisors, such as financial advisors and investment bankers, generally must be retained under Section 327(a),
bankruptcy courts have permitted retention of certain advisors and other employees under alternative provisions of the Bankruptcy Code, including under Section 363(b), in instances where such persons did not play a central role in the administration of the bankruptcy. See *In re ITG Vegas, Inc.*, No. 06-16350 (PGH), 2007 WL 1087212, at *3 (Bankr. S.D. Fla. Apr. 3, 2007) (authorizing the debtors to employ political consultants to provide political consulting and lobbying services for the Debtors pursuant to Section 363(b)); *Comm. Of Asbestos-Related Litigants v. Johns-Manville Corp., et al. (In re Johns-Manville Corp.)*, 60 B.R. 612, 619 (Bankr. S.D.N.Y. 1986) (holding that the retention of several law firms serving as lobbyists was in the ordinary course of business pursuant to Section 363(b) based off past employment of such firms and industry practice, and that such lobbyists were not professional persons for the purposes of the notice and hearing requirements of Section 327, as they were not intimately involved in the administration of the reorganization process); see also *In re SageCrest II, LLC*, 2011 WL 134893, at *7 (D. Conn. Jan. 14, 2011) (finding that “professional persons” are defined to include firms or individuals who have been “hired for the purpose of reorganizing the corporation or otherwise assisting it through the Chapter 11 bankruptcy process”); *In re Dairy Dozen-Milnor, LLP*, 441 B.R. 918, 920 (Bankr. D.N.D. 2010) (stating that a “professional person” under Section 327(a) is one who “takes a central role in the administration of the debtor’s bankruptcy estate and bankruptcy proceedings as opposed to one who provides services to the debtor that are
necessary regardless of whether a bankruptcy petition was filed”); *In re Phoenix Steel Corp.*, 110 B.R. 141, 142 (Bankr. D. Del. 1989) (finding that workout managers hired as officers to evaluate company’s financial condition and oversee day-to-day operations were not “professional persons” within the meaning of Section 327(a)); *In re Seatrain Lines, Inc.*, 13 B.R. 980, 981 (Bankr. S.D.N.Y. 1981) (concluding that maritime engineers hired by the debtor were not “professional persons” subject to retention under Section 327 because they did not play a central role in the administration of the bankruptcy case and the need for their employment did not arise from the bankruptcy itself).

b. In *In re Heritage Home Group LLC*, et al., Case No. 18-11736 (KG), 2018 WL 4684802 (Bankr. D. Del. Sept. 27, 2018), the bankruptcy court provided some analysis as to which “professional persons” must be retained under Section 327(a) versus Section 363(b).

i. The debtors sought to retain SB360 Capital Partners, LLC (the “Consultant”) pursuant to a store closing and asset disposition agreement (the “Disposition Agreement”).

» The Disposition Agreement detailed the services to be provided by the Consultant and the payment terms for its services.

ii. The debtors sought approval of the Disposition Agreement, including the retention and payment of the Consultant, through a
motion seeking relief under Sections 105(a) and 363(b) of the Bankruptcy Code.

» The U.S. Trustee filed an objection arguing that the Consultant fell under the term “professional person” and should be retained under Section 327.

iii. The bankruptcy court held, inter alia, that the approval of the Consultant’s retention through the Disposition Agreement and under Section 363(b) was permissible because the Consultant was not in a position where it could:

» control, purchase or sell assets important to the reorganization; and

» negotiate the terms of the reorganization.

c. In In re Nine W. Holdings, Inc., 588 B.R. 678 (Bankr. S.D.N.Y. 2018), the bankruptcy court held that the debtors were authorized to use Section 363(b) to hire a management consultant, who had overseen the debtors’ daily operations for over four years prior to the petition date, to provide the debtors with an interim CEO and certain additional personnel.

i. More specifically, the court held that the management consultant did not play an intimate or central role in the reorganization, and declined to find that it constituted a “professional person” as such term is utilized under Section 327(a). See id. at 695.
F. Retention of Chief Restructuring Officers (“CROs”) using Section 363

I. Traditional Retention of CROs: Section 327

a. Debtors are permitted to hire directors and officers without court approval.

11 U.S.C. § 327(b); see also Jacobson v. AEG Capital Corp., 50 F.3d 1493, 1500 (9th Cir. 1995) (”[D]irectors still have the power to elect officers.”).

However, CROs are not considered corporate officers – rather, courts consider CROs to be hybrid professionals, having not only professional responsibilities that would ordinarily require retention under Section 327, but also executive functions that would ordinarily permit retention under Section 363.

b. Section 327(a) was the traditional method used by debtors to retain CROs.

It specifies the types of professionals to whom the section applies, and also includes certain requirements that the petitioning professionals must comply with before the court will allow retention.

i. Attorneys, accountants, appraisers, and auctioneers are required to be retained using Section 327(a). Section 327(a) also references “other professional persons,” though the phrase “other professional persons” is not defined in the Bankruptcy Code.

ii. Section 327 also includes certain disclosure requirements regarding, among other things, the professional’s relationship with the debtor and other parties in interest.

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2 This section was prepared by Eric W. Anderson and Michael Sullivan Parker, Hudson, Rainer & Dobbs LLP Atlanta, Georgia
Courts are primarily concerned with whether the professional is “disinterested,” as that term is defined in the Bankruptcy Code, and with requiring the professional to file his or her fee applications with the court. For many courts, the “twin goals of [Section 327] are impartiality of the professional and professional fees subject to court review for reasonableness.” *In re Ajubeo LLC*, Case No. 17-17924, 2017 WL 5466655, at *3 (Bankr. D. Colo. Sept. 27, 2017).

c. Therefore, when addressing a debtor’s request to retain a CRO under other sections of the Code (including Section 363), courts generally attempt (i) to confirm that the CRO is not a professional person within the scope of Section 327(a), and (ii) to preserve the “twin goals” of impartiality and requiring a reasonableness review of fees.

II. Retention of CROs under Section 363(b) – the “Jay Alix Protocol”

a. Given the somewhat cumbersome process of complying with the requirements of Section 327(a) (and because courts give some measure of deference to the debtor’s business judgment when considering whether to approve a debtor’s use of estate property outside the ordinary course of business), more recently debtors began to seek retention of CROs through the use of Sections 363(b) and 105(a). The rationale for using these sections is as follows:

i. Section 363(b) provides that a debtor, “after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business,
property of the estate.” 11 U.S.C. 303(b)(1). Paying a CRO constitutes a use of the debtor’s funds that is outside the ordinary course of business.

ii. Additionally, pursuant to Section 105(a), the “court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” Though many cases rely on the equitable authority provided by Section 105(a), not all do. See, e.g., In re Grede Foundries, Inc., Case No. 09-14337 (Bankr. W.D. Wis. 2009).

b. As a result of this growing trend, a protocol was developed in 2001 as part of a settlement between the Office of the United States Trustee and Jay Alix & Associates (the “Protocol”), concerning applications by debtors in two separate Delaware bankruptcy cases to employ Jay Alix & Associates as CRO pursuant to Section 363(b). In re Harnischfeger Indus., Inc., Case No. 99-2171 (Bankr. D. Del. 1999); In re Safety-Kleen Corp., Case No. 00-2303 (Bankr. D. Del. 2000). The key elements of the Protocol include:

» The professional may only serve in one capacity (e.g., CRO, financial advisor, claims agent, etc.)

» The professional may not be a member of the debtor’s board or have served on the board within two years prior to the petition date;

» The professional must disclose its relationships with all interested parties; and
» The professional’s compensation will be reviewed under a reasonableness standard at the end of the case; however, the professional is not required to file a formal fee application, and any success fees payable to the professional must be approved at the conclusion of the case.

c. Retaining a CRO under Sections 363(b) and 105(a) presents several potential advantages as compared to retention of a CRO as a “professional person” under Section 327(a).

i. CROs retained under Section 363 are not required to file formal fee applications. While courts typically still require some review of fees for reasonableness, the requirements are usually less onerous than complying with Sections 330 and 331. See In re Copenhaver, Inc., 506 B.R. 757, 764 (Bankr. C.D. Ill. 2014) (“[W]hen the constraints of § 330 and § 331 do not apply, fee applications may be made in different forms, at different times, and with different procedures for review. . .”).

ii. In addition, CROs retained under Section 363 are not subject to a disinterestedness requirement. A CRO retained under Section 363 is not required to make the same disclosures about his or her connections with the debtor or other parties in interest as a professional retained pursuant to Section 327(a) would. Fed. R. Bankr. P. 2014(a).
Despite the lack of requirement, many CROs voluntarily make such disclosures in anticipation of objections from the U.S. Trustee. See, e.g., In re WP Steel Ventures LLC, Case No. 12-11661 (Bankr. D. Del. 2012); In re Dippin’ Dots Inc., Case No. 11-51077 (Bankr. W.D. Ky. 2011); In re BI-LO LLC, Case No. 09-02140 (Bankr. D.S.C. 2009).

This is probably wise, following the general maxim in bankruptcy court of “when in doubt, disclose.”

Finally, CROs retained pursuant to Section 363 may have additional protection from liability that professionals retained pursuant to Section 327(a) would not have. For example, a CRO retained pursuant to Section 363(b) may be covered under the debtor’s directors and officers liability insurance policy. See In re Ajubeo LLC, 2017 WL 5466655, at *3.


e. In recent years, a number of other districts have adopted the Protocol as well. See In re Copenhaver, Inc., supra., 506 B.R. 757, 764; In re Clare
**III. Considerations When Retention of CRO Sought Pursuant to Section 363(b)**

a. Since the Protocol was established, the use of Section 363(b) to retain CROs has grown. However, despite the deference ordinarily given to debtors’ business judgment under Section 363, courts continue to review such retention applications carefully to ensure that the debtor’s decision to seek retention outside of Section 327(a) is appropriate.

b. Courts have permitted CROs to be retained using Section 363(b) where it is determined that the CRO will not play a central role in the reorganization, and is therefore not a “professional person” within the scope of Section 327.

i. In *In re Heritage Home Group LLC*, et al., 2018 WL 4684802 (Bankr. D. Del. Sept. 27, 2018), the bankruptcy court addressed whether a consultant retained to help the debtor conduct “going out of business” sales of its stores should be considered a “professional person” pursuant to Section 327(a). The court held, over an objection from the U.S. Trustee, that the consultant did not qualify as a “professional person” within the scope of Section 327(a) because “it is clear that [the consultant] is not at the center of [the debtors’] reorganization….”

» The court in Heritage derived its understanding of what constitutes a “professional person” from the Delaware District Court case of *In re First Merchants Acceptance...*
in reviewing First Merchants, the Heritage court held that a professional “is limited to those occupations which control, purchase or sell assets that are important to reorganization, is negotiating the terms of a plan of reorganization, has discretion to exercise his or her own personal judgment, and whether he or she contributes ‘some degree of special knowledge or skill.’” The Heritage court found that the store-closing consultant was not an auctioneer (which may have been considered a professional), and while the consultant did have some specialized knowledge, it was not at the center of the reorganization process. Thus, retention under Section 363 was appropriate.

ii. In In re Nine West Holdings, Inc., 588 B.R. 678 (Bankr. S.D.N.Y. 2018), the court addressed whether a CRO who had been overseeing the debtors’ operations for four years should be considered a “professional person” subject to the requirements of Section 327(a). The court held that the CRO’s role was to focus on business operations, work that would otherwise largely be done by officers and managers, and that the CRO was therefore not intimately involved in the reorganization process. Accordingly, the court permitted the CRO to be retained pursuant to Section 363(b).
iii. The case of *In re Brookstone Holdings Corp.*, 592 B.R. 27 (Bankr. D. Del. 2018) is similar to Heritage. The court held that a consultant hired to liquidate certain assets was not a “professional person” because it had limited discretion to make liquidation decisions, was not significantly involved in the administration of the debtor’s estate, and was not involved at all in the negotiation of the plan of reorganization.

iv. Lastly, in *In re hhgregg, Inc.*, Case No. 17-01302 (Bankr. S.D. Ind. May 8, 2017), the court similarly rejected the requirement that the debtor use Section 327(a) to retain its consultant. There, the court found that the consultant had limited independence and carried out the debtor’s judgment, did not play a central role in the reorganization, and did not have broad discretion.

c. As the case law indicates, whether a particular CRO is a “professional person” is a fact-intensive inquiry. Courts will scrutinize the CRO’s duties closely to determine whether retention pursuant to Section 363(b) is appropriate.

i. In *In re Blue Stone Real Estate Const. & Dev. Corp.*, 392 B.R. 897 (Bankr. M.D. Fla. 2008), the debtor sought to appoint a CPA as chief restructuring officer to review the Debtors’ books and records and conduct relevant investigations, conduct a thorough inventory of the assets, negotiate with and verify the financial viability of all
potential purchasers of any assets, and oversee and monitor the liquidation of the assets.

» The court determined that the CRO’s duties and responsibilities made him a “professional person” under the First Merchants standard. As a result, the court authorized the CRO’s retention under Section 327(a), and not Section 363(b).

ii. The bankruptcy court in *In re Marion Carefree Ltd. P’ship*, 171 B.R. 584, 588-89 (Bankr. N.D. Ohio 1994) collected and cited several other illustrative cases in which CROs were deemed to be “professional persons”:

» *Stahl v. Bartley Lindsay Co. (In re Bartley Lindsay Co.)*, 137 B.R. 305, 309 (D. Minn. 1991) (financial advisor and workout consultant was a professional in case where advisor “acted with relatively unfettered discretion and autonomy in supervising the day-to-day affairs of the [debtor’s] business” and “was effectively responsible for the operation of the [debtor’s] company”); *In re United Color Press, Inc.*, 129 B.R. 143, 145 (Bankr. S.D. Ohio 1991) (management consultant who formulated financial plan for debtor, monitored debtor’s operations, collected accounts receivable, and sought to reestablish customer confidence was a “professional person” under the Bankruptcy Code); *In
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re Washington Mfg. Co., 101 B.R. 944, 959 (Bankr. M.D. Tenn. 1989) (management consultants who performed management functions were professionals); In re Rusty Jones, Inc., 109 B.R. 838, 842 (Bankr. N.D. Ill. 1989) (retaining person to perform lease negotiations, dispose of nonessential assets, supervise personnel, perform accounting functions and formulate a business plan required court approval under Section 327); In re Hospitality Ltd., 86 B.R. 59 (Bankr. W.D. Pa. 1988) (management company was a professional); In re Carolina Sales Corp., 45 B.R. 750 (Bankr. E.D.N.C. 1985) (management consultant was a professional); In re Schatz Federal Bearings Co., 17 B.R. 780, 783 (Bankr. S.D.N.Y. 1982) (former directors of debtor “retained by the debtor because of their professional and financial acumen” were professional persons).

d. Courts have also permitted CROs to be retained pursuant to Section 363 if they can ensure that some level of impartiality exists and that fees are subject to court review.

i. In In re Copenhaver, Inc., supra., 506 B.R. 757, 764, the debtor sought to retain the CRO pursuant to Section 363 because the CRO was a former employee of the debtor and therefore could not meet the disinterestedness requirement of Section 327(a). The application to retain expressly stated that because retention was
pursuant to Section 363, the CRO’s fees would not be subject to court oversight, but that the CRO would keep fee statements for the U.S. Trustee to review.

» The court denied the initial retention application without prejudice because the CRO refused to submit his fees to the court for approval. The court stated that it would grant an amended application pursuant to Sections 363(b) and 105(a) if the debtor and CRO agreed to submit the CROs fees to the court.

» The debtor subsequently filed an amended application to retain the CRO, in which it provided that the CRO would file a final fee application pursuant to applicable Bankruptcy Rules and guidelines established by the Office of the U.S. Trustee. The amended retention application was ultimately granted. Cf. the Alix Protocol.

ii. In *In re Ajubeo LLC*, 2017 WL 5466655, at *3 (Bankr. D. Colo. Sept. 27, 2017), the debtor similarly used Section 363(b) because its CRO had been appointed as an officer of the debtor pursuant to Colorado law and could therefore not be considered disinterested. However, in *Ajubeo* the CRO demonstrated he had no conflicts of interest and voluntarily offered to submit monthly fee reports and subject his fees to court review under Section 330. The court approved his retention, stating that the court was “satisfied that the
safeguards and twin goals of impartiality and court review of fees are present here.”

G. **What Constitutes the “Ordinary Course of Business”? Or — Do We Need Court Approval for That?**

I. **The Ordinary Course of Business and Section 363**


   i. “The discretion [for a debtor in possession] to act with regard to ordinary business matters without prior court approval has been said to be ‘at the heart’ of the powers of a ... debtor in possession, and courts have shown a reluctance to interfere, in the making of routine, day-to-day business decisions.” 7 Collier on Bankruptcy ¶ 1108.07 (Alan N. Resnick and Henry J. Sommer eds. 16th ed.).

   ii. Courts have consistently deferred to debtors’ business judgment with respect to ordinary course transactions. *See In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 797 (Bankr. D. Del. 2007) (“[I]f the Court determines that a transaction is in the ordinary course of a debtor’s business, the Court will not entertain an objection to the transaction, provided that the conduct involves a business judgment made in good faith upon a reasonable basis and within the scope of authority under the Bankruptcy Code.”)
b. Both 363(b) and 363(c) reference transactions in the ordinary course of business:

i. Section 363(c)(1) provides that, unless otherwise ordered by the court, a debtor in possession may enter into transactions, including the use, sale or lease of estate property in the ordinary course of business, without notice and a hearing. 11 U.S.C. § 363(c)(1).

ii. Section 363(b)(1) provides that a debtor in possession, “after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” 11 U.S.C. § 363(b)(1) (emphasis added).

c. Section 363 is thus “designed to allow a trustee (or debtor in possession) the flexibility to engage in ordinary transactions without unnecessary creditor and bankruptcy court oversight, while protecting creditors by giving them an opportunity to be heard when transactions are not ordinary.”

In re Roth American, Inc., 975 F.2d 949, 952 (3d Cir. 1992).

d. However, the phrase “ordinary course of business” is not defined in the Bankruptcy Code. As a result, courts have crafted the following tests to determine whether a given transaction or use of property is or is not within the debtor’s ordinary course of business.

II. The “Sound Business Purpose” Standard

a. One standard used by courts “require[s] the debtor to show that a sound business purpose justifies” the use or sale outside of the ordinary course of business. In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (D.
Del. 1999). The “Sound Business Purpose” standard is primarily found in cases discussing the sale of assets under Section 363(b). *Id.; In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983); *In re Delaware & Hudson Ry. Co.*, 124 B.R. 169, 176 (D. Del. 1991); *In re WBQ P’ship*, 189 B.R. 97, 102 (Bankr. E.D. Va. 1995).

b. To determine what constitutes a “sound business purpose,” courts “consider a variety of factors, which essentially represent a ‘business judgment test.’” Montgomery Ward, 242 B.R. at 153.

i. In *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983), the Second Circuit listed various considerations for a court addressing a sale of assets under Section 363(b):

In fashioning its findings, a bankruptcy judge must not blindly follow the hue and cry of the most vocal special interest groups; rather, he should consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike. He might, for example, look to such relevant factors as the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions, and most importantly perhaps, whether the asset is increasing or decreasing in value.

ii. Other courts similarly look to the overall effect of the transaction on the estate, as well as the good faith of the negotiating parties:

exists where “the sale transaction is clearly in the best interest of the Debtor’s estate and its creditors.”).  

» In re MF Global Inc., 467 B.R. 726, 730 (Bankr. S.D.N.Y. 2012) (“If a valid business justification exists, then a strong presumption follows that the agreement…was negotiated in good faith and is in the best interest of the estate….“).  

» In re Trans World Airlines, Inc., 2001 WL 1820326, at *11 (Bankr. D. Del. Apr. 2, 2001) (“[A] sale under Section 363(b) is intended to benefit the estate by minimizing loss of value to the estate.”).  

» Montgomery Ward, 242 B.R. at 155 (“As this Court…recognized, the debtor carries the burden of demonstrating that a use, sale or lease will assist the debtor’s reorganization….”).  

» In re Delaware & Hudson Ry. Co., 124 B.R. 169, 176 (D. Del. 1991) (“Once a court is satisfied that there is a sound business reason or an emergency justifying pre-confirmation sale, the court must also determine that the trustee has provided the interested parties with adequate and reasonable notice, that the sale price is fair and reasonable, and that the purchaser is proceeding in good faith.”).

III. The “Horizontal Dimension” and “Vertical Dimension” Tests
a. Another standard used by courts is a set of commonly used joint tests known as the Horizontal Dimension Test and the Vertical Dimension Test, developed by the courts in the early- to mid-1980s. In its review of the Bankruptcy Code and existing law surrounding ordinary course transactions, the bankruptcy court for the Southern District of New York in Johns-Manville found that “a synthesis of existing case law reveals a developing yet workable analysis to be used in deciding whether an activity is within the debtor’s ordinary course of business… The analysis, using vertical and horizontal components, embodies the elastic rehabilitation policies of the Code yet respects its boundaries.” *In re Johns-Manville Corp.*, 60 B.R. 612, 616 (Bankr. S.D.N.Y. 1986).

b. The Horizontal Dimension Test requires the court to look to similar businesses and determine whether the transaction at issue is one that would normally be entered into by a similar business. In other words, this test is aimed at determining whether a transaction is abnormal or unusual, and therefore probably not in the ordinary course of business. *See In re Waterfront Cos.*, 56 B.R. 31, 34-35 (Bankr. D. Minn. 1985).

i. In *In re Dant & Russell, Inc.*, 853 F.2d 700 (9th Cir. 1988), the debtor operated a wood treatment facility. After filing a bankruptcy petition, the debtor both renewed certain leases and entered into other new leases for land and transportation. The court found that the execution of the leases satisfied the horizontal dimension test
given that the leases were related to the business in which the debtor operated.

ii. In *In re Lavigne*, 183 B.R. 65 (Bankr. S.D.N.Y. 1995), the court held that the cancellation of malpractice insurance when facing growing malpractice claims failed the horizontal dimension test and was “an extraordinary transaction which required court authorization.” The court reasoned that a reasonable doctor facing declining revenue and increasing potential liability would not cancel a malpractice insurance policy.

iii. Notably, a transaction can still be considered reasonably common under the horizontal dimension test even if it occurs infrequently, provided it is an ordinary type of transaction within the business and the industry. *See, e.g.*, *Dant & Russell, Inc.*, 853 F.2d at 705; *In re Roth Am., Inc.*, 975 F.2d 949 (3d Cir. 1992).

c. The Vertical Dimension Test, also known as the “creditor expectation test,” reviews the transaction from the perspective of creditors, asking whether the transaction is one that creditors would reasonably expect the debtor to enter into. *See In re Watford*, 159 B.R. 597 (M.D. Ga. 1993). It “measures the types of risks that creditors impliedly agreed to when they extended credit to the debtor and determines whether the transaction at issue is within the range of risks reasonably expected by creditors.” 3 Collier on Bankruptcy ¶ 363.03 (Alan N. Resnick and Henry J. Sommer eds. 16th ed.).
Therefore, under the vertical dimension test, a transaction that may be ordinary for similar businesses may be outside the ordinary course of business for a particular debtor; likewise, an otherwise unusual transaction for businesses in the same industry may be within the ordinary course for a particular debtor.

» *In re Johns-Manville Corp.*, 60 B.R. 612 (Bankr. S.D.N.Y. 1986) (employment of lobbyists satisfied the vertical dimension test because debtor had retained lobbyists for many years prior to bankruptcy).

» *In re G.S. Distribution Inc.*, 331 B.R. 552 (Bankr. S.D.N.Y. 2005) (private sale of $5 million in jewelry held not to be in ordinary course of business of debtor that had no experience with private sales).

» *In re The Leslie Fay Cos., Inc.*, 168 B.R. 294 (Bankr. S.D.N.Y. 1994) (collective bargaining agreement failed vertical test because it contained terms significantly different from previous agreements).

» *In re Dant & Russell, Inc.*, 853 F.2d 700 (9th Cir. 1988) (execution of leases satisfied vertical test because debtor routinely entered into similar leases prior to bankruptcy).

IV. What happens to non-ordinary course transactions that are not approved by the Bankruptcy Court?
a. When in doubt, parties should seek court approval if there is any doubt as to whether a transaction is, or is not, within the ordinary course of business.

b. “Liability for transactions entered into by a debtor in possession outside the ordinary course of business may be avoided if notice was not given to parties in interest and the transaction was not blessed by the Court as being in the best interests of the estate.” *In re Git-N-Go, Inc.*, 322 B.R. 164 (Bankr. N.D. Okla. 2004); *See also Dalton Development Project # 1 v. Unsecured Creditors Committee (In re Unioil)*, 948 F.2d 678, 682–83 (10th Cir. 1991)(“Since the assignments violated section 363(c)(1), we conclude that it was appropriate for the bankruptcy court to issue an order rendering those transfers null and void.”); *In re Manchester Gas Storage, Inc.*, 309 B.R. 354, 379 (Bankr. N.D. Okla. 2004)(“Transactions requiring, but lacking, approval may be set aside as void.”); *In re Waterfront Companies, Inc.*, 56 B.R. 31, 35-36 (Bankr. D. Minn. 1985) (indemnity agreement was outside ordinary course of business and was therefore void as to the debtor as it was entered into without notice and a hearing).
H. Section 363(b)(1) as the Basis for Approval of Business Transactions that Are Outside of the Ordinary Course of Business

I. Section 363(b)(1) of the Bankruptcy Code

a. Section 363(b)(1) states that “[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—

(A) such sale or lease is consistent with such policy; or

(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—

i. giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and

ii. finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law”. 11 U.S.C. § 363(b)(1)

b. Courts have applied the business judgment test when considering whether to approve a business transaction under section 363(b)(1). Meyers v. Martin

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This section was prepared by Lisa G. Beckerman, Akin Gump Strauss Hauer & Feld LLP
(In re Martin), 91 F.3d 389, 395 (3d Cir. 1996). A debtor has the burden of establishing that a valid business purpose exists for use of estate property in a manner that is not in the ordinary course of business. Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983). If the debtor articulates a valid business reason for the transaction, it is presumed that the decision was made “on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company.” Official Comm. of Subordinated Bondholders v. Integrated Res, Inc. (In re Integrated Res., Inc.), 147 B.R. 650, 656 (S.D.N.Y. 1992) (quoting Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), overruled on other grounds, Gantler v. Stephens, 965A.2d 695 (Del. 2009), superseded by statute, 8 Del.C. § 102(b)(7)).

c. The business judgment rule protects a debtor’s management’s decisions from judicial second guessing, Comm. of Asbestos-Related Litigants v. Johns-Manville Corp. (In re Johns-Manville Corp.), 60 B.R. 612, 615-16 (Bankr. S.D.N.Y. 1986). “In evaluating a debtor’s exercise of business judgment, courts afford that debtor some deference because the debtor is familiar with its business and industry.” In re SW Boston Hotel Venture, LLC, 10-14535, 2010 WL 3396863, at *3 (Bankr. D. Mass. 2010). “A debtor’s business decision should be approved by the court unless it is shown to be so manifestly unreasonable that it could not be based upon sound business judgment, but only on bad faith, or whim or caprice.” White

d. Debtors regularly seek authorization from the bankruptcy court to engage in transactions that are not in the ordinary course of business under section 363(b)(1) but do not involve the purchase or sale of assets. Some examples of this are (a) debtors seeking to enter into a contract for information technology managed services where it was separating from its parent through the Chapter 11 process and a service company affiliated with the parent currently provided all such services to the debtors. Motion of the Debtors for Entry of an Order Authorizing FirstEnergy Solutions Corp. to Enter into and Perform Under an IT Managed Services Contract, In re FirstEnergy Solutions Corp., Case No. 18-50757 (AMK), (Bankr. N.D. Ohio Jan. 15, 2019) (Docket No. 1971); (b) a debtor who owned a hotel and condominium project seeking authorization from the bankruptcy court to lease a select number of condominium units. SW Boston Hotel Venture, 2010 WL 3396863, at *1; (c) a debtor who owned a hotel seeking authorization from the bankruptcy court to execute a franchise agreement with a new franchisor to re-flag the hotel. In re Shubh Hotels Pittsburgh, LLC, 439 B.R. 637 (Bankr. W.D. Pa. 2010); and (d) debtors seeking authorization from the bankruptcy court to enter into an amendment to a contract for pharmacy services which would provide for significantly different payment terms. Debtors’ Motion for Entry of an Order Approving Amendment to Contracted Pharmacy Service Agreement with CCN
Section 363(b)(1) as the Basis for Approval of Asset Purchases by a Debtor

I. While it is not typical for a debtor to be acquiring additional assets outside of the ordinary course of its business during a Chapter 11 proceeding, it does occasionally happen. The statutory basis for a debtor to seek authorization from the bankruptcy court for such an asset purchase is section 363(b)(1). Courts also apply the business judgment test, which is discussed in detail above, when considering whether to approve an asset purchase outside of the ordinary course of business.

II. In *Official Comm. of Unsecured Creditors v. Raytech Corp. (In re Raytech Corp.),* 190 B.R. 149 (Bankr. D. Conn. 1995), the debtor sought authorization from the bankruptcy court to use estate property, cash, to acquire stock of a company in the wet friction materials, construction, agricultural, and automotive transmissions replacement business. The debtor argued that it would increase its share in such markets and that there would be economies of scale. The official committee of unsecured creditors objected to the proposed purchase. The court held that the debtor had sustained its burden of proof under the business judgment standard and approved the stock purchase. *Id.* at 153. In *In re BPZ Resources, Inc.,* the debtor sought authorization from the bankruptcy court under section 363(b)(1) to buy turbine assets from its subsidiary in exchange for repayment of intercompany debt. *Debtor’s Emergency Motion Pursuant to 11 U.S.C. §§ 105(A) and 363 and*
Bankruptcy Rules 2002 and 6004 for Orders (I) (A) Approving Bidding Procedures and Notice Procedures Related to the Proposed Sale of Assets and (B) Scheduling A Hearing On Approval Of The Proposed Sale Of Assets; (II) Approving the Sale of Assets Free and Clear of Claims and Liens; (III) Authorizing the Debtor to Take Certain Corporate Actions to Purchase the Turbine Assets and (IV) Granting Related Relief, In re BPZ Resources, Inc., Case No. 15-60016 (DRJ), (Bankr. S.D.Tex, June 8, 2015) (Docket No. 187). In In re Erickson Incorporated, the debtor sought authorization from the bankruptcy court to purchase certain aircraft through a UCC Article 9 sale from a lender who was foreclosing on such aircraft. Debtors’ Amended Motion for Entry of an Order (I) Approving Aircraft Purchase Agreement and the Debtors Performing Their Obligations Thereunder; (II) Approving the Form and Manner of Private Foreclosure Sale, And (III) Authorizing Rejection of a Certain Aircraft Lease, In re Erickson Incorporated, Case No. 16-34393 (HDH), (Bankr. N.D. Tex. Mar. 2, 2017) (Docket No. 467). The debtor in each case was not comfortable that the asset purchase would be in the ordinary course of the debtor’s business and thus, made the decision, whether it was out of an abundance of caution or it was clearly necessary, to seek court approval of the asset purchase under section 363(b)(1). The Bankruptcy Code does not define “ordinary course of business” so whether an asset purchase or other business transaction is or is not in the “ordinary course of business” is left to the judgment of the debtor and its bankruptcy counsel.
J. **Sections 365(h), 363(f) and Tenant’s Rights**

I. The Basics of Sections 363 and 365

   a. Section 365 of the Bankruptcy Code grants a debtor lessor the authority to reject the lease of a tenant. Rejection of a lease typically results in the cancellation of future performance under the contract.

   b. Section 365(h) also grants the lessee multiple options in the event of rejection. A lessee may retain all the rights that his lease initially provided, including use of the premises and the right to sublet or assign the lease, or he may choose to treat the lease as terminated, treat the rejection as a breach of contract, and assert a claim of damages from the breach. *See* 11 U.S.C. § 365(h)(1)(A)(2).

   c. Owners and trustees are permitted to sell property “free and clear of any interest” if they meet one of five conditions for sale. 11 U.S.C. § 363(f).

   d. In the event of a sale of property in which an entity retains an interest, that entity can request that the court condition the sale as necessary to provide “adequate protection” of its interests. 11 U.S.C. § 363(e).

II. *Qualitech* Allows a Sale to Extinguish a Leasehold Interest

   a. Sections 365(h) and 363(e) are straightforward when read in isolation. When read together, they both seem to grant exclusive rights “that, when invoked, would override the interest of the other.” *In re Churchill Props.*, 197 B.R. 283, 286 (Bankr. N.D. Ill. 1996).

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4 Many thanks to Jennifer E. Matthes and Stephanie J. Bentley with their assistance in research and editing these materials. This section was prepared by Douglas M. Foley, McGuire Woods LLP.
b. The Seventh Circuit is the only circuit to have addressed how to read both provisions together. In *Precision Industries, Inc. v. Qualitech Steel SBQ, LLC*, the court held a section 363(f) sale of property can terminate a lessee’s possessory interest, despite the guarantee of rights provided to lessees in 365(h). 327 F.3d 537 (7th Cir. 2003).

c. The court began by examining section 363 generally, which provides for the sale of the debtor’s property. Section 363(f) provides for a sale free and clear of “any interest”, a phrase not defined in the Bankruptcy Code. The court concluded the phrase “any interest” in section 363(f) should have a broad construction and that “interest” includes any legal claim rooted in the property itself. *Qualitech*, 327 F.3d at 545; see also *United States v. Gonzales*, 520 U.S. 1, 5 (1997) (holding the use of “any” warrants a broad construction). As a result, “any interest” includes a lessee’s possessory interest, which meant a sale could proceed even if a lessee retained an interest in the property.

d. However, when considering the guarantees of section 365(h), the court held that the two statutes were not in tension. It found no indication that Congress intended one provision to prevail over another. Rather, Congress’ word choice—“sell” in section 363(f) and “reject” in section 365(h)—meant each provision was intended for a different circumstance: sale for section 363, and rejection for section 365. *Qualitech*, 327 F.3d at 548. The court also noted section 365(h)’s scope, which is limited to circumstances
in which a debtor rejects a lease of real property, indicates it applies in a narrower, separate context from section 363. *Id.* at 545.

i. Under *Qualitech’s* reasoning, whether property will be sold indicates whether section 363 or 365 governs. If property is to be sold, section 363 applies and any guarantee of tenants’ rights under section 365 is irrelevant. *Qualitech*, 327 F.3d at 547 (“365(h) says nothing at all about sales of estate property, which are the province of § 363.”). If the property will not be sold, then section 365 applies and the lessee has the right to terminate the lease or continue to possess the property pursuant to section 365(h). *Id.* at 548.

ii. The court relied on *In re Downtown Athletic Club of N.Y. City* to support its conclusion that sections 363(f) and 365(h) apply in separate contexts. 2000 U.S. Dist. LEXIS 7917 (D.N.Y. June 9, 2000). There, the court noted that once title had passed due to a section 363(f) sale, “any interest the Defendants had in their leaseholds was extinguished and they had no right to continue to occupy the premises.” Section 365(h) will provide no relief to lessees once a debtor-lessee sells the property. *Id.* at *12.

e. The court mitigated the strictness of this decision by noting a tenant can use section 363(e) to request adequate protection from the court. Adequate protection would not guarantee continued use of the property, but, at a minimum, it would require the lessee be compensated for the value of the leasehold. *See Qualitech*, 327 F.3d at 548.
f. This decision was contradictory to In re Taylor, a prior bankruptcy court decision prohibiting a sale of property free and clear of a leasehold interest under section 363(f) as section 365(h) reflects Congress’ “careful balance between the needs of the estate and rights of a tenant to the state to which the tenant bargained.” 198 B.R. 142, 165-66 (Bankr. D.S.C. 1996).

i. The court in Qualitech also ignored a previous decision holding section 365 was the exclusive remedy to a debtor of an executory lease. See LHD Realty Corp. v. Metro Life Ins. Co. (In re LHD Realty Corp.), 20 B.R. 717 (Bankr. S.D. Ind. 1982).

III. Post-Qualitech Landscape Among Lower Bankruptcy Courts

a. Following Qualitech, some courts agree section 363(f) permits a sale despite a leasehold interest, and that, absent a section 363(e) request from the lessee, a sale extinguishes the lease. See Hill v. MKBS Holdings, LLC (In re Hill), 307 B.R. 821 (Bankr. W.D. Pa. 2004) (finding section 363(f) sale extinguished a leasehold interest as defendant did not make a section 363(e) or other objection).

i. Courts supporting Qualitech appeal to the plain meaning of the statute. Since section 365(h) does not specifically prohibit a section 363(f) sale when a tenant is in possession, the plain meaning of the statute should apply, which permits a sale free and clear of a leasehold interest. See South Motor Co. v. Carter-Pritchett-Hodges, Inc. (In re MMH Auto. Grp., LLC), 385 B.R. 347, 366 (Bankr. S.D. Fla. 2008).
ii. The court in *Jetz Laundry Sys. v. Wingates, LLC*, held a lessee is entitled to remain in possession of estate property after a debtor’s rejection of the lease. Case No. 2:04-cv-243, 2005 U.S. Dist. LEXIS 11301, at *7 (D.S.C. June 10, 2005) (following *Qualitech* as it applies to section 365 rejections).

b. Nevertheless, most courts have pushed against *Qualitech*, holding instead that the tenant’s rights under section 365(h) trumps section 363(f). One basis for this conclusion is rooted in statutory construction. Rather than focusing on the omission of a provision stating section 365 bars a section 363(f) sale, *Qualitech* opponents turn to the statutory interpretation principle that “the specific governs the general.” *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992). Because section 365(h) specifically addresses the rights of non-debtor lessees in bankruptcy, it prevails over section 363.

c. Additionally, opponents point to Congress’ intent to protect the rights of tenants.

i. The court in *Haskell* stated that to uphold a section 363(f) sale would remove all tenant protections guaranteed under section 365(h) and allow debtors to use section 363 to accomplish what section 365 prohibits. As a result, it granted the tenant automatic continued possession of the property under section 365(h) and prohibited a section 363(f) sale, thereby protecting the tenant’s interests. 321 B.R. 1, 9 (Bankr. D. Ma. 2005); see also *IDEA Boardwalk v. Revel*
Entm’t Grp. 532 B.R. 216, 227-28 (Bankr. D.N.J. 2015) (holding the statute should not permit a debtor to take an action indirectly (dispossessing a tenant via a free and clear sale) that it would not be able to do directly); In re Churchill Props., 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996) (holding section 365(h) must prevail since to hold otherwise would render section 365(h) “nugatory”); In re Taylor, 198 B.R. at 142 (holding section 365 provides the sole avenue for transferring property subject to a leasehold interest); In re Samaritan Alliance, LLC, Case No. 07-50735, 2007 Bankr. LEXIS 3896 (Bankr. E.D. Ky. Nov. 21, 2007) (holding section 365(h) preserved a tenant’s rights in both sale and rejection contexts).

ii. The court in In re Zota Petroleums agreed, stating that to allow a section 363 sale “would give open license to debtors to dispossess tenants by utilizing the § 363 sale mechanism.” 482 B.R. 154, 163 (Bankr. E.D. Va. 2011). The court explained Congress created section 365 “to mandate that lessees cannot have their rights stripped away if a debtor rejects its obligation as a lessor in bankruptcy.” Id. at 161 (citing 140 Cong. Rec. H10752-01 (Oct. 4, 1994)).

d. Last, Qualitech opponents rely on the reasoning in In re LHD Realty Corp., in which the court explained section 365 was “the exclusive remedy available to a debtor in an executory lease situation.” 20 B.R. 717, 719 (Bankr. S.D. Ind. 1982). Even though the court in In re LHD did not discuss
a sale of property, subsequent cases relied on the court’s view in concluding that section 365 was the only avenue available for transfer of property with a leasehold interest. See *In re Haskell*, 321 B.R. at 7; *In re Taylor*, 198 B.R. at 164.

e. One commentator agreed with the separation of the circumstances under which sections 363 and 365 apply as set out in *Qualitech*, but believes it is more appropriate to treat *tenancy* as a priority interest. Like any other holders of interest in property, tenants should be treated in accordance with the priorities of interests in the property. If a lease has first priority, the sale should be subject to tenant’s possessory rights under section 365(h). If the lease is subordinate to a monetary lien, the sale should be free and clear so long as the tenant is paid the value of its lease after payment to other interests. See Bruce Grohsgal, *Colder Than a Landlord’s Heart? Reconciling a Debtor’s Authority to Sell Property Free and Clear of a Lease under Bankruptcy Code Section 363(f) with the Tenant’s Right to Remain in Possession on a Lease Rejection Under Bankruptcy Code Section 365(h)*, 100 MARQ. L. REV. 295, 300 (2016).

K. **What Constitutes “Adequate Protection” of a Lessee’s Possessory Interest?**

I. In *Dishi & Sons v. Bay Area Condos*, the district court followed the holding in *Qualitech* and agreed section 363(f) could permit the extinguishment of a leaseholder’s rights. 510 B.R. 696 (S.D.N.Y. 2014). The court elaborated on the usage of section 363(e) by granting a tenant continued possession of the property under section 363(e). The court also emphasized 363(f) may be used to extinguish
a tenant’s leasehold interest in the property, while a tenant may use section 363(e) to request its rights be considered through requiring adequate protection. In *Dishi*, adequate protection amounted to continued possession; however, continued possession is not required (adequate protection may be given in many ways, including cash payments). *Id.* at 701.

a. Some courts agree with the opinion in *Dishi*, providing continued possession is available to tenants through section 363(e), but also require tenants request such protection prior to the auction to receive continued possession or compensation. *In Pinnacle Restaurant At Big Sky, LLC v. CH SP Acquisitions, LLC (In re Spanish Peaks Holdings)*, the Ninth Circuit addressed an individual who created two entities that entered into a landlord-tenant agreement. The arrangement, which heavily favored the tenant, allowed the individual to receive a windfall during bankruptcy proceedings. 872 F.3d 892, 895-96 (9th Cir. 2017).

i. The court in *Dishi* considered this situation in dicta and explained continued possession would be the appropriate adequate protection under such circumstances. 510 B.R. at 711-12. However, the Ninth Circuit decided the section 363(f) sale was valid with no consideration of the tenant’s rights specifically because they did not request adequate protection under section 363(e).

II. Other courts have denied continued possession is a valid form of adequate protection under section 363(e).
a. *In re MMH Auto* dealt with a case in which the tenant did not seek adequate protection under section 363(e), but the court granted adequate protection anyway due to the tenant’s lack of notice of the sale. 385 B.R. at 372. The tenant received the value of its interest from the sale proceeds as adequate protection, with no mention made of continued possession as an option for the tenant. *Id.*

b. In keeping with its holding that section 365(h) trumps section 363(f), *Haskell* argues that continued possession is the only appropriate remedy available when a leaseholder requests adequate protection. *In re Haskell*, 321 B.R. at 10.

**L. 365(n) and Its Impact on 363(f) Sales in light of Mission Prod. Holdings**

**I. Section 365(n) and Its Application to Trademarks**

a. Section 365(n) allows for the protection of intellectual property licenses sold in the event that the licensor enters bankruptcy. Just as section 365(h), section 365(n) provides that if a trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee may treat the contract as terminated by the rejection or may retain its rights under the contract to any intellectual property. 11 U.S.C. § 365(1)(a)-(b).

i. Prior to the adoption of section 365(n), the Fourth Circuit held a tech licensor could unilaterally reject a contract and strip licensees of their intellectual property rights. *Lubrizol Enterps., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). Congress responded with section 365(n).
b. Both a leasehold in real property and a license in intellectual property are considered “interests” for the purpose of a section 363(f) sale. *Precision Industries, Inc.*, 327 F.3d at 545; see *FutureSource LLC v. Reuters, Ltd.*, 312 F.3d 281, 285 (7th Cir. 2002).

c. Just as it was unclear how sections 365(h) and 363(f) interact, the Bankruptcy Code did not make clear how section 365(n) interacted with a section 363(f) sale.

i. Complicating the question was Congress’ omission of trademark licenses from the applicable licenses guaranteed rights under section 365(n).

ii. The Seventh Circuit determined Congress’ omission of trademarks from the scope of section 365(n) was because of the need for more study, not because they approved of applying *Lubrizol* to the trademark context. *Sunbeam Prods., Inc. v. Chicago Am. Mfg., LLC*, 686 F.3d 372, 375 (7th Cir. 2012). When analyzing the trademark question, the Seventh Circuit went against Lubrizol and said that a licensor’s decision to reject a contract was a breach but did not terminate the licensee’s rights.

d. The Supreme Court’s recent decision in *Mission Prod. Holdings v. Tempnology* clarified this question. 139 S.Ct. 1652 (2019). The Court held that a rejection of an executory trademark licensing agreement results in a breach of contract, not a rescission of the contract. This means that the
licensee may continue to rely on the trademark license purchased in the original contract. *Id.* at 1661.

II. Future Predictions

a. In the aftermath of *Qualitech*, commentators wondered if the reasoning used in that decision would be used to allow section 363(f) sales to extinguish the rights of licensees in the intellectual property context in section 365(n). See Baxter, notes 141, 145, 156-57. Now, in the wake of *Mission Prod. Holdings*, the opposite question is raised: will the “continued possession” of trademarks by licensees be applied to the landlord-tenant relationship under section 365(h).

b. *Mission Prod. Holdings* makes no mention of section 363, and gives no insight as to how its conclusion for section 365(n) may impact sales of intellectual property or leases under section 363(f). One bankruptcy court has held that, in the absence of consent, a sale under section 363(f) does not trump section 365(n). *See In re Crumbs Bake Shop*, 522 B.R. 766, 777 (Bankr. D.N.J. 2014). Going forward, the court may choose to combine this reasoning with its holding in *Mission Prod. Holdings* and find that a lessee is also entitled to continued possession after a section 363(f) sale.
ABI Consumer Commission: Part II

Members of the Commission will report on its findings related to chapter 7 trustee fees, chapter 7 debtor attorney fees, attorney competency and means testing.

Rudy J. Cerone
McGlinchey Stafford PLLC; New Orleans

Ariane Holtschlag
The Law Office of William J. Factor, Ltd.; Chicago

Hon. Elizabeth L. Perris (ret.)
Portland, Ore.

Clifford J. White, III
Executive Office for U.S. Trustees; Washington, D.C.
“The ABI Commission on Consumer Bankruptcy is charged with researching and recommending improvements to the consumer bankruptcy system that can be implemented within its existing structure.”
“These changes might include amendments to the Bankruptcy Code, changes to the Federal Rules of Bankruptcy Procedure, administrative rules or actions, recommendations on proper interpretations of existing law other best practices that judges, trustees and lawyers can implement.”

Why Now?

• Over 40 years have passed since the Bankruptcy Code was adopted.
• 14 years since the BAPCPA amendments.
• In that time, there have been major changes in
  – the economy
  – technology
  – law practice
  – the regulatory environment.
Final Report

• The Commission’s Final Report has now been issued.
• It sets out recommendations on 48 discrete issues with a discussion of the background and reasoning.
• The Commission’s work was supported by three committees:
  – Committee on Case Administration and the Estate
  – Committee on Chapter 7
  – Committee on Chapter 13.
Ideas for Areas of Sources

• The Commission received 131 written submissions that included ideas for areas of study.
• The Commission and its committees held 6 public meetings in conjunction meetings of organizations of bankruptcy professionals.
• The Commission and its committees conducted their own research.

Professional Experience of Commissioners and Committee Members
ABI Commission Final Report

Foreword
1. Effectuating the Fresh Start
2. Improving Creditor Certainty
3. Facilitating Effective Access
4. Making Chapter 13 Work
5. Systems Issues

Appendices
Discussion of Particular Recommendations

• Only a few brief examples now
• You can find all the recommendations and the rationale for the recommendations in the final report which is available at https://consumercommission.abi.org/

Student Loans

• Should be dischargeable if
  – made by a nongovernmental entity,
  – incurred by a person other than the one receiving the education, or
  – first payable more than seven years before the bankruptcy.
• Changes to interpretation of existing law
• Changes to administrative procedures
Racial Justice in Bankruptcy

• Substantial empirical evidence shows that African Americans are both
  – disproportionately more likely to file chapter 13 cases than debtors of other races and
  – disproportionately less likely to obtain a discharge.

• Recommendations for equal access to the bankruptcy system:
  – training programs
  – collection of race and ethnicity data

Credit Counseling & Financial Management Course

• Prepetition credit counseling should be eliminated
• The requirement of a financial management course for a chapter 7 discharge should be eliminated.
• The requirement of a financial management course for a chapter 13 discharge should be retained, with further study of its effectiveness.
• The Fair Credit Reporting Act should require the reporting of a debtor’s successful completion of a financial management course
Chapter 7 Trustee Compensation

• The Commission recommends statutory amendments to address trustee undercompensation:
  • increase the trustees’ base compensation from $60 to $120 dollars in each case, with the increase coming from existing fees rather than an increase in filing fees or a reduction in payments to creditors, and
  • increase in the commission allowed under § 326(a) by increasing the levels of distributions to creditors at which lower percentages of the distributions are paid to the trustee.

Forms

• Advisory Committee on Bankruptcy Rules should study whether new forms have accomplished their goals.
• Forms should be data enabled to allow data extraction by trustees, attorneys, and researchers. This will allow input and output to be different.
• The government should encourage the private marketplace of develop electronic methods of assembly of information relevant to bankruptcy filings.
Chapter 7 Attorney Fees

- Current law creates barriers to payment of chapter 7 fees, reducing access to the bankruptcy system.
- Bankruptcy law should address this problem, possible mechanisms include
  - delay of discharge to allow collection of attorney fees, and
  - an exception from discharge, with judicial oversight.
- The Commission also recommends other steps to reduce the cost of chapter 7.

Attorney Competence & Lawyer Misconduct

- Well-established rules of professional conduct governing bankruptcy cases should be vigorously enforced.
- Local committees should form to investigate and resolve complaints against attorneys.
- Disciplinary orders should be published.
- Attorneys should receive enhanced fees for being board certified or demonstrated skill in the bankruptcy field, 11 U.S.C. § 330(a)(3)(F).
Means Test Revisions & Interpretations

• The Commission recommends retaining the means test but with important amendments.

• These amendments are:
  – Reduced documentation below-median income debtors;
  – Exclusion of public assistance, government retirement, and disability benefits from income
  – Removal of the presumption of abuse if the debtor shows special circumstances, even if the circumstances arose voluntarily; and
  – Allowance of certain statutory expense deductions only to the extent actually incurred and necessary for support.

Stand-in Counsel

• Increase meaningful participation by stand-in counsel through:
  – Adopting rules that require competent, efficient, and ethical representation by stand-in counsel
  – FRBP 9010 should require notice of stand-in counsel to disclose any limitation on representation

• Minimize the use of stand-in counsel by:
  – Increased use of video and telephonic hearings
  – Reducing the need for hearings through increased use of negative notices
Denial of Exemption for Knowing and Fraudulent Concealment

• A debtor who knowingly and fraudulently conceals an asset cannot exempt that asset when it is discovered

• Limits the application of *Law v. Siegel*

Discharge Violation Remedies

• The Commission recommends:
  • creation of a statutory private right of action for violations of the discharge, like the right for violations of the automatic stay, which would provide the full range of sanctions, including costs, attorney fees, and punitive damages; and
  • amendments to the Bankruptcy Rules allowing motions to determine whether particular creditor conduct would violate the discharge.
Definition of Surrender

• Courts should interpret surrender to mean that the debtor:
  – relinquishes the property;
  – cannot impede a trustee or secured creditor from taking possession of, or foreclosing its interest in, the property subject to any nonbankruptcy defenses, and
  – must make the property available to the trustee or secured creditor. Whether debtor must deliver the property depends on the facts.

• Congress should add a statutory definition of surrender to the Code that incorporates the elements above.

Timing Issues in Defining and Valuing the Principal Residence

• The petition date is the appropriate date for:
  – determining whether a claim is secured by the debtor’s principal residence.
  – determining the value of the debtor’s principal residence.

• In a case converted to chapter 7, courts should interpret section 348(f)(1)(B) to mean that there has not been a binding valuation of the debtor’s principal residence.

• The Commission also supports clarifying amendments to the same effect to the Code.
Next Steps

- The Report needs to come to the attention of legislators, judges, regulators, and other policymakers.
- Lawyers can support these efforts.
- ABI’s Endowment, bankruptcy organizations, and professors can assist in efforts to study issues that the Report has pointed out.
Biographies
ERIC W. ANDERSON

Eric W. Anderson is a partner in the bankruptcy group of Parker, Hudson, Rainer & Dobbs LLP in Atlanta, where he concentrates his practice in bankruptcy, workouts, financial restructuring and commercial finance. He represents lenders and other parties in bankruptcy and financial restructuring matters both in and out of bankruptcy, debtor-in-possession financing, purchase and sale of assets of distressed companies, and various related transactions. A frequent writer and speaker, Mr. Anderson is an ABI Board member and a past chair of the advisory board for ABI’s Southeast Bankruptcy Workshop, and he has contributed articles to the ABI Journal and other publications. He is a Fellow in the American College of Bankruptcy and chairman of the College’s 11th Circuit Educational Programs Committee, and is a member of the boards of directors of the Southeastern Bankruptcy Law Institute and of Meritas, a worldwide law firm organization. He also served on the board of directors of the Atlanta Bar Association and is a past chair of the Atlanta Bar Association’s Bankruptcy Section. Mr. Anderson was selected as one of Georgia’s Legal Elite in 2007-14, and has been listed as a “Georgia Super Lawyer” in Atlanta Magazine. He is also recognized by Chambers USA as one of America’s leading lawyers for business, and by The Best Lawyers in America. In addition, he is a Master of the Bench in the W. Homer Drake, Jr. Georgia Bankruptcy Inn of Court. Mr. Anderson received his undergraduate degree with distinction in 1982 from the University of Wisconsin-Madison and his J.D. cum laude in 1986 from the University of Wisconsin Law School.

BUSINESS

You Can Use § 363 for That?

This panel will discuss uses of § 363 other than in connection with asset sales, such as first-day relief, entry into contracts, payment of fees of professionals of ad hoc groups and other uses.
LISA G. BECKERMANN

Lisa G. Beckerman is a partner with Akin Gump Strauss Hauer & Feld LLP in New York in its Financial Restructuring Group. She has more than 25 years of experience advising on corporate restructurings and creditors’ rights, working with clients across the country in a broad range of industries, including manufacturing, airlines, media, energy and real estate. She assists both in chapter 11 cases and out-of-court restructurings. Her clients include official creditors’ committees, informal groups of creditors, hedge funds, private-equity funds and debtors. Ms. Beckerman has been recognized in Chambers USA, The Legal 500 US, The Who’s Who Legal and other key industry publications. She is a Fellow in the American College of Bankruptcy and is admitted to practice in the District of Columbia, New Jersey and New York, and before the U.S. District Courts for the Eastern and Southern Districts of New York and the District of New Jersey. Ms. Beckerman received her B.A. with honors from the University of Chicago in 1984, her M.B.A. from the University of Texas at Austin in 1986 and her J.D. from Boston University School of Law in 1989.

BUSINESS

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ALANE A. BECKET

Alane A. Becket is an AV-rated attorney and managing partner of Becket & Lee LLP, a Malvern, Pa., law firm providing comprehensive nationwide representation of financial institutions in bankruptcy matters, with a focus on consumer lenders and debt-purchasers. In addition to client and industry relations, she focuses on litigation strategy, and Becket & Lee has been lead or co-counsel in some of the most influential decisions in consumer bankruptcy over the last 20 years. In addition to her duties at the firm, Ms. Becket is ABI’s President and formerly chaired its Consumer Committee and has served on its Board since 2009, most recently as Vice President-Publications. She is currently co-chair of the Bankruptcy Section and of the Professional Standards and Grievance Committees of the National Creditors Bar Association (NCBA), and is a member of the National Association of Chapter Thirteen Trustees (NACTT). Ms. Becket has written and lectured extensively on consumer bankruptcy issues for a variety of professional organizations, including ABI, the Federal Judicial Conference, NACTT, NABT, Norton Bankruptcy Law Advisor, NCBA, the National Conference of Bankruptcy Judges, and a host of local and regional organizations. She also served as a commissioner on ABI’s Commission on Consumer Bankruptcy. Ms. Becket graduated from Pennsylvania State University and received her J.D. from Widener University School of Law.

CONSUMER

ABI Consumer Commission: Part I

Members of the Commission will report on its findings related to debt limits in chapter 13, the concept of a reserve fund, collateral and discharge violations.
STEVEN M. BERMAN

Steven M. Berman is a partner in the Tampa, Fla., office of Shumaker, Loop & Kendrick, LLP, specializing in the firm’s bankruptcy and creditors’ rights practice group. He has more than 28 years of bankruptcy experience and focuses his practice on business bankruptcy litigation, representing creditors, investors, distressed-debt lenders, trustees, committees and business entities litigating disputes in bankruptcy court. Mr. Berman is Board Certified by the American Board of Certification in both Creditors’ Rights Law and Business Bankruptcy Law, and he is a member of the Florida, California, District of Columbia and Puerto Rico (Federal) bars. He serves on the board of directors of the American Board of Certification and is a member of its Faculty Committee. He also serves on ABI’s Board of Directors, works on several committees and task forces, and routinely volunteers and speaks at seminars. On a local level, Mr. Berman is a member of the Tampa Bay Bankruptcy Bar Association, the Bankruptcy Bar Association of the Southern District of Florida, the Southwest Florida Bankruptcy Professionals Association and the San Diego Bankruptcy Forum. He also guest lectures for the University of Florida’s Levin College of Law. Mr. Berman serves as the Judge Advocate to the Coronado Yacht Club in Coronado, Calif., and volunteers in providing pro bono bankruptcy and insolvency services and training for U.S. Navy Judge Advocate General officers and staff, along with enlisted service families in need. He received his B.S. in multinational business operations from Florida State University and his J.D. from the University of Florida Levin College of Law.

CROSS-OVER

Cutting-Edge Issues in Avoidance Actions

This panel of experts will discuss timely issues in avoidance actions, including the circuit split regarding unpaid new value and other cutting-edge avoidance issues.
EDWARD C. BOLTZ

Edward C. Boltz is a partner at the Law Offices of John T. Orcutt, P.C. in Durham, N.C., where he has represented clients in not only chapters 7 and 13, but also in related consumer-rights litigation, including fighting abusive mortgage practices and developing solutions for student loans. He is a member of the North Carolina State Bar, where he has been certified as a specialist in consumer bankruptcy law, and he is admitted to practice before the U.S. Districts Courts in both the Eastern and Middle Districts of North Carolina. Mr. Boltz served as the president of the National Association of Consumer Bankruptcy Attorneys (NACBA) from 2013-16 and remains on its board of directors and as co-chair of its Legislative Committee. He also serves on the Bankruptcy Council for the North Carolina Bar Association and was a commissioner of ABI’s Commission on Consumer Bankruptcy. Mr. Boltz is a frequent speaker on bankruptcy issues at both national and local seminars, including at NACBA conventions and workshops, past NCLC Workshops and the North Carolina Bankruptcy Institute. In April 2008, he testified on behalf of NACBA in Congress regarding the need for changes to the Bankruptcy Code to protect National Guard and Reservists from the harsh results of the means test, which was enacted as the National Guard and Reservists Debt Relief Act. Mr. Boltz is president of the Monti, a North Carolina organization that produces live storytelling shows; recordings of his and others tales can be heard at www.themonti.org. He received his B.A. from Washington University in St. Louis in 1993 and his J.D. from George Washington University in 1996.
JASON S. BROOKNER

Jason S. Brookner is a partner with Gray Reed & McGraw, P.C. in Dallas and chair of its Corporate Restructuring and Bankruptcy Department, where he represents and advises companies, buyers, creditors, trustees, committees, lenders and other constituents in all aspects of distressed, insolvency and restructuring scenarios. He has broad experience representing debtors, trustees, committees, individual creditors and sellers/purchasers of assets. Mr. Brookner has obtained successful outcomes in complex cases in many industries ranging from oil and gas, manufacturing, distribution and health care to poultry- and meat-processing, metals-trading and restaurants (including fast casual and quick-service). He has been listed in Chambers & Partners USA as one of the leading bankruptcy/restructuring lawyers in Texas every year since 2005. He also was recently recognized for his important role in the Life Partners Holdings, Inc. case, which was named the 2017 “Turnaround of the Year” in the large company category by the Turnaround Management Association. Mr. Brookner received his B.A. from the University of New York at Binghamton and his J.D. from Hofstra University School of Law, where he was the articles editor of the Hofstra Property Law Journal.

BUSINESS

All You Need to Know About Liquidating Chapter 11 Plans

This panel will provide an overview on pointers and pitfalls in obtaining confirmation of liquidating chapter 11 plans, implementing liquidating chapter 11 plans, and successfully operating post-confirmation liquidating and litigation trusts.
G. Eric Brunstad, Jr.

G. Eric Brunstad, Jr. is a partner with Dechert LLP in Hartford, Conn., and is currently involved with the pending reorganization of the Commonwealth of Puerto Rico. He has argued 10 cases in the U.S. Supreme Court, has worked on more than 40 other matters in the Court, and argues cases regularly in the various federal courts of appeals. In addition to his practice, he is an adjunct professor of law at NYU and a visiting lecturer in Law at the Yale Law School, where he teaches courses on bankruptcy, secured transactions, commercial law, argument and reason, federal courts, and other subjects. He began teaching at Yale in 1990 and has also taught at the Harvard Law School and the Georgetown Law Center. He is a contributing authority to the Collier treatise on bankruptcy law. His scholarly work has been cited by numerous courts, including the U.S. Supreme Court. Mr. Brunstad published a textbook entitled Secured Transactions, Teaching Materials. He has been recognized in Leading Lawyers in Appellate Law, The Best Lawyers in America, Connecticut Super Lawyers, International Who’s Who of Insolvency & Restructuring Lawyers and Leading Lawyers in Bankruptcy Law. Mr. Brunstad has been recognized as a leading lawyer in numerous venues, including Leading Lawyer in Appellate Law, The Best Lawyers in America, Connecticut Super Lawyers, International Who’s Who of Insolvency & Restructuring Lawyers and Leading Lawyer in Bankruptcy Law. His scholarly work has been cited or quoted by many courts, including the U.S. Supreme Court. Mr. Brunstad received his B.A. magna cum laude from Connecticut College in 1983, his J.D. from the University of Michigan Law School in 1986, where he was an associate editor and contributing editor of the Michigan Law Review, and both his LL.M. in 2011 and his J.S.D. in 2014 from Yale Law School.

CROSS-OVER

2018 & 2019
Supreme Court Review

This panel of experts will discuss and analyze important bankruptcy-related Supreme Court and certain important circuit court decisions from the last year. In addition, the panel will discuss the effect of new conservative Justices on bankruptcy cases.
BEVERLY M. BURDEN

Beverly M. Burden has served as the chapter 13 trustee for the Eastern District of Kentucky in Lexington since 1999. She previously clerked for Hon. Joe Lee, and prior to that was an assistant attorney general for the Commonwealth of Kentucky in its Consumer Protection Division. Ms. Burden has presented at numerous national, regional and local bankruptcy seminars, and strives to share practical information that consumer bankruptcy attorneys can use. She is a member of the National Association of Chapter Thirteen Trustees (NACTT) and serves on the board of directors of the NACTT Academy for Consumer Bankruptcy Education (www.considerchapter13.org). Ms. Burden chairs the University of Kentucky Biennial Consumer Bankruptcy Law Conference and served on the Chapter 13 Advisory Committee to the ABI Commission on Consumer Bankruptcy. She also is a regular contributor to www.considerchapter13.org. Ms. Burden was the 1997 recipient of the Kentucky Bar Association’s Justice Thomas B. Spain Award for Outstanding Service in Continuing Legal Education and in 2017 was inducted as a Fellow in the American College of Bankruptcy. She received her J.D. from the University of Kentucky College of Law and holds a B.B.A. in accounting.

This expert panel will discuss recent developments in cases involving preference and fraudulent transfer avoidance litigation, clawbacks of tuition payments, carve-outs, chapter 13 discharges where the debtor has failed to cure their home mortgage defaults, and more.
Andrew W. Caine chairs Pachulski Stang Ziehl & Jones’s Post Confirmation Practice Group in Los Angeles, where he oversees the entire spectrum of claims and avoidance litigation for debtors, creditors’ committees, trustees, liquidation or post-confirmation trusts, and defendants, from “mega cases” to smaller individual matters. He also helped develop proprietary avoidance and preference claim analysis software and spends considerable time as “general counsel,” assisting in the administration of post-confirmation estate/corporate wind-downs, and representing individuals and business entities in avoidance and claims-litigation defense. Mr. Caine has lead responsibility in litigation concerning a variety of business, bankruptcy and commercial law issues, as well as the representation of debtors, trustees, creditors and committees in chapter 11 reorganization cases. He handles matters in state and federal courts, with an emphasis on disputes tried in bankruptcy court, including contested reorganization matters. Mr. Caine has written numerous articles and often lectures nationally on bankruptcy and litigation, and he is a Past President and former Chair and Vice President-Education of ABI. He is a member of the Registry of Mediators for the U.S. Bankruptcy Court for the District of Delaware, and a former member of the Los Angeles Superior Court panel of business law arbitrators. Mr. Caine holds an AV-Preeminent Peer Rating from Martindale-Hubbell and has been named a “Super Lawyer” in the field of Bankruptcy & Creditor/Debtor Rights every year since 2007 in a peer survey conducted by Law & Politics and the publishers of Los Angeles magazine. He also was named in The Best Lawyers in America in 2017 in the practice area of Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law. Mr. Caine received his B.A. from Northwestern University and his J.D. from the University of California at Los Angeles, where he was elected Phi Beta Kappa and was a member of the Mortar Board.
PROF. ANTHONY J. CASEY

Prof. Anthony J. Casey is a professor of law at The University of Chicago Law School in Chicago, where his research focuses on corporate bankruptcy and reorganization, covering topics including valuation procedures, entity partitioning, creditor priority, the constitutionality of the bankruptcy courts, and the enforcement of intercreditor agreements. He teaches courses on bankruptcy, business organizations and civil procedure. Prof. Casey has chaired the Creditors’ and Debtors’ Rights Section of the American Association of Law Schools, chaired and organized the National Business Law Scholars Conference, and was the bankruptcy-area organizer for the American Law and Economics Association. He also testified before the ABI Commission to Study the Reform of Chapter 11 in 2013, and his article on bankruptcy priority was cited in support of the Commission’s proposed reforms to priority rules. In 2017, he was included in ABI’s inaugural class of “40 Under 40” insolvency professionals. Before entering academia, Prof. Casey was a partner at Kirkland & Ellis LLP. He received his J.D. with high honors from The University of Chicago Law School, where he was awarded the John M. Olin Prize for outstanding student of law and economics. After law school, Prof. Casey clerked for Chief Judge Joel M. Flaum of the U.S. Court of Appeals for the Seventh Circuit.

CROSS-OVER

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RUDY J. CERONE

Rudy J. Cerone is a member of McGlinchey Stafford, PLLC, resident in its New Orleans offices and served as a commissioner on ABI’s Commission on Consumer Bankruptcy. He was admitted to the California Bar in 1979 and to the Louisiana Bar in 1984. Mr. Cerone is a Fellow of the American College of Bankruptcy (2001) and is certified as a Business Bankruptcy Specialist by the American Board of Certification (1993) and by the Louisiana Board of Legal Specialization (1997). He is a long-time member of the American Bankruptcy Institute and has served as co-chair of its Caribbean Insolvency Symposium since 2015. Previously, he served as the American Bankruptcy Institute’s Secretary and an Executive Committee member from 2010-15, as a member of its Board of Directors from 2004-15, as co-chair of its Bankruptcy Litigation Committee from 2005-06, as chair of its Hospitality, Entertainment Venues and Gaming Subcommittee from 2001-05, and as a member of the advisory board of its Southwest Bankruptcy Conference from 2003-11. He also is a former chair, president and board member of the American Board of Certification. Mr. Cerone is a member of the State Bar of California, the Louisiana State Bar Association (for which he chaired its Consumer Protection and Bankruptcy Section from 1994-97 and was chair from 2002-04 and a member from 2013-present), the Bankruptcy Law Advisory Commission of the Board of Legal Specialization, the Bar Association of the Federal Fifth Circuit and the American Bar Association. He also is an author and lecturer on both business and complex consumer bankruptcy issues. He received his B.A. summa cum laude from the University of California at San Diego in 1976 and his J.D. cum laude from Boston College Law School in 1979, where he received the Order of Coif (1979), was the executive editor of the Boston College International & Comparative Law Review (1978-79) and received the Best Law Review Editor Award (1979).
HON. ROBERT D. DRAIN

Hon. Robert D. Drain is a U.S. Bankruptcy Judge for the Southern District of New York in White Plains. Since his appointment, he has presided over such chapter 11 cases as Loral, RCN, Cornerstone, Refco, Allegiance Telecom, Delphi, Coudert Brothers, Frontier Airlines, Star Tribune, Reader’s Digest, A&P, Hostess Brands, Christian Brothers and Momentive. He also has presided over the ancillary or plenary cases of Corporacion Durango, Satellites Mexicanas, Parmalat S.p.A. and its affiliated U.S. debtors, Varig S.A., Yukos (II), SphinX, Galvex Steel, TBS Shipping, Excel Maritime, Nautilus, Landsbanki Islands, Roust and Ultrapetrol. He also has served as the court-appointed mediator in a number of chapter 11 cases, including New Page, Cengage, Quicksilver, LightSquared, Molycorp and Breitburn Energy. Prior to his appointment to the bench in May 2002, Judge Drain was a partner in the bankruptcy department of Paul, Weiss, Rifkind, Wharton & Garrison, where he represented debtors, trustees, secured and unsecured creditors, official and unofficial creditors’ committees, and buyers of distressed businesses and distressed debt in chapter 11 cases, out-of-court restructurings and bankruptcy-related litigation. He was also actively involved in several transnational insolvency matters. Judge Drain is a Fellow of the American College of Bankruptcy and a member and board member of ABI, a member of the International Insolvency Institute, and a member and board member of the National Conference of Bankruptcy Judges, as well as a founding member of the Judicial Insolvency Network. He is a past member and secretary of the Bankruptcy and Reorganization Committee of the Association of the Bar of the City of New York. He also was an adjunct professor for several years at St. John’s University School of Law’s LL.M. in Bankruptcy Program and currently is an adjunct professor at Pace University School of Law. Judge Drain has lectured and written on numerous bankruptcy-related topics and is the author of the novel The Great Work in the United States of America. He received his B.A. cum laude from Yale University and his J.D. from Columbia University School of Law, where he was a Harlan Fiske Stone Scholar for three years.
**ROSA J. EVERGREEN**

*Rosa J. Evergreen* is a partner in the Washington, D.C., office of Arnold & Porter Kaye Scholer LLP in its Bankruptcy and Restructuring group. She has experience in all aspects of bankruptcy and corporate restructuring, including complex chapter 11 cases, bankruptcy litigation, out-of-court restructurings and distressed acquisitions. Ms. Evergreen is active in many bankruptcy-related professional organizations, including ABI and the International Women’s Insolvency & Restructuring Confederation. She has been recognized in *Chambers USA*, *The Best Lawyers in America, Washington, DC Super Lawyers* and *Washingtonian Magazine*. She was named one of 12 “Outstanding Young Restructuring Lawyers” by *Turnarounds & Workouts* for 2017, and she was named as one of ABI’s “40 under 40” emerging leaders for 2018. Ms. Evergreen maintains an active *pro bono* practice and received the DC Bar’s Laura N. Rinaldi Pro Bono Lawyer of the Year Award for 2018. Prior to joining Arnold & Porter, she was a law clerk to Hon. Stephen C. St. John of the U.S. Bankruptcy Court for the Eastern District of Virginia. Ms. Evergreen received her B.A. from Georgetown University and her M.B.A. and J.D. from William & Mary.

**BUSINESS**

*You Can Use § 363 for That?*

This panel will discuss uses of § 363 other than in connection with asset sales, such as first-day relief, entry into contracts, payment of fees of professionals of ad hoc groups and other uses.
DOUGLAS M. FOLEY

Douglas M. Foley is a partner with McGuireWoods LLP in Washington, D.C., where he focuses his practice on all aspects of insolvency and debtor/creditor issues. He has substantial experience representing large and small creditors and debtors in a variety of business chapter 11 proceedings throughout the U.S., and he has had significant involvement in many of the largest chapter 11 cases filed in the Eastern District of Virginia, including Workflow Management Inc., Circuit City Stores Inc., Movie Gallery Inc., Rowe Furniture Inc., US Airways Group Inc., AMF Bowling Worldwide Inc., Best Products Company Inc., Heilig-Meyers Co., Trak Auto Corp. and FasMart Convenience Stores. He also chaired McGuireWoods’s Restructuring and Insolvency Department from September 2006 through August 2012. In 2011, Mr. Foley was inducted into the American College of Bankruptcy. He is Board Certified in Business Bankruptcy Law by the American Board of Certification and has spoken at various bankruptcy bar and trade association meetings on bankruptcy topics. He is also a past chairperson of the Virginia State Bar Bankruptcy Law Section Board of Governors. Following law school, Mr. Foley clerked for Hon. Loren A. Smith, Chief Judge at the U.S. Court of Federal Claims, and for Chief Judge Douglas O. Tice, Jr. of the U.S. Bankruptcy Court for the Eastern District of Virginia. He received his B.A. cum laude from Mary Washington College in 1988 and his J.D. with distinction in 1992 from George Mason University School of Law, where he was a member and production editor of the George Mason Law Review.

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EDWARD T. GAVIN

Edward T. Gavin, CTP is a managing director and founding partner of Gavin/Solmonese LLC in Wilmington, Del., where he leads the firm’s Restructuring and Fiduciary Services Practice and specializes in complex bankruptcy matters, representing debtors, creditors and committees as financial advisor, asset sale advisor, chief restructuring officer or in other responsible party roles. He is frequently called upon to provide expert testimony in matters involving breach-of-fiduciary-duty and bankruptcy matters, including preferences. In addition, he is frequently appointed liquidating trustee, litigation trustee or plan administrator for post-confirmation liquidating trusts. Mr. Gavin is ABI’s Immediate Past-President, previously served as ABI’s Vice-President-Development, and served as a commissioner on ABI’s Commission on Consumer Bankruptcy. He also co-chaired ABI’s Financial Advisors & Investment Banking Committee, was co-chair and education director of ABI’s Ethics Committee, and served on ABI’s Civility Task Force and the ABI National Ethics Standards Task Force, leading that group’s Committee Solicitation Protocols Subcommittee. Mr. Gavin is a 30th Anniversary Circle contributor to ABI’s Endowment Fund and co-chaired ABI’s Mid-Atlantic Bankruptcy Workshop from 2009-14. He also co-authored ABI’s Chief Restructuring Officer’s Guide to Bankruptcy and writes the “Turnaround Tactics” blog for Forbes. He is on Twitter as @tedgavin. Mr. Gavin attended the University of the Arts in Philadelphia, studying music theory and education.

CROSS-OVER
Cutting-Edge Issues in Avoidance Actions

This panel of experts will discuss timely issues in avoidance actions, including the circuit split regarding unpaid new value and other cutting-edge avoidance issues.
Lee Jason Goldberg is a vice president of GLC Advisors & Co. in New York, which he joined in 2015. He has worked with companies and creditors on a number of assignments, including bankruptcy reorganizations, out-of-court workouts, M&A, financing transactions and recapitalizations, both domestically and abroad. Mr. Goldberg’s recent transactions include representing creditors in FirstEnergy Solutions, Puerto Rico, RCS and Caesars. He was previously an associate in the Business Finance & Restructuring group at Weil, Gotshal & Manges LLP, where he focused on company and creditor representations prior to and during chapter 11 cases, including Lehman Brothers, Hawkeye Renewables, FairPoint Communications, Circuit City, Powerwave Technologies, Great Atlantic & Pacific Tea (A&P), Chassix and M*Modal. Before joining Weil, Mr. Goldberg clerked for Hon. Arthur J. Gonzalez in the U.S. Bankruptcy Court for the Southern District of New York. He has successfully completed the Series 63 and 79 FINRA Administered Qualification Examinations. Mr. Goldberg received his B.A. *cum laude* in economics-philosophy from Columbia University and his J.D. *cum laude* from Fordham University School of Law.

The panelists will discuss cutting-edge issues in energy cases, including the PG&E case, competitive generation, renewables, power purchase agreement rejection issues and other issues.
NEIL C. GORDON

Neil C. Gordon is a partner in the Atlanta office of Arnall Golden Gregory LLP and serves as an SEC receiver and court-appointed conservator. He previously served for two years as a law clerk in Atlanta for U.S. District Court Judge Robert L. Vining, Jr. followed by 35 years in private practice, with the last 32 years being exclusively in the areas of bankruptcy, business reorganization, fraud investigations and creditors’ rights. Mr. Gordon represents trustees and receivers throughout the country. He chaired the Bankruptcy Law Section of the Atlanta Bar Association from 1992-93, has been a panel trustee since 1994, and also serves as a SEC receiver. Mr. Gordon was first elected to the board of the National Association of Bankruptcy Trustees in 2000. He has held every office including president (2011-12) and for eight years chaired its Amicus Committee. Mr. Gordon has authored or co-authored more than 70 scholarly articles and book chapters on bankruptcy law related topics and has made over 150 seminar presentations throughout the country. A Lifetime Member of ABI, he served for three years ending in April 2015 as co-chair of its Legislation Committee. He is a member of the NABT President’s Circle, a Master of the Bench in the W. Homer Drake, Jr., Georgia Bankruptcy American Inns of Court, and a Fellow of the American College of Bankruptcy. Mr. Gordon received his B.B.A. with a focus on real estate and urban land studies in 1976 from the University of Florida and his J.D. in 1979 from the University of Georgia School of Law.

CONSUMER

Hot Trustee Topics in Consumer Cases

This expert panel will discuss recent developments in cases involving preference and fraudulent transfer avoidance litigation, clawbacks of tuition payments, carve-outs, chapter 13 discharges where the debtor has failed to cure their home mortgage defaults, and more.
HENRY E. HILDEBRAND, III

Henry E. Hildebrand, III has served as standing trustee for chapter 13 matters in the Middle District of Tennessee in Nashville since 1982 and as standing chapter 12 trustee for that district since 1986. He also is Of Counsel to the Nashville law firm of Farmer Purcell White & Lassiter, PLLC. Mr. Hildebrand is a Fellow of the American College of Bankruptcy and the Nashville Bar Foundation. He is Board Certified in Consumer Bankruptcy Law by the American Board of Certification and serves on its faculty committee, and he is chairman of the Legislative and Legal Affairs Committee for the National Association of Chapter 13 Trustees (NACTT). In addition, he is on the board of directors for the NACTT Academy for Consumer Bankruptcy Education, Inc. and is an adjunct faculty member for the Nashville School of Law and St. Johns University School of Law. Mr. Hildebrand served as a commissioner on ABI’s Commission on Consumer Bankruptcy. He graduated from Vanderbilt University and received his J.D. from the National Law Center of George Washington University.

CONSUMER

ABI Consumer Commission: Part I

Members of the Commission will report on its findings related to debt limits in chapter 13, the concept of a reserve fund, collateral and discharge violations.
ARIANE HOLTSCHLAG

Ariane R. Holtschlag is an attorney with the Law Office of William J. Factor in Chicago, where her practice is focused primarily in the field of consumer bankruptcy and is equally divided among representing trustees, debtors and creditors in chapters 7 and 13. She also represents individuals and small businesses in chapter 11. Ms. Holtschlag has spoken at several bankruptcy education programs and also volunteered for CARE, speaking to high school students about credit and bankruptcy. In 2017, she was chosen as one of ABI’s inaugural “40 Under 40” award recipients in recognition of her achievements. Ms. Holtschlag was a commissioner on ABI’s Commission on Consumer Bankruptcy and in 2018 testified before Congress on chapter 7 trustee fees. She received her undergraduate degree in 2004 from Illinois Wesleyan University and her J.D. from the University of Iowa in 2007.
DANA P. KANE

Dana P. Kane is special counsel with Kelley Drye & Warren LLP in Parsippany, N.J., where she advises on restructuring, bankruptcy and creditors’ rights. She has represented liquidating trustees, major secured and unsecured creditors, creditors’ committees, debtors and lenders in chapter 11 and 7 bankruptcy cases. Her practice spans various industries, including retail, energy and technology. Previously, Ms. Kane served as in-house counsel at a company that specializes in buying and selling claims and interests in distressed situations, primarily in pending federal bankruptcy cases and insurance insolvency proceedings, under state law. Much of her practice involves serving as a post-confirmation trustee, and she has nearly 20 years of hands-on legal and management experience. Ms. Kane received her B.S. summa cum laude in mathematics in 1995 from the University of Notre Dame and her J.D. cum laude from New York University School of Law in 1998, where served as articles editor of the Environmental Law Journal.

BUSINESS

All You Need to Know About Liquidating Chapter 11 Plans

This panel will provide an overview on pointers and pitfalls in obtaining confirmation of liquidating chapter 11 plans, implementing liquidating chapter 11 plans, and successfully operating post-confirmation liquidating and litigation trusts.
SHANTI M. KATONA

Shanti M. Katona is a shareholder in Polsinelli PC’s Finance Services Department in Wilmington, Del., where she focuses on corporate restructuring as well as non-bankruptcy alternatives. While she primarily works with debtors and creditors in all capacities, she also manages Polsinelli’s Delaware federal practice, representing firm clients in complex commercial litigation matters pending in Delaware. She is also a member of Polsinelli’s Women’s Initiative and Diversity & Inclusion Committees. Ms. Katona co-chairs ABI’s Mid-Atlantic Bankruptcy Workshop and is active in ABI’s Unsecured Trade Creditors Committee. She is also currently the vice chair of the Delaware Network of the International Women’s Insolvency & Restructuring Confederation and a member of the executive board of the Delaware South Asian Bar Association. Ms. Katona has experience presenting and writing on topics pertinent to the industry as well as the legal profession generally, including being one of the primary drafters of the inaugural Polsinelli/TrBK Healthcare Distress Indices, which has been widely cited across industries. For her efforts, she was named a Delaware Super Lawyers “Rising Star” and was selected as one of the inaugural class of ABI’s “40 Under 40” in 2017. Prior to becoming a lawyer, Ms. Katona was a social science research analyst with the Social Security Administration working on policy initiatives relating to the Supplemental Security Income program. She received her undergraduate degree from the University of Pennsylvania and her J.D. from Washington University in St. Louis.

CROSS-OVER
Cutting-Edge Issues in Avoidance Actions

This panel of experts will discuss timely issues in avoidance actions, including the circuit split regarding unpaid new value and other cutting-edge avoidance issues.
RICHARDO I. KILPATRICK

Richardo I. Kilpatrick is the president of Kilpatrick & Associates, PC in Auburn Hills, Mich., where he focuses on corporate, consumer and commercial litigation and bankruptcy, real property remedies for creditors, real property transactions and general corporate counseling, and specializes in creditors’ rights and insolvency law. He is a past president and chairman of ABI, served as a commissioner on ABI’s Commission on Consumer Bankruptcy, and served on the board of directors for the American College of Bankruptcy. Mr. Kilpatrick is a member of the ABA’s Litigation Committee and Business Law Committee, the Federal and Oakland County Bar Associations, the National Association of Bankruptcy Trustees’ Ethics Committee, the National Association of Chapter 13 Trustees’ Bankruptcy Arbitration and Mediation Services and board of directors, and the Trustees’ Education Network’s board of directors, and he has been an interviewer for admissions for the Harvard Alumni Association and an adjunct professor at St. John’s University School of Law’s LL.M. in Bankruptcy program. Mr. Kilpatrick has spoken at the National Conference of Bankruptcy Judges and is a presenter at numerous seminars focusing on bankruptcy and collections presented by the Institute of Continuing Legal Education faculty for the Norton Litigation Institute, PESI and ABI. He is a frequent speaker and an editor for Norton’s Treatise on Bankruptcy, and he frequently publishes articles on consumer and commercial bankruptcy. In October 2008, Mr. Kilpatrick was invited to be a conferee at the National Bankruptcy Conference, and in August 2011 he accepted an invitation to serve as a member of the Judicial Conference Advisory Committee on Bankruptcy Rules. He is Board Certified in Consumer Bankruptcy Law by the American Board of Certification, and he received his B.A. in economics in 1973 from Harvard University and his J.D. in 1982 from the University of Michigan Law School.

CONSUMER

Hot Trustee Topics in Consumer Cases

This expert panel will discuss recent developments in cases involving preference and fraudulent transfer avoidance litigation, clawbacks of tuition payments, carve-outs, chapter 13 discharges where the debtor has failed to cure their home mortgage defaults, and more.
DAVID R. KUNEY

David R. Kuney is a retired partner from the law firm of Sidley & Austin in Washington, D.C., and has practiced law since 1973, with an emphasis on commercial bankruptcy and appellate litigation. Since 2015, his primary activities have focused on appellate work before the U.S. Supreme Court and the courts of appeals, mostly in the consumer bankruptcy area. He has represented amici curiae in recent cases, including Taggart v. Lorenzen (18-489), Ritter v. Brady (18-747), Gorman v. Cantu (4th Cir. 17-1034), Lamar v. Appling (16-1215), Husky International Electronics Inc. v. Ritz, (15-145), Czyewski v. Jevic Holding Corp. (15-649), Bank of America v. Caulkett (14-163) and Baker Botts LLP v. ASARCO LLC, (14-103). Mr. Kuney has been an adjunct professor for over 25 years, including teaching bankruptcy law at American University’s Washington College of Law and at New York Law School. He is currently an adjunct professor at Georgetown University Law Center, where he teaches a practicum entitled “Bankruptcy Advocacy.” He also is a Fellow in the American College of Bankruptcy and the American College of Real Estate Lawyers, as well as an ABI Board member. Mr. Kuney is a frequent lecturer and has published numerous articles. He is the author of Retail and Office Bankruptcy: Landlord/Tenant Rights (ABI 2018) and The Single Asset Real Estate Case (ABI), and he has authored various chapters for Collier on Bankruptcy, as well as numerous articles for the ABI Journal. Mr. Kuney was member of the ABI Commission to Study the Reform of Chapter 11, focusing on bankruptcy law as it pertains to commercial landlords and intellectual property issues in bankruptcy. Prior to his legal career, he served with the U.S. Marine Corps in Vietnam and was honorably discharged with the rank of captain. Mr. Kuney graduated with high honors from the University of Virginia in 1967 and from the University of Virginia Law School in 1973.
Charles M. Moore, CPA, CTP, CFF is a managing director within Alvarez & Marsal’s North American restructuring division in Southfield, Mich. He brings more than two decades of experience in operational and financial restructuring, turnaround consulting, performance improvement and interim management. Mr. Moore serves underperforming companies, as well as financially distressed municipalities and their constituents. He currently serves as CRO of FirstEnergy Solutions and was involved in the analysis, renegotiation and rejection of a number of executory contracts, including purchased-power agreements. Mr. Moore recently provided advisory services to the Governance Committee of the board of NRG REMA, LLC, a merchant power generator and subsidiary of GenOn Inc., to assist with an analysis of claims NRG REMA may have against GenOn and its subsidiaries in their chapter 11 cases. In addition, he is nationally recognized for his work in the automotive industry. He has counseled more than 75 automotive suppliers across all component parts segments, with revenues ranging from under $100 million to multi-billions of dollars. He also has experience negotiating with unions and in matters including defined benefit pension plans and other post-employment benefits (OPEB). Mr. Moore led the team that provided operational restructuring services to the City of Detroit and facilitated the creation of the $1.7 billion Reinvestment Plan, the cornerstone of the city’s plan of adjustment in emerging from bankruptcy in December 2014. He provided expert testimony in the Stockton, Calif., bankruptcy as well, and he was engaged by the Commonwealth of Puerto Rico to conduct an extensive analysis of the underfunding of its Employee Retirement System. Mr. Moore has served as an expert witness in bankruptcy and commercial litigation matters and has held fiduciary roles, including liquidating trustee and special fiduciary. Prior to joining A&M, he was a senior managing director at Conway MacKenzie, Inc. and served as CFO for Horizon Technology Group. He began his career in the middle market consulting group at Deloitte & Touche. Mr. Moore received his B.A. in accounting from Michigan State University and his M.B.A. in professional accounting from the Eli Broad Graduate School of Management at Michigan State University.

The panelists will discuss cutting-edge issues in energy cases, including the PG&E case, competitive generation, renewables, power purchase agreement rejection issues and other issues.
HON. ELIZABETH L. PERRIS

Hon. Elizabeth L. Perris is a retired U.S. Bankruptcy Judge for the District of Oregon in Portland, where she served for more than 30 years, from April 1984 through January 2015, and was a member of the Bankruptcy Appellate Panel for the Ninth Circuit from 1988-93 and 1998-2005. She also was an adjunct professor at Lewis & Clark College of Law from 2005-06 and 2008-09, and at Willamette University School of Law in 1998. From 1976-1984, Judge Perris worked in Oregon as a bankruptcy court law clerk, served as a bankruptcy trustee and was an attorney in private practice specializing in bankruptcy. She was a member of the U.S. Judicial Conference Advisory Committee on Bankruptcy Rules from 2007-14. She also chaired the Bankruptcy Judges’ Education Committee and was a board member of the Federal Judicial Center, in the process helping educate new bankruptcy judges from throughout the country. Judge Perris is a Fellow of the American College of Bankruptcy and served on ABI’s Commission on Consumer Bankruptcy. She received her A.B. From the University of California, Berkeley in 1972 and her J.D. from the University of California, Davis in 1975.

CONSUMER

ABI Consumer Commission: Part II

Members of the Commission will report on its findings related to chapter 7 trustee fees, chapter 7 debtor attorney fees, attorney competency and means testing.
RONALD R. PETERSON

Ronald R. Peterson is a partner in the law firm of Jenner & Block LLP in Chicago, where he concentrates his practice in the areas of commercial, insolvency and bankruptcy law. He has presided over numerous complex commercial cases, including Stotler & Co., the country’s 10th-largest commodities house, and Lancelot Investors Fund L.P., a $1.7 billion Ponzi scheme. Mr. Peterson is the chairman of the creditors’ committee in Thomas J. Petters, a $3.5 billion Ponzi scheme. He also served as the examiner in the chapter 11 case of Robert Lund, a large real estate developer. Mr. Peterson has been a member of the panel of chapter 7 trustees for the Northern District of Illinois, Eastern Division, since 1987, and he is the immediate past president of the National Association of Bankruptcy Trustees. He is a Fellow of the American College of Bankruptcy and an ABI member. He also is a member of the Business Bankruptcy Committee of the Business Law Section and the Bankruptcy Litigation Committee of the Litigation Section of the American Bar Association, and he is a member of the International Association of Restructuring, Insolvency & Bankruptcy Professionals and the Commercial Law League of America, which in 2014 awarded him the Lawrence P. King Award. Mr. Peterson served as a commissioner on ABI’s Commission on Consumer Bankruptcy. He received his A.B. *cum laude* in speech and political science from Ripon College in 1970 and his J.D. in 1973 from the University of Chicago Law School.

CONSUMER

Hot Trustee Topics in Consumer Cases

This expert panel will discuss recent developments in cases involving preference and fraudulent transfer avoidance litigation, clawbacks of tuition payments, carve-outs, chapter 13 discharges where the debtor has failed to cure their home mortgage defaults, and more.
WILLIAM J. ROCHELLE, III

William J. Rochelle, III is ABI’s Editor-at-Large and resides in New York. Previously, he published for Bloomberg from 2007-15. Prior to his second career in journalism, Mr. Rochelle practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP. In addition to writing, he travels the country for ABI, speaking to bar groups and professional organizations on hot topics in the turnaround community and trends in consumer bankruptcies. Mr. Rochelle earned his undergraduate and law degrees from Columbia University, where he was a Harlan Fiske Stone Scholar.

CROSS-OVER

2018 & 2019
Supreme Court Review

This panel of experts will discuss and analyze important bankruptcy-related Supreme Court and certain important circuit court decisions from the last year. In addition, the panel will discuss the effect of new conservative Justices on bankruptcy cases.
DAVID R. SELIGMAN

David R. Seligman is a partner in the Restructuring Practice Group of Kirkland & Ellis LLP in Chicago, where he concentrates in all aspects of U.S. and worldwide corporate restructurings and insolvency proceedings. He has extensive experience advising large publicly and privately held U.S. and multinational corporations and their boards in complex domestic and international restructuring matters, both in and out of court. He also advises buyers and lenders in complex distressed situations and insolvency planning matters, as well as trustees, administrators and creditors’ committees in all types of bankruptcy and insolvency proceedings. Mr. Seligman focuses on transportation, energy, financial institutions, gaming, technology and real estate. He is a frequent lecturer and author on restructuring matters, having spoken at conferences sponsored by ABI, the Association of Insolvency and Restructuring Advisors, the Turnaround Management Association, the Chicago Bar Association, the National Conference of Bankruptcy Judges and the Ontario Bar Association, among others. He also has taught several advanced restructuring courses at the University of Chicago’s Graham School, NYU Law School, and in association with the Osgoode Hall Law School at York University in Toronto. Mr. Seligman has been recognized as a leading restructuring lawyer in Chambers USA every year since 2006. In addition, The Best Lawyers in America named him the 2018 Lawyer of the Year for Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law in Chicago. Mr. Seligman received his A.B. cum laude in 1993 from Dartmouth College and his J.D. summa cum laude in 1996 from the University of Miami School of Law, where he was an editor for the University of Miami Law Review and a member of the Order of the Coif.

The panelists will discuss cutting-edge issues in energy cases, including the PG&E case, competitive generation, renewables, power purchase agreement rejection issues and other issues.
BRADLEY D. SHARP

Bradley D. Sharp is the president and CEO of Development Specialists, Inc. (DSI) in Los Angeles and has nearly 25 years of experience providing crisis management, financial advisory and third-party fiduciary services. He has advised and operated companies in numerous industries, including consumer finance, real estate development, high-tech, manufacturing, food and agriculture. Mr. Sharp has served as CRO as well as trustee under chapters 7 and 11 and post-confirmation. He is also an expert witness with respect to fiduciary duties, banking, finance and securitizations. Mr. Sharp received his B.S. in accounting with an emphasis in business computer information systems from Mesa College in Grand Junction, Colo.

BUSINESS

All You Need to Know About Liquidating Chapter 11 Plans

This panel will provide an overview on pointers and pitfalls in obtaining confirmation of liquidating chapter 11 plans, implementing liquidating chapter 11 plans, and successfully operating post-confirmation liquidating and litigation trusts.
**CAMISHA L. SIMMONS**

Camisha L. Simmons is the founder and managing member of the law firm Simmons Legal PLLC in Dallas, which she founded after practicing in New York and Dallas for nearly eight years as an associate for Weil, Gotshal & Manges LLP, DLA Piper and Norton Rose Fulbright. She has experience representing companies in chapter 11 bankruptcy proceedings and related litigation and restructuring matters. In 2018, Ms. Simmons was recognized as one of the Top 50 Women Lawyers in Dallas by the Texas Diversity Council. In 2013, the *Texas Lawyer* named her as one of Texas’s up-and-coming 25 Legal Leaders on the Rise. She has also been named a Texas Rising Star and a New York Metro Rising Star by *SuperLawyers* and a “Top 40 Under 40” attorney by National Black Lawyers. In addition to practicing law, Ms. Simmons is an adjunct professor of law at the University of North Texas College of Law and is a frequent author and speaker on various bankruptcy, restructuring, creditors’ rights and litigation topics. She currently serves as an associate editor of the *ABI Journal*. From 2006-07, Ms. Simmons clerked for Hon. Mary F. Walrath of the U.S. Bankruptcy Court for the District of Delaware. She served on active duty in the U.S. Army from 1999-2003. Ms. Simmons received her B.B.A. from Campbell University, her M.Ed. from the University of Maryland, College Park and her M.B.A. and J.D. *magna cum laude* from Texas Tech University.

**BUSINESS**

**Energy: PG&E Panel**

The panelists will discuss cutting-edge issues in energy cases, including the PG&E case, competitive generation, renewables, power purchase agreement rejection issues and other issues.
Danielle Spinelli is vice-chair of the Appellate and Supreme Court Litigation group at WilmerHale in Washington, D.C. Her practice includes advocacy in the Supreme Court and courts of appeals, and in trial-level matters involving complex legal questions, with a particular emphasis on matters involving bankruptcy, administrative law, constitutional law, criminal law and procedure, and federal Indian law. Ms. Spinelli has argued before the Supreme Court four times, in *Bank of America v. Caulkett*, *Clark v. Rameker*, *United States v. Tohono O’odham Nation* and *Rothgery v. Gillespie County*. She also represented the prevailing parties in *Stern v. Marshall*, *Schwab v. Riley*, *Hall v. Florida* and *Roper v. Simmons*. In addition, she has represented parties or amici in many other Supreme Court cases, including the bankruptcy cases *Wellness Int’l Network Ltd. v. Sharif*, *Executive Benefits, Inc. v. Arkison*, *Law v. Siegel*, *RadLAX Gateway Hotel v. Amalgamated Bank*, *Marrama v. Citizens Bank*, *Marshall v. Marshall* and *Rousey v. Jacoway*, and she has successfully briefed and argued many bankruptcy appeals in the courts of appeals. Ms. Spinelli regularly speaks and writes on issues relating to bankruptcy law and Supreme Court and appellate practice. She received her J.D. from Harvard Law School, and subsequently clerked for Hon. Guido Calabresi on the U.S. Court of Appeals for the Second Circuit and for Justice Stephen Breyer on the U.S. Supreme Court.
HON. DEBORAH L. THORNE

Hon. Deborah L. Thorne is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago, appointed on Oct. 22, 2015. Prior to joining the bench, she was a partner in the Chicago office of Barnes & Thornburg LLP, where she was a member of its Financial Insolvency and Restructuring Department. Her practice included the representation of creditors and other parties in insolvency proceedings, and she frequently served as a federal equity receiver in commodity fraud cases brought by the Commodity Futures Trading Commission. In addition, she co-chaired the Women’s Initiative for the firm. Judge Thorne is past chair of the Chicago Bar Association Bankruptcy and Restructuring Committee and a past member of the Board of Governors and chair of the Bankruptcy Committee for the Seventh Circuit Bar Association. She is a Fellow of the American College of Bankruptcy and previously served as ABI’s Vice President-Communications & Information Technology. Judge Thorne is the author of the Preference Defense Handbook: The Circuits Compared, Third Edition and a co-author of Interrupted! Understanding Bankruptcy’s Effects on Manufacturing Supply Chains, both published by ABI. She is listed in The Best Lawyers in America in the area of Bankruptcy and Creditor/Debtor Rights Law, is recognized as a Leading Lawyer in Illinois and has been recognized by Illinois Super Lawyers every year since 2003. Judge Thorne served as chair for seven years of Women Employed, a Chicago nonprofit policy organization focused on improving the lives of low-wage women through enhancing access to post-secondary education and improving job quality. She remains on the Board of Women Employed and as a member of the Governance Committee, and she currently is a mentor to an Evanston Scholar. Judge Thorne received her B.A. from Macalester College, her M.A.T. from Duke University and her J.D. with honors from Illinois Institute of Technology Chicago-Kent College of Law.

CROSS-OVER

Cutting-Edge Issues in Avoidance Actions

This panel of experts will discuss timely issues in avoidance actions, including the circuit split regarding unpaid new value and other cutting-edge avoidance issues.
Hon. Eugene R. Wedoff served as a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago from 1987-2015 and as chief judge from 2002-07. He is a past president of ABI and served on ABI’s Commission on Consumer Bankruptcy. Judge Wedoff presided over the chapter 11 reorganization of United Air Lines, was a member of the Advisory Committee on Bankruptcy Rules from 2004-14 and served as its chair after 2010. His work on the Rules Committee involved both the implementation of the means test forms and creation of the national form for chapter 13 plans. Judge Wedoff was the president of the National Conference of Bankruptcy Judges from 2013-14 and also served as a member of the NCBJ’s Board of Governors, as its secretary, and as chair of its education committee. Judge Wedoff is a Fellow in the American College of Bankruptcy, as well as a member of the National Bankruptcy Conference. He is the author of the chapter on professional employment in Queenan, Hendel and Hillinger, *Chapter 11 Theory and Practice* (LRP Publications 1994), has been an associate editor of the *American Bankruptcy Law Journal* and currently serves as a contributing editor of the *Thomson Reuters Bankruptcy Law Letter*. Judge Wedoff is a frequent lecturer and has served as a member of the Federal Judicial Center’s Committee on Bankruptcy Judge Education. In 2016, he received the Judge William L. Norton Jr. Judicial Excellence Award; in 2009, he received the Lawrence P. King Award from the Commercial Law League; and in 1995, he received the Excellence in Education Award from the NCBJ. Judge Wedoff graduated from the college and law school of the University of Chicago.

Members of the Commission will report on its findings related to debt limits in chapter 13, the concept of a reserve fund, collateral and discharge violations.
CLIFFORD J. WHITE, III

Clifford J. White, III is the director of the Executive Office for U.S. Trustees in Washington, D.C., and has led the U.S. Trustee Program (USTP) for 14 years. In May 2005, he was named acting director, then was appointed director in 2006. During his nearly 40 years of public service, Mr. White has served as deputy director of the USTP, as an Assistant U.S. Trustee, and in other positions. Among his accomplishments as director, the USTP implemented major provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, launched an enforcement campaign both to ensure compliance by debtors and to protect debtors against creditors and mortgage servicers that violate bankruptcy law, promulgated new attorney fee guidelines to eliminate premium billing and promote market-based billing practices, and designed strategies to ensure greater accountability by management of corporations seeking to reorganize under chapter 11. The USTP is currently engaged in a coordinated effort to ensure that consumer bankruptcy professionals comply with their obligations under the Bankruptcy Code and Rules. Mr. White is a frequent speaker at bankruptcy conferences and legal education programs across the country, and regularly contributes articles to national professional publications. He is an ex officio member of the ABI Commission on Consumer Bankruptcy and received two Presidential Rank Awards throughout his career: one from President Bush and one from President Obama. Mr. White is an honors graduate of the George Washington University and of the George Washington University Law School.
RISA LYNN WOLF-SMITH

Risa Lynn Wolf-Smith is a partner with Holland & Hart LLP in Denver and has in-depth expertise in complex financial restructurings both in and out of court, as well as in complicated bankruptcy sale and acquisition transactions. She represents secured lenders, creditors’ committees, unsecured creditors, asset-purchasers, landlords, franchisors, licensors and licensees, and receiver clients in bankruptcy proceedings of all sizes in many jurisdictions. Recently, Ms. Wolf-Smith represented major power-purchase-agreement creditors in large energy cases across the country, including the First Energy and Energy Future Holdings bankruptcies. She is a Fellow of the American College of Bankruptcy and an ABI Board member, and she currently serves as an executive editor of the ABI Journal. Ms. Wolf-Smith chaired Holland & Hart’s Bankruptcy and Creditors’ Rights Practice Group for more than 17 years, and she is admitted to practice in Colorado and California. She has been named in The Best Lawyers in America for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law for the past decade, and has been listed in The Legal 500 and Colorado Super Lawyers for Bankruptcy: Business since 2006. Ms. Wolf-Smith received her B.A. summa cum laude in 1982 from Colorado College, where she was a Boettcher Scholar and was elected to Phi Beta Kappa, and her J.D. in 1985 from Stanford Law School.

BUSINESS
Energy: PG&E Panel

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