Recent Developments in Adversary Proceedings

These materials have been prepared for use in connection with a continuing legal education program. They should not be interpreted as reflecting the opinions of the judges who will participate in the program, or as indications of how the judges might rule in cases that come before them.

1. Extraterritorial Reach of Bankruptcy Code Section 550

The Bankruptcy Code contains a number of provisions that permit a trustee to “avoid” certain transfers that a debtor made or obligations that a debtor incurred. More particularly:

- If certain conditions are met then section 544(b) allows a trustee to avoid transfers or obligations that a creditor could have avoided under state law;
- Certain statutory liens may be avoided under section 545;
- Preferential transfers may be avoided under section 547;
- Fraudulent transfers may be avoided under section 548;
- Certain post-petition transfers may be avoided under section 549;
- Certain pre-petition setoffs may be avoided under section 553(b); and
- In a chapter 7 case, the trustee may avoid liens that secure the payment of fines, penalties or forfeitures pursuant to section 724(a).

See 11 U.S.C. §§ 544, 545, 547, 548, 549, 553(b), 724(a).

If a transfer is avoided under any of these provisions, section 550 of the Bankruptcy Code permits a trustee (subject to certain defenses) to recover the transferred property or its value from (1) the initial transferee or the entity for whose benefit the transfer was made; or (2) any “immediate or mediate transferee” of such initial transferee. See 11 U.S.C. § 550.

The United States Court of Appeals for the Second Circuit addressed this issue in *In re Picard*, 917 F.3d 85 (2d Cir. 2019). *In re Picard* involved a consolidated appeal of dismissals in 88 adversary proceedings that had been initiated by the trustee of Bernard L. Madoff Investment Securities, LLC (the “BLMIS Trustee”). *Id.* at 91. The BLMIS Trustee sought to recover transfers that BLMIS had made to certain foreign investment funds and that those funds, in turn, had made to their own customers. A number of the investment funds were subject to liquidation proceedings in their home jurisdictions (largely, the BVI and the Caymans). *Id.* at 93. The lower courts had dismissed the cases on two grounds: (1) that the avoidance powers did not reach transfers that took place abroad between foreign entities, and (2) that comity considerations counseled in favor of dismissal since potentially conflicting rules would apply in foreign liquidation proceedings regarding the unwinding of transactions between a fund and its investors.
The Second Circuit reversed the dismissals of the cases. As to the first question, the Second Circuit concluded that the primary focus of the fraudulent transfer provisions of the Bankruptcy Code is to regulate a debtor’s own transfers, and that Section 550(a) is a remedy provision that is “merely the means by which the statute achieves its end of ‘regulating and remedying the fraudulent transfer of property.’” Id. at 98 (quoting WesternGeco LLC v. ION Geophysical Corp., 138 S.Ct. 2129, 2138 (2019)). Put another way: giving extraterritorial effect to section 550 is not a means of regulating overseas transfers, but instead is a remedy that is provided in connection with the regulation of domestic transactions. Accordingly, so long as the debtor’s own transfers took place in (or from) the United States, the “remedy” set forth in section 550 may have extraterritorial effect without offending the principles set forth in Morrison and other cases.

The Court also held that comity considerations could not defeat the particular claims that were before it. Id. at 100–101. The interests of the U.S. in regulating a domestic debtor’s activities, the Court found, amounted to a compelling reason why U.S. law should not give way to foreign proceedings. Id. at 105. The Court’s reasoning demonstrates that while comity may be a barrier to the application of U.S. law to foreign activity, it nevertheless may not be quite as independent a shield from the presumption against extraterritoriality as previously believed to be the case.

The decision revives billions of dollars of dismissed claims, which will now be returned to the Bankruptcy Court for resolution.

2. Extension of Lien Enforcement Periods Under Section 108(c)

State laws may place time limits on the enforcement of certain liens. Section 362 of the Bankruptcy Code automatically stays a creditor’s exercise of its rights to enforce liens, unless an exception to the stay applies or the creditor is granted relief from the stay. See 11 U.S.C. § 362.
From time to time, however, a creditor may fail to enforce or renew a state law lien while a bankruptcy is pending and while the automatic stay is in effect. One issue is whether the “tolling” provisions of section 108(c) are applicable in this situation. Section 108(c) provides:

Except as provided in section 524 of this title, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor . . . and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of –

(1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or

(2) 30 days after notice of the termination or expiration of the stay under section 263, 922, 1201 or 1301 of this title, as the case may be, with respect to such claim.

See 11 U.S.C. § 108(c). Is a state law deadline for the enforcement or renewal of a state law lien a “period for commencing or continuing a civil action” for purposes of section 108(c)?

The United States Court of Appeals for the Ninth Circuit has held that section 108(c) is applicable in such a case. See Daff v. Good (In re Swintek), 906 F.3d 1100 (9th Cir. 2018).

In Swintek, a woman named Karen Good had obtained a one-year California Order for Appearance and Examination (ORAP) lien against the debtor in June of 2010. In August of 2010, the debtor filed a chapter 7 bankruptcy petition. Due to the automatic stay, Good was unable to execute on her lien within the one-year period. However, in March 2013, Good commenced an adversary proceeding seeking a declaration that her ORAP lien had a priority superior to that of the chapter 7 trustee. In response, the trustee argued that Good’s lien had expired in June 2011.

The United States Bankruptcy Court for the Central District of California ruled in favor of the trustee, concluding that Good’s lien was only valid for one year under state law and had therefore expired, and that the one-year period had not been tolled pursuant to section 108(c).
Bankruptcy Appellate Panel reversed and remanded, and the Court of Appeals affirmed the BAP’s decision.

The crux of the trustee’s argument on appeal was that sections 108, 362 and other provisions of the Bankruptcy Code distinguish between the enforcement of a judgment – for example, by executing on a lien – and the commencement or continuation of an action, and that Good’s efforts to enforce her lien should not be treated as the “commencement or continuation” of an action for purposes of section 108(c). The trustee noted, for example, that different provisions of section 362 apply to the commencement or continuation of an action or proceeding (section 362(a)(1)) and to the enforcement of a judgment (section 362(a)(2)). “Thus, in the trustee's view, treating the enforcement of a judgment as the continuation of a civil action would render the subsections of the stay provision redundant.” In re Swintek, 906 F.3d at 1104.

The Court of Appeals disagreed, noting that the subsections of section 362(a) are not mutually exclusive and that they plainly overlap in many respects. The Court also held that the trustee’s textual argument was not in line with the Court’s prior decisions in In re Spirtos, 221 F.3d 1079 (9th Cir. 2000) and Miner Corp. v. Hunters Run Ltd. P'ship (In re Hunters Run Ltd. P'ship), 875 F.2d 1425 (9th Cir. 1989), in which the Court held that the extension of a lien constitutes a “continuation of a civil action” pursuant to section 108. Accordingly, the Court held that “the period in which a creditor may enforce a judgment by executing on a lien constitutes the continuation of the original action that resulted in the judgment.” 906 F.3d at 1106.

Circuit Judge Wardlaw, in dissent, argued that the Court’s holding was inconsistent with the plain language of section 108(c). An ORAP lien is a tool for enforcing a judgment, “which by definition has ended the civil action.” Id. at 1107. Judge Wardlaw also noted that an ORAP
lien is unlike most liens. While most liens (e.g., those in *Spirtos* and *Hunters Run*) require perfection, ORAP liens do not. They are often called “secret liens,” and can be nearly impossible to locate. As such, “[a]llowing Good to maintain her priority despite her failure to renew the ORAP lien . . . creates problems of inequity. The majority's decision to allow ORAP liens, which are by nature temporary tools of judgment enforcement, to become a secured claim in a bankruptcy proceeding without time limitations, would lead to inequitable results among other creditors. This could not have been what Congress intended.” *Id.* at 1108-09.

3. **Does “New Value” Have to Remain Unpaid?**

One of the defenses to a “preference” claim under section 547 of the Bankruptcy Code is that “after such transfer” the creditor gave “new value to or for the benefit of the debtor” that was not secured by an otherwise unavoidable security interest and on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor. *See* 11 U.S.C. § 547(c)(4). The “new value” defense is relatively easy to apply if there were only one or two transactions between a debtor and the defendant in a preference action. It is often the case, however, that a supplier who makes regular deliveries to a debtor will have received a series of payments during the preference period, each one of which was followed by a new delivery of goods. Assume, for example, that March 1, 2019 was the first day of a preference period; that a supplier delivered $10,000 of goods every two weeks for a number of weeks; and that the debtor made a number of belated payments, as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>New Value (Payment)</th>
<th>Net Owed</th>
</tr>
</thead>
<tbody>
<tr>
<td>3/1/19</td>
<td>$90,000</td>
<td></td>
</tr>
<tr>
<td>3/9/19</td>
<td>($10,000)</td>
<td>$80,000</td>
</tr>
<tr>
<td>3/15/19</td>
<td>$10,000</td>
<td>$90,000</td>
</tr>
<tr>
<td>3/22/19</td>
<td>($10,000)</td>
<td>$80,000</td>
</tr>
<tr>
<td>3/29/19</td>
<td>$10,000</td>
<td>$90,000</td>
</tr>
</tbody>
</table>
In the above example, is the $10,000 of “new value” provided on March 15 a defense to the preference claim as to the payment made on March 9? Or does the fact that the March 15 “new value” was arguably paid for on March 22 affect the application of the defense?

The United States Court of Appeals for the Eleventh Circuit addressed this question in *Kaye v. Blue Bell Creameries, Inc. (In re BFW Liquidation, LLC)*, 899 F.3d 1178 (11th Cir. 2018). The case involved the bankruptcy filing of a grocery store chain that operated in Florida and Alabama. *Id.* at 1183. Blue Bell provided ice cream products to the debtor on credit over the course of the preference period, and payments were made by the debtor to Blue Bell in exchange for those goods even though the debtor still owed Blue Bell for deliveries that were made before the period. Relying on prior dicta in *Charisma Investment Company, N.V. v. Airport Systems, Inc. (In re Jet Florida System, Inc.)*, 841 F.2d 1082 (11th Cir. 1988), the trustee of the debtor’s estate asserted that the deliveries of the ice cream products served to offset the preference payments to Blue Bell only to the extent that the new value “remained unpaid” as of the petition date—and, as a result, that Blue Bell’s defense could not apply to most of the transfers since it was, in fact, actually paid for most of the more recent ice cream deliveries. *In re BFW Liquidation, LLC*, 899 F.3d at 1182.

The Court of Appeals disagreed with the trustee and reversed the lower court’s ruling. The Court held that section 547(c) does not require that new value “remain unpaid,” but instead merely requires that the new value has not been paid for with an otherwise avoidable transfer. Accordingly, “so long as the transfer that pays for the new value is itself avoidable, that transfer is not a barrier to assertion” of the new value defense. *Id.* 1188–89. The Court also found support for this conclusion in the legislative history, which showed that Congress chose not to retain a “remains unpaid” limitation on the new value defense, and in policy considerations (such
as the need to encourage creditors to continue to do business with troubled entities). *Id.* at 1193–94. Finally, the Court noted that other Circuit Courts of Appeal had followed the approach urged by Blue Bell. *See id.* at 1189 (citing *Hall v. Chrysler Credit Corp. (In re JKJ Chevrolet, Inc.)*, 412 F.3d 545, 551–52 (4th Cir. 2005) (rejecting the idea that § 547(c)(4) requires new value to remain unpaid and holding that, “under the plain terms of the statute,” whether payments for new value deprive a creditor of the statute's new-value defense “depends on whether the payments were otherwise unavoidable” (emphasis in original)); *Jones Truck Lines, Inc. v. Cent. States, Se. & Sw. Areas Pension Fund (In re Jones Truck Lines, Inc.)*, 130 F.3d 323, 329 (8th Cir. 1997) (concluding that, “under the plain language of § 547(c)(4)(B),” payments that the creditor received from the debtor after providing new value did not prevent the creditor from using that new value as a defense to avoidance because the payments at issue were themselves “otherwise avoidable”); *Mosier v. Ever–Fresh Food Co. (In re IRFM, Inc.)*, 52 F.3d 228, 231–33 (9th Cir. 1995) (holding that “a new value defense is permitted unless the debtor repays the new value by a transfer which is otherwise unavoidable”); *Laker v. Vallette (In re Toyota of Jefferson, Inc.)*, 14 F.3d 1088, 1090–93, 1093 n.2 (5th Cir. 1994) (holding that a creditor was entitled to § 547(c)(4)'s subsequent-new-value defense because, although the debtor had paid for the new value provided, it did so “with preferences that were not ‘otherwise unavoidable’ ”)).

4. **When is an “Earmarking” Defense Available?**

Normally an avoidable transfer has the effect of increasing the recovery of one creditor (the one who receives the payment) and reducing the recoveries of other creditors (the ones who were unpaid). What if, however, a debtor pays one creditor using assets that otherwise would not have been available to other creditors? Or what if a third party lends money to a debtor for the express purpose of repaying a designated creditor, thereby merely substituting one debt for another?
Parties have long sought to apply so-called “earmarking” theories to payments that are made in such circumstances. They have argued that the payments in such situations should not be treated as though they were payments from assets of the debtor’s estate, and therefore should not be treated as payments that are subject to avoidance. The issue has arisen most often in preference actions. As explained in the Collier’s treatise:

Under the “earmarking doctrine,” funds provided to a debtor for the purpose of paying a specific indebtedness may not be recoverable as a preference from the creditor to which they are paid, because the property “transferred” in such a situation was never property of the debtor and so the transfer did not disadvantage other creditors. One creditor has been substituted for another; thus when new funds are provided by the new creditor to or for the benefit of the debtor for the purpose of paying the obligation owed to the old creditor, the funds are said to be “earmarked” and the payment is held not to be a voidable preference.

See 5 Collier on Bankruptcy ¶ 547.03 (16th ed. 2019).

Two recent decisions have addressed the availability of the “earmarking” defense and/or the circumstances under which a transfer should be considered to be a transfer of an interest in the debtor’s own property. See Feldman v. People First FCU (In re White), 2019 WL 2067360 (Bankr. E.D. Pa. 2019); In re Wagenknecht, 2019 WL 2353534 (BAP 10th Cir. June 4, 2019).

The White decision arose out of an action to recover a transfer that had allegedly been made in violation of section 549 of the Bankruptcy Code. However, the court analyzed the earmarking doctrine using the standards that other courts had applied in preference actions, noting that the earmarking doctrine is a court-made interpretation of the statutory requirement that a voidable preference must involve a transfer of “an interest of the debtor in property.” The White court held that a transfer is exempt from avoidance under the earmarking doctrine if three elements are established: (1) the existence of an agreement between the new lender and the debtor that the new funds will be used to pay a specified debt; (2) performance of the agreement
according to its terms; and (3) the transaction as a whole does not result in any diminution of the debtor’s estate.

In White, immediately prior to filing her bankruptcy petition, the debtor withdrew funds from a 401(k) account to pay her mortgagee and stop a foreclosure on her residence. The funds in the 401(k) account were not part of the debtor’s bankruptcy estate. See 11 U.S.C. § 541(c). When an avoidance action was filed to recover the transfer, the mortgagee asserted that the withdrawal from the 401(k) fund by the debtor was intended for payment to the mortgagee (with the proceeds check given to the debtor’s attorney with instruction to pay the mortgagee) and that the earmarking doctrine should apply. However, the court disagreed.

First, the court determined that when the funds were withdrawn from the 401(k) pre-petition, they ceased to be part of the 401(k) fund and became property of the debtor, and then became property of her bankruptcy estate upon the filing of the petition. The mortgagee bore the burden of showing that a transfer was exempt from avoidance, and in this case (the court held) the mortgagee would be unable to establish the first element of the earmarking doctrine because the relevant funds did not come from a new lender, but instead came from the debtor’s own account. The court concluded that without a new lender, earmarking was inapplicable, and that this outcome was “consistent with the well accepted rule that earmarking must be narrowly construed.”

In the Wagenknecht decision, the bankruptcy court rejected the proposed application of the earmarking defense, holding that the defense was limited to situations in which codebtors were involved. The Bankruptcy Appellate panel did not directly address the issue of earmarking because the law firm had not appealed the portion of the bankruptcy court’s decision that rejected the application of the defense. However, the BAP in Wagenknecht did address the
question of whether the transfer at issue was “of an interest of the debtor in property.” 11 U.S.C. § 547(b)(1).

In Wagenknecht, a payment owed by the debtor to a law firm had been paid directly to the law firm by the debtor’s mother, who contemporaneously received a promissory note from the debtor. The chapter 7 trustee sought to avoid the payment to the law firm as a preference under section 547(b) of the Bankruptcy Code. The law firm argued that the payment had actually been made by the debtor’s mother and that “there was not a transfer of an interest of the [d]ebtor, and the estate was not diminished by the payment to the [law firm].”

Relying on the Tenth Circuit decision in Parks v. FIA Card Servs., N.A. (In re Marshall), 550 F.3d 1251 (10th Cir. 2008), the BAP panel in Wagenknecht determined that the transfer was an interest of the debtor in property and, therefore, a preferential transfer that the trustee could avoid. In Marshall, the Court of Appeals had held that paying off one credit card account with borrowed funds advanced by another credit card account was a preference even where the new credit card company paid the prior credit card company directly, because the debtor controlled the disposition of the proceeds of the new credit card advance. Applying the rulings set forth in Marshall, the BAP held that the transfers to the law firm in Wagenknecht effectively amounted to a debtor’s discretionary use of borrowed funds to pay another debt. The law firm argued that the use of the funds was not “discretionary” because a condition of the loan was that it “be used exclusively to pay the specific debt owed to the [l]aw [f]irm and for no other purpose.” The Wagenknecht court rejected this interpretation as ignoring the debtor’s “role in the transaction.” The court noted that “[i]f the transferred funds had been a gift, the [d]ebtor would have had no control, but that the promissory note between the debtor and his mother was evidence that the
debtor exercised control of the loan proceeds, because he agreed to repay his mother and he had the option of refusing the loan if the proceeds were not distributed to him.

The estate was not diminished by the combination of the loan and payment that were at issue in Wagenknect, but the Wagenknecht court held that it was constrained to follow the prior Court of Appeals decision in Marshall. Accordingly, even if the loan proceeds were only fleetingly an asset of the debtor’s estate, they nevertheless should be ratably apportioned among all creditors.

5. **Joint Check Agreements**

On a few occasions courts have addressed the preference implications of “joint check” arrangements. For example, a contractor may issue a check that is payable jointly to a subcontractor and to a supplier to the subcontractor, with the expectation that the money will be paid to the supplier. In one such case, the court held that the joint check was held in constructive trust by the subcontractor for the benefit of the supplier, and therefore that the payment to the supplier was not made from assets of the subcontractor’s estate. *See Mid-Atlantic Supply, Inc. of Virginia v. Three Rivers Aluminum Co.*, 790 F.2d 1121 (4th Cir. 1986).

The United States District Court for the Eastern District of Virginia recently considered a similar arrangement in *Myers Controlled Power, LLC v. Gold (In re Truland Grp., Inc.)*, 2019 WL 2251704 (E.D. Va. 2019) No. 1:18-CV-979 LMB/IDT, 2019 WL 2251704 (E.D. Va. May 24, 2019). There, Clark Construction Group, LLC (“Clark”), the prime contractor for a large-scale construction project, subcontracted with the debtor to perform electrical contracting work. The subcontract included a “flow-down” provision requiring the debtor to pay its own subcontractors and suppliers. The debtor employed Myers Controlled Power, LLC (“Myers”) as a second-tier subcontractor to provide electrical equipment and switches. When the debtor became insolvent, shortly before filing a chapter 7 petition, Clark, Myers and the debtor signed a
Joint Check Agreement (the “JCA”), under which Clark would make checks jointly payable to Myers and the debtor. On July 11, 2014, Clark delivered a check made jointly payable to the debtor and Myers in the total amount of $2,107,039.86. Myers negotiated the check and retained the proceeds.

After the debtor filed a chapter 7 petition the chapter 7 trustee instituted an adversary proceeding, arguing that the payment to Myers was an avoidable preference. The United States Bankruptcy Court for the Eastern District of Virginia, Alexandria Division, granted judgment in favor of the trustee, finding that (i) Myers was the debtor’s creditor at the time of the transfer; (ii) the joint check was properly part of the bankruptcy's estate as of the date of the transfer; (iii) the JCA and resulting payment constituted an avoidable transfer from the debtor to Myers; and (iv) although the parties had intended to effect an exchange for new value through the JCA, that exchange was not “substantially contemporaneous” and thus was not covered by § 547(c)'s defense to avoidance. Myers filed an appeal, and the United States District Court for the Eastern District of Virginia, Alexandria Division, affirmed each of the findings in the bankruptcy court’s order.

6. **Authority to Enter Final Orders in Preference and Fraudulent Transfer Actions.**

The constitutional limits on the authority of bankruptcy courts continues to generate uncertainty. The authority of bankruptcy courts, along with other federal courts whose judges are not afforded life tenure, “has been characterized as one of the most confusing and controversial areas of constitutional law.” N. Pipeline Const. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 93, 102 S.Ct. 2858, 2883 (1982) (White, J., dissenting) (quoting Glidden Co. v. Zdanok, 370 U.S. 530, 534, 82 S.Ct. 1459, 1464 (1962) (plurality opinion of Harlan, J.) (considering authority of (formerly Article I) United States Court of Customs and Patent Appeals and the United States Court of Claims)). This issue recently has been the subject of decisions
regarding the authority of bankruptcy courts to enter final orders in fraudulent transfer and preference actions.

The recent opinions are not writing tabula rasa. In Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 36, 109 S.Ct. 2782, 2787 (1989), the Court considered “whether a person who has not submitted a claim against a bankruptcy estate has a right to a jury trial when sued by the trustee in bankruptcy to recover an allegedly fraudulent monetary transfer.” The Court concluded that there was a right to a jury trial under the Seventh Amendment\(^1\) in such circumstances “notwithstanding Congress’ designation of fraudulent conveyance actions as ‘core proceedings’ in 28 U.S.C. § 157(b)(2)(H) . . . .” Id. The Seventh Amendment provides the right to a jury trial in “[s]uits at common law . . . ,” which the Court had interpreted as suits in which legal rights, rather than equitable rights were at issue. Id. at 40-41, 109 S.Ct. 2789-90. In determining whether a statutory action concerns legal or equitable rights, the Court followed a two part test under which it first compared “‘the statutory action to 18th-century actions brought in the courts of England prior to the merger of the courts of law and equity.’” Id. at 41, 109 S.Ct. 2790 (quoting Tull v. United States, 481 U.S. 412, 417-18, 107 S.Ct. 1831 (1987)). Second, and more importantly, the Court considered whether the type of relief sought was legal or equitable in nature. Id. at 42, 109 S.Ct. at 2790. If “on balance,” these factors indicated that there was a right to a jury trial, the Court must decide “whether Congress may assign and has assigned resolution of the relevant claim to a non-Article III adjudicative body that does not use a jury as a factfinder.” Id. The Court determined that actions to recover preferential\(^2\) or fraudulent transfers

\(^1\) The petitioners in Granfinanciera based their jury demand solely on the Seventh Amendment. Id. at 40, 109 S.Ct. 2789.

\(^2\) To the extent, if any, that it was unclear whether the holding in Granfinanciera applied in preference actions, that uncertainty was removed by the Court in Langenkamp v. Culp, 499 U.S. 42, 111 S.Ct. 330 (1990) (holding that defendants waive right to jury trial in preference actions by filing claims against the bankruptcy estate).
were legal actions in 18th-century England, id. at 43, 109 S.Ct. 2791, and the monetary relief sought is legal, rather than equitable. Id. at 47, 109 S.Ct. 2793.

The Court next considered whether, having created a statutory action that is legal in nature, Congress may delegate the determination of that matter to non-Article III courts without a jury as factfinder. The Court concluded that Congress may not do so unless the legal cause of action involves “public rights,” id. at 53, 109 S.Ct. 2796, and “a bankruptcy trustee’s right to recover a fraudulent conveyance . . . seems to us more accurately characterized as a private right than a public right as we have used those terms in Article III decisions.” Id. at 55, 109 S.Ct. at 2797.

3 Unlike the opinion in Marathon, Granfinanciera garnered a majority of the Court, with which Justice Scalia concurred other than in connection with this portion of the majority’s analysis. Specifically, Justice Scalia disagreed with the majority’s conclusion that the public rights doctrine might apply to legal disputes in which the government is not a party. Id. at 65-66, 109 S.Ct. 2802-03 (Scalia, J., dissenting). Instead, he would have limited the public rights doctrine solely to those cases involving the government as a party, and interpreted the public rights doctrine to prohibit Congress from assigning litigation of legal controversies between private individuals to non-Article III tribunals. Id.

4 The Court first observed that fraudulent transfer and preference actions were plenary suits tried in the district courts prior to the passage of the Bankruptcy Reform Act of 1978, but noted that the 1984 amendments in the wake of Marathon designated fraudulent transfer actions as “core,” while preserving pre-Code rights to jury trials. Id. at 49-50, 109 S.Ct. 2794.

5 There has been some debate whether the Court’s analysis with respect to the right to a jury under the Seventh Amendment is applicable in determining the authority of non-Article III courts to enter final judgments. In Granfinanciera, the Court stated:

Indeed, our decisions point to the conclusion that, if a statutory cause of action is legal in nature, the question whether the Seventh Amendment permits Congress to assign its adjudication to a tribunal that does not employ juries as factfinders requires the same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal. For if a statutory cause of action, such as respondent’s right to recover a fraudulent transfer conveyance under 11 U.S.C. § 548(a)(2), is not a “public right” for Article III purposes, then Congress may not assign its adjudication to a specialized non-Article III court lacking “the essential attributes of the judicial power.” Crowell v. Benson, supra, 285 U.S., at 51, 52 S.Ct. at 292. And if the action must be tried under the auspices of an Article III court, then the Seventh Amendment affords the parties a right to a jury trial whenever the cause of action is legal in nature. Conversely, if Congress may assign the adjudication of a statutory cause of action to a non-Article III tribunal, then the Seventh Amendment poses no independent bar to the adjudication of that action by a nonjury factfinder. See, e.g., Atlas Roofing, supra, 430 U.S., at 453-455, 460, 97 S.Ct., at 1268-1269, 1271; Pernell v. Southall Realty, supra, 416 U.S., at 383, 94 S.Ct., at 1733; Block v. Hirsh, supra, 256 U.S., at 158, 41 S.Ct., at 460. In addition to our Seventh Amendment precedents, we therefore rely on our decision exploring the restrictions Article III
The bankruptcy court in Delaware recently concluded that it had authority to enter final orders in fraudulent transfer actions. In Offshore PLC v. Noble Corp. PLC (In re Paragon Offshore PLC), 598 B.R. 761 (Bankr. D. Del. 2019), the debtor proposed several plans for confirmation under chapter 11, which the bankruptcy court denied. One such plan included a settlement agreement that included broad releases of the defendant Noble from any potential claims, including any fraudulent transfer claims. Confirmation of that plan was denied, and the debtor ultimately confirmed a plan that did not include the settlement and that granted the bankruptcy court exclusive jurisdiction to adjudicate claims brought by the successor trust. Noble contributed to the formation of the plan but did not object to the jurisdictional language and did not file a claim in the case. The trust initiated an adversary proceeding seeking recovery of fraudulent transfers from Noble. All parties characterized the fraudulent transfer claims as statutorily core. However, Noble argued that the bankruptcy court could not constitutionally enter final judgment under the holdings in Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989), and Stern v. Marshall, 564 U.S. 462 (2011).

As an initial matter, the bankruptcy court determined an absence of implied consent under the standards set by Wellness Int’l Network, Ltd. v. Sharif, --- U.S. ---, 135 S. Ct. 1932 (2013) and In re Tribune Media Co., 902 F.3d 384 (3d Cir. 2018). Although Noble had places on Congress’ choice of adjudicative bodies to resolve disputes over rights to determine whether petitions are entitled to a jury trial. Id. at 53-4, 109 S.Ct. at 2796-97. Despite this seemingly definitive statement regarding the transitive properties of the analysis, the Court specifically cabined its holding in the case, stating:

We are not obliged to decide today whether bankruptcy courts may conduct jury trials in fraudulent conveyance suits brought by a trustee against a person who has not entered a claim against the estate . . . . [n]or need we decide whether, if Congress has authorized bankruptcy courts to hold jury trials in such actions, that authorization comports with Article III when non-Article III judges preside over the actions subject to review in, or withdrawal by, the district courts. Id. at 49-50, 109 S.Ct. 2794
consented to the bankruptcy court’s determination that the settlement adhered to § 1123(b) and Bankruptcy Rule 9019, “that act di[d] not necessarily constitute consent to the [bankruptcy court’s] later adjudication of certain issues that were included in, but not the sole subject of,” the settlement. Further, Noble’s failure to object to the jurisdictional plan provision did “not constitute waiver of [Noble’s] right to have claims heard by an Article III tribunal.” Paragon, 598 B.R. at 770. Specifically, §§ 157(b)(1) and (c)(1) do “not implicate questions of subject matter jurisdiction.” Id. (quoting Stern, 564 U.S. at 462).

Based on a narrow reading of both cases, the bankruptcy court further held constitutional authority to enter final judgment on the fraudulent transfer claims. According to the court, in Granfinanciera, a case with facts “closely analogous to the facts here,” the Supreme Court decided the applicability of the “7th Amendment right to a jury trial, and whether such a right could be limited by the . . . ‘public rights exception.’” Paragon, 598 B.R. at 772. While the Court relied on Article III case law to support its analysis, the decision “specifically avoid[ed] determining that the division of labor between bankruptcy courts and District Courts [under § 157(b)(2) of the Code] is unconstitutional.” Id. at 773 (emphasis in original). Similarly, the bankruptcy court observed that Stern “d[id] not bind lower courts on issues that were not directly before it.” Id. at 774.6 Recognizing that the Ninth Circuit and several district courts “have held that Stern extends Granfinanciera to the Article III context,” the bankruptcy court found such

---

6 But see, e.g., Cuevas v. U.S., 778 F.3d 267, 272 (1st Cir. 2015) (observing that “‘federal appellate courts are bound by the Supreme Court’s considered dicta almost as firmly as by the Court’s outright holdings, particularly when, as here, a dictum is of recent vintage and not enfeebled by any subsequent statement,’” quoting McCoy v. Mass. Inst. Of Tech., 950 F.2d 13, 19 (1st Cir. 1991)); and Galli v. N.J. Meadowlands Comm’n, 490 F.3d 265, 274 (3d Cir. 2007) (observing that, even if the holdings in Supreme Court cases are dicta and not binding, “we do not view them lightly . . .” “[b]ecause the ‘Supreme Court uses dicta to help control and influence the many issues it cannot decide because of its limited docket,’ [and] failing to follow those statements could ‘frustrate the evenhanded administration of justice by giving litigants an outcome other than the one the Supreme Court would be likely to reach were the case heard there,’” quoting Official Comm. Of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 561 (3d Cir. 2003)).
decisions suggestive but not decisive. \textit{Id.} (citing \textit{Exec. Benefits Ins. Agency v. Arkison}, 573 U.S. 25, (2014) and the Supreme Court’s “assum[ption] without deciding, that the fraudulent conveyance claims in th[at] case [we]re \textit{Stern} claims”). As such and cognizant of “[t]he general principal of judicial restraint [that] weighs heavily against” finding a statute unconstitutional, the bankruptcy court declined to “extend the holdings of [\textit{Granfinanciera} and \textit{Stern}] in order to find that . . . § 157(a) is unconstitutional to the extent that it directs bankruptcy judges to enter final orders in fraudulent transfer claims against parties who have not filed claims against the bankruptcy estate.” \textit{Id.} at 771, 775 (emphasis in original).

Four days after the Delaware Bankruptcy Court entered \textit{Paragon}, the Arizona Bankruptcy Court determined that bankruptcy courts may enter final orders in preference actions. However, contrary circuit precedent bound the Arizona bankruptcy court with respect to fraudulent transfer actions. In \textit{MorrisAnderson & Assocs., Ltd. v. Redeye II, LLC (In re Swift Air)}, 2019 WL 1266100 (Bankr. D. Ariz. March 15, 2019), the litigation trustee initiated an adversary proceeding against several defendants, alleging breach of fiduciary duty, preference, and fraudulent transfer claims. For those defendants that had not filed a claim in the underlying bankruptcy case, the court looked to \textit{Stern} to “determine [the] bankruptcy court’s constitutional authority to enter final orders.” 2019 WL 1266100 at *3 (citing \textit{Stern}, 564 U.S. at 499). Under \textit{Stern}, for a bankruptcy court to have constitutional authority to enter a final order, the proceeding must stem from the bankruptcy itself or necessarily be resolved in the claims allowance process. \textit{Id.} Where a defendant has filed a claim against the estate, the preference action necessarily must be resolved in the claims allowance process. \textit{Id.} (citing \textit{Langenkamp v. Culp}, 498 U.S. 42, 44-45 (1990)). The court observed that, even when the defendant has not filed a claim, the recovery of a preference gives rise to an allowable claim by the defendant
under 11 U.S.C. §§ 502(d) and (h). *Id.* at *4. Given “[t]he Supreme Court’s admonition as to the narrow scope of *Stern*, together with preference law being a creature of the Bankruptcy Code bear[ing] directly upon . . . claims [administration],” the bankruptcy court found “all . . . preferential transfer avoidance claims” to be core proceedings over which the bankruptcy court had authority to enter final orders irrespective of a defendant’s status as a claimant. *Id.* at *4.

Despite its conclusion that the bankruptcy court may enter final orders in a preference action, the court determined that it could not enter a final order in a fraudulent transfer action absent the consent of the defendant under the Ninth Circuit’s opinion in *In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 565 (9th Cir. 2012), aff’d sub nom. *Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25, 134 S.Ct. 2165 (2014). In *Bellingham*, the bankruptcy court held that fraudulent transfer defendants who have not filed a claim are not subject to final adjudication without the consent of those defendants or a waiver of their rights. *Swift Air*, 2019 WL 1266100 at *5-6. Given that consent may be implied where “a party is aware of the ability to challenge a non-Article III court’s authority and fails to do so,” the court turned to the defendants in *Swift Air*. *Id.* at *6 (citing *Bellingham*, 702 F.3d at 569). A single defendant made a setoff argument, which “implicated the bankruptcy [c]ourt’s claims allowance process, thereby submitting itself” to the court’s constitutional authority. In contrast, the remaining defendants repeatedly contested the court’s constitutional authority to enter final judgments against them, and requested language preserving their right to challenge that authority in orders even when the rulings received were in their favor. *Id.* Rejecting arguments by the litigation trustee, the bankruptcy court further held that defendants’ failure to request a jury trial did not indicate consent and defendants’ participation in the administrative process of the underlying bankruptcy “does not waive that
participant’s right to adjudication by an Article III court in a subsequent adversary proceeding brought against them.” Id. at *7.

7. Bankruptcy Court May Hear and Determine Personal Injury Claim Where Claimant Consents or Waives Right to Have the Claim Heard by the District Court.

Following up on the finding in Stern v. Marshall, 564 U.S. 462, 479-80, 131 S.Ct. 2594, 2606-07 (2011), that 28 U.S.C. § 157(b)(5) is not jurisdictional, the Third Circuit has held that a bankruptcy court may hear and determine personal injury tort and wrongful death claims in proceedings where the claimant consents to adjudication by the bankruptcy court or waives any objection to the bankruptcy court’s determination. In re Tribune Media Co., 902 F.3d 384 (3d Cir. 2018). In Tribune, the claimant filed a proof of claim pro se in the debtor’s bankruptcy case seeking recovery for personal injuries under Title VII of the Civil Rights Act, 42 U.S.C. § 2000e et seq. The debtor objected and the claimant responded. Subsequently, the claimant hired counsel and the bankruptcy court permitted supplemental replies from both parties. After notifying all parties that the objection would be construed as a motion for summary judgment, the bankruptcy court found as a matter of law that the claimant could not establish the elements for the torts asserted. The claimant appealed and for the first time contested the bankruptcy court’s authority and jurisdiction. Because the claimant failed to raise these issues to the bankruptcy court and instead sought the bankruptcy court’s resolution, the district court held that the claimant waived any objection to adjudication in bankruptcy court and impliedly consented to its jurisdiction. The claimant appealed again, citing § 157(b)(2)(B)(5)’s explicit exception from a core proceeding any “liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate” and § 157(b)(5)’s requirement that the district court order such claims to be heard in the applicable district court. The claimant further
contested the bankruptcy court’s constitutional authority to hear his case in the absence of his express consent.

A three-judge panel for the Third Circuit affirmed. On the issue of statutory authority, Judge Ambro, writing for the majority, held that “a party may forfeit or waive any objections to § 157(b)(5) because that provision is not jurisdictional,” citing Stern v. Marshall, 564 U.S. 462, 479-80 (2011). Though the claimant initially engaged in the bankruptcy case pro se, “neither his counseled filing . . . nor his counsel’s statements to the [bankruptcy c]ourt included any type of objection to . . . statutory authority.” Tribune, 902 F.3d at 394. Relying on Wellness Int’l Network, Ltd. v. Sharif, --- U.S. ---, 135 S.Ct. 1932, 1948 n.13 (2013), for the proposition that “[n]o court has stated that a litigant must expressly consent to a bankruptcy court’s jurisdiction,” the court further held that consent to constitutional authority may be implied so long as the consent is knowing and voluntary. Tribune, 902 F.3d at 394. In support, the court referenced a Fifth Circuit decision finding implied consent to bankruptcy court jurisdiction where a litigant joined the case and raised no constitutional objection. Id. at 395 (citing Matter of Delta Produce, L.P., 845 F.3d 609, 617 (5th Cir. 2016)). In the Third Circuit’s view, such a holding reflects the Wellness reasoning: implied consent increases judicial efficiency and reduces gamesmanship. Id. (citing 134 S.Ct. at 1948). In the case at hand, the claimant “filed a proof of claim, a response to [the debtor’s] objection, and a supplemental response [and did not] question the [b]ankruptcy [c]ourt’s constitutional authority.” Tribune, 902 F.3d at 395-96. Instead, the claimant “made clear that he sought final judgment on the merits . . . and presented additional evidence . . .” for the express purpose of the bankruptcy court evaluating his claim, including liability. Id. at 396. Such action and inaction implied a knowing and voluntary “submission to the [b]ankruptcy [c]ourt’s deciding his claims.” Id.
8. **Claimant’s Failure to Respond to Motion for Summary Judgment does not Constitute Implied Consent to Final Adjudication by Bankruptcy Court.**

In Ball v. Soundview Capital Mgmt. Ltd. (In re Soundview Elite Ltd.), 594 B.R. 108 (Bankr. S.D.N.Y. 2018), the trustee sought recovery from a claimant for breaches of fiduciary duty and fraudulent transfers. In his answer to the trustee’s complaint, the claimant contested the bankruptcy court’s jurisdiction and authority to enter final judgments. The claimant also demanded a jury trial. The trustee moved for summary judgment to which the claimant failed to respond. According to the trustee, such failure sufficed as implied consent to final adjudication by the bankruptcy court. Ball, 594 B.R. at 120 (citing Exec. Sounding Bd. Assocs., Inc. v. Advanced Machine & Eng’g (In re Oldco M Corp.), 484 B.R. 598, 601 (Bankr. S.D.N.Y. 2012) (failure to respond to summons constitutes implied consent to entry of final judgment by non-Article III court)). In Oldco, the bankruptcy court held that “Stern does not limit the bankruptcy court’s authority to enter a default judgment when the defendant has failed to respond to the summons and complaint,” 484 B.R. at 601, which the trustee asserted applied under a motion for summary judgment.

The Ball court disagreed, distinguishing between “the legal effects of failing to respond to a complaint and failing to respond to a motion for summary judgment.” 594 B.R. at 120. “In Oldco, the defendants, despite having received notice on four separate occasions, failed altogether to respond to the [t]rustee’s summons and complaint . . . [whereas claimant] did not default.” Id. at 121. Instead, the claimant “responded to the [c]omplaint with an [a]nswer . . . explicitly contest[ing] the [b]ankruptcy [c]ourt’s jurisdiction over him . . . [and] demand[ing] a jury trial.” Id. On these facts and procedural history, the bankruptcy court refused to find knowing and voluntary implied consent. Id. (citing Wellness Intl’l Network, Ltd. V. Sharif, --- U.S. ---, 135 S. Ct. 1932, 1937 (2015)).
9. **Venue in Proceedings Arising Under Title 11.**

Two recent courts have examined what may or may not be a drafting error in need of a Congressional fix. See 1 Collier on Bankruptcy ¶ 4.03[2] (2019). In In re J & J Chemical, Inc., 596 B.R. 704 (Bankr. D. Idaho 2019), the court held that venue for avoidance actions under 11 U.S.C. §§ 548(a) and 544(b) is controlled by 28 U.S.C. § 1409(a), not 28 U.S.C. § 1409(b). In January 2017, the debtor, an Idaho corporation, filed a chapter 11 petition in the United States Bankruptcy Court for the District of Idaho. The court appointed the plaintiff as the chapter 11 trustee in June 2017. Thereafter, the court confirmed a chapter 11 plan, which, *inter alia*, authorized the plaintiff to pursue avoidance actions. The defendant, a Delaware limited partnership, operates an online service which accepts bets on horse races. The defendant’s headquarters and principal place of business are both in Los Angeles, California.

The debtor’s president and sole owner placed a number of bets with the defendant. Between April 2013 and May 2016, the debtor’s president made fifty-nine separate transfers of funds from the debtor’s bank account to the defendant for bets. During the two years prior to the petition, these transfers totaled $5,200. In the four years preceding the petition, these transfers totaled $11,100. In August 2018, the plaintiff commenced an avoidance action against the defendant in the District of Idaho pursuant to 11 U.S.C. §§ 548(a) and 544(b). The defendant moved to dismiss the adversary proceeding on the grounds that venue was improper under 28 U.S.C. § 1409(b). The defendant argued that the “adversary proceeding must be prosecuted in the Central District of California, the district where the [d]efendant ‘resides,’” because the plaintiff seeks to recover less than $12,850. 596 B.R. at 708. The plaintiff asserted that venue was proper in the District of Idaho. The plaintiff argued that venue of the adversary proceeding

---

7 See § 10, infra.
is controlled by 28 U.S.C. § 1409(a), in part, “because this action ‘arises under’ title 11, whereas 28 U.S.C. § 1409(b) requires venue in a defendant’s home district only for actions ‘arising in’ or ‘related to’ Title 11.” Id.

Section 1409, in relevant part, provides:

(a) Except as otherwise provided in subsections (b) and (d), a proceeding arising under title 11 or arising in or related to a case under title 11 may be commenced in the district court in which such case is pending.

(b) Except as provided in subsection (d) of this section, a trustee in a case under title 11 may commence a proceeding arising in or related to such case to recover a money judgment of or property worth less than $1,375 or a consumer debt of less than $20,450, or a debt (excluding a consumer debt) against a noninsider of less than $13,650, only in the district court for the district in which the defendant resides.

The court first determined that § 1409(a) “applies to three discrete types of bankruptcy proceedings: those (1) ‘arising under’; (2) ‘arising in’; or (3) ‘related to.’” Id. at 709. The court then noted that § 1409(b), unlike § 1409(a), “makes no mention of cases ‘arising under’ title 11.” Id. at 709. Both parties agreed that the plaintiff’s avoidance claims, which were brought under §§ 548(a) and 544(b), were proceedings “arising under” title 11. The defendant asserted that the court should follow In re Little Lake Indus., Inc., 158 B.R. 478 (B.A.P. 9th Cir. 1993), which held that “the terms ‘arising under’ and ‘arising in’ in 28 U.S.C. § 1409(b) [are] not meant to be mutually exclusive, but [are] instead intended to be interchangeable.” 596 B.R. at 710–11. The defendant argued that “Congress inadvertently omitted ‘arising under’ from 28 U.S.C. § 1409(b), and [urged] the court to construe the phrase ‘arising in’ as including claims ‘arising under’ title 11.” Id. at 713. The court acknowledged that the “[d]efendant might be correct that Congress mistakenly failed to include the phrase ‘arising under’ in 28 U.S.C. § 1409(b),” but the court determined that it could not “read ‘arising under’ into the statute where Congress’ enactment omitted it.” Id. Accordingly, the court held that venue for this avoidance action was controlled by § 1409(a), not § 1409(b).
Another court that addressed the issue came to a similar conclusion. In In re Tadich Grill of Wash. DC LLC, 598 B.R. 65 (Bankr. D.D.C. 2019), the court held that venue for a preference action under 11 U.S.C. § 547(b) is controlled by 28 U.S.C. § 1409(a), not § 1409(b). The chapter 7 trustee brought an adversary proceeding to avoid certain prepetition transfers totaling $11,741.73. The defendant was not an insider and did not reside in the district. The defendant moved to dismiss the adversary proceeding on the grounds that venue was improper under 28 U.S.C. § 1409(b).

The court began by acknowledging that “there is a split of authority on whether § 1409(b), only applicable to ‘a proceeding arising in or related to’ a case under title 11, applies to a proceeding ‘arising under title 11.’” 598 B.R. at 67. The court, citing J & J Chemical, concluded that § 1409(b) does not apply to proceedings “arising under title 11.” First, the court determined that the omission of “arising under” from § 1409(b) was intentional. The court noted that the original bankruptcy venue statute, 28 U.S.C. § 1473, applied to proceedings “arising in or related to” cases under title 11. When Congress relocated the venue statute to 28 U.S.C. § 1409, it only added “arising under” to two of the subsections of 28 U.S.C. § 1409, which indicates that the omission of “arising under” from § 1409(b) was intentional.

Second, the court rejected the argument that the terms “arising under” and “arising in” are not mutually exclusive. The court held that the category of proceedings “arising in” title 11 does not include proceedings “arising under” title 11. Finally, the court found that “odd results” would occur if 28 U.S.C. § 1409(b) is applicable to proceedings “arising under” title 11 because § 1409(b) only applies to certain proceedings to recover a debt, money judgment, or property. “Sometimes a trustee brings a proceeding only to avoid a transfer and not to recover a debt, money judgment, or property.” 598 B.R. at 70. Because an avoidance proceeding is not a
proceeding to recover a debt, money judgment, or property, “a trustee can always sue in the ‘home court’ of the case under § 1409(a) to avoid a transfer without running afoul of § 1409(b).” Id. at 71. However, if a trustee seeks to avoid a transfer and recover a money judgment, “then [the] trustee, upon avoiding a transfer in the ‘home court’ as a proper venue under § 1409(a), could nevertheless be barred by § 1409(b) from using the ‘home court’ as the proper venue for recovering a judgment for the amount of the avoided transfer.” Id.


In addition to creating a new subchapter V of title 11, the proposed Small Business Reorganization Act of 2019 (H.R. 3311) includes revisions to 11 U.S.C. § 547(b) and 28 U.S.C. § 1409(b). Currently, § 547(b) permits the trustee to avoid a preferential transfer by providing that “the trustee may avoid any transfer of an interest of the debtor in property” that meets the elements of a preferential transfer set forth in the section. The proposed amendment would alter the section to add the following underlined language: “the trustee may, based on the reasonable due diligence in the circumstances of the case and taking into account a party’s known or reasonably knowable affirmative defenses under subsection (c), avoid any transfer of an interest of the debtor in property” that meets the elements of a preference.

The proposed act also would amend the venue provision of 28 U.S.C. § 1409(b) by increasing the threshold from $10,000 to $25,000 for covered proceedings that must be commenced in the district of the defendant. Note that the amendment once again does not propose to fix any perceived drafting error in the omission of actions “arising under” title 11.

11. Trustee’s Authority Over an Individual Debtor’s Attorney Client Privilege.

In Commodity Futures Trading Comm’n v. Weintraub, 471 U.S. 343, 105 S.Ct. 1986 (1985), the Supreme Court held that the trustee of a corporation in bankruptcy, as the entity in
control of the organization analogous to the pre-bankruptcy board of directors, was entitled to control (and therefore waive) the attorney client privilege of the debtor. The Court has not extended its holding in *Weintraub* to individual debtors, and its rationale based on corporate management does not seem applicable in individual cases. Since *Weintraub*, several courts have considered a trustee’s authority over the privilege in individual cases, with varying conclusions. The most recent cases have been reluctant to imbue the trustee with an individual’s privilege. In *In re Gaime*, No. 8:18-bk-0519-RCT, 2018 WL 7199806 (M.D. Fla. Dec. 18, 2018), the debtor attempted to kill herself and her two sons by drugging the children and putting them in a running car in a closed garage. One son was killed, but the debtor survived. The father and surviving son sued the debtor for wrongful death and injuries, and the debtor tendered the defense to her insurance company. After the insurance company denied coverage, the insurance defense attorney withdrew from his representation of the debtor. The debtor represented herself at trial, and a judgment was entered against her for over $500,000,000. The judgment creditors thereafter filed an involuntary petition against the debtor, after which the chapter 7 trustee issued third-party subpoenas to the former insurance defense counsel under Bankruptcy Rule 2004 in support of an action he had commenced for bad faith against the insurer. Both the insurer and the judgment creditors moved for a protective order, asserting that the files were protected by the debtor’s attorney client privilege and work product. The court granted the protective order on numerous bases, including the pending proceeding rule. *Id.* at *3*. Nevertheless, the court flatly disagreed with the trustee’s argument that “as a result of her ownership of the claim and her duties under the Bankruptcy Code, [she] may waive the attorney client privilege of an individual debtor.” *Id.* at *4* (citing, *inter alia*, *In re Behn*, No. 3:12-bk-5146-PMG, 2013 Bankr. 8 The opinion is unclear why the judgment creditors objected. The court notes that, under Florida law, both the insured and the judgment creditors were entitled to bring an action for bad faith against the insurer. 27
Prior cases come to varying conclusions on the issue. See In re McDonald, 2014 Bankr. LEXIS 3780 (Bankr. M.D.N.C. 2014) (employing a balancing test in which the particular circumstances of the case must be examined to determine if the bankruptcy trustee has the power to waive the debtor's attorney-client privilege over his objection, weighing the potential harm to the individual debtor against the trustee’s duty to maximize the value of the debtor’s estate); In re Miller, 247 B.R. 704 (Bankr. N.D. Ohio 2000) (employing a balancing test); In re Smith, 24 B.R. 3 (Bankr. S.D. Fla. 1982) (attorney-client privilege that the individual debtor had concerning attorneys who had represented him in a wrongful death action passed by operation of law to the chapter 7 trustee); In re Silvio De Lindegg Oci an Devs. of Am., Inc., 27 B.R. 28 (Bankr. S.D. Fla. 1982) (chapter 7 trustee, in two jointly administered cases involving a corporation and the individual who owned all the corporate stock, could not waive the individual debtor’s attorney-client privilege as to communications pertaining to the individual-debtor’s personal affairs rather than the corporate affairs); In re Ginzburg, 517 B.R. 175 (Bankr. C. D. Cal. 2014) (rejecting balancing test and holding that chapter 7 debtor remained in control of his attorney-client privilege, relying on Swidler & Berlin v. United States, 524 U.S. 399, 409, 118 S.Ct. 2081 (1998)); In re Courtney, 372 B.R. 519 (Bankr. M.D. Fla. 2007) (using balancing test and holding that chapter 7 trustee could waive individual debtor’s privilege in wrongful death case); Foster v. Hill (In re Foster), 188 F.3d 1259 (10th Cir. 1999) (“Because Foster does not advocate a per se rule that a trustee may never control an individual debtor’s privilege, this court need not consider any such rule. We instead simply assume for purposes of this appeal that in some cases, subject to the above balancing, a trustee may control an individual debtor’s privilege.”), remanded by 10th Cir. (holding that the bankruptcy court had failed to balance the weight of potential harm to the
debtor from disclosure of possible incriminating confidences against the trustee’s needs to continue with the civil lawsuits.; McClarty v. Gudenau, 166 B.R. 101 (E.D. Mich. 1994) (holding that an individual debtor’s attorney-client privilege does not pass to trustee); *In re Hunt*, 153 B.R. 445 (Bankr. N.D. Tex. 1992) (holding that privilege of individual chapter 11 debtors does not pass to liquidating trustees); *In re Williams*, 152 B.R. 123 (Bankr. N.D. Tex. 1992) (holding that a chapter 11 trustee was owner of individual chapter 11 debtor’s attorney-client privilege relating to pre-petition transfers to debtor’s relatives); *In re Behn*, No. 3:12-bk-5146-PMG, 2013 Bankr. LEXIS 5820, 2013 WL 12377690 (Bankr. M.D. Fla. April 17, 2013) (determining that Florida law controlled the issue and holding that, under Fla. Stat. § 90.502(3), an individual’s attorney-client privilege belonged to the client and could not be held or controlled by a third party absent clear assignment, and debtor did not assign his privilege to the trustee even though the bad faith claim was property of the estate); *In re Bame*, 251 B.R. 367 (Bankr. D. Minn 2000) (“Based upon this Eighth Circuit precedent, the weight of the developing case law, and the foregoing analysis of the issue, I find the balancing approach to be the applicable test.”); *In re Pearlman*, 381 B.R. 903 (M.D. Fla. 2007) (balancing the potential harm to the individual principal of the corporate debtor with respect to communications between the principal and the attorney jointly representing the corporate debtor against the trustee’s duty to maximize the value of the estate, and considering criminal liability of the principal); cf. *S.E.C. v. Marker*, No. 1:02-CV-01109, 2006 WL 288426 (M.D.N.C. Feb. 6, 2006) (rejecting blanket rule that a receiver for an individual may waive the attorney-client privilege, and instead applying a balancing test, balancing the potential harm to the debtor against the trustee’s duty to maximize the value of the estate (citing *Foster v. Hill* (In re Hill), 188 F.3d 1259, 1268 (10th Cir. 1999)); see also David M.