91st Annual
**National Conference of Bankruptcy Judges**

October 8–11, 2017
Las Vegas, Nevada

# The Best Show in Vegas: Broken Bench TV

Honorable Bruce A. Harwood, U.S. Bankruptcy Court (D.N.H.)
Professor Katherine M. Porter, University of California, Irvine School of Law
Professor John A. E. Pottow, The University of Michigan Law School

# The Best Show in Vegas: Broken Bench TV

# Table of Contents

1. *Technology Drives Trends in Car Repo*, Prof. Katherine Porter (UC Irvine) ..........................1

2. *Current Developments in the Saga of Sunnyslope Housing*,
   Susan M. Freeman (Lewis Roca Rothgerber Christie LLP) ......................................................7

3. *Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973*, Hon. John E. Hoffman, Jr.
   (Bankr. S.D. Ohio) and Brian L. Gifford (law clerk) ..............................................................13

4. *Midland Funding, LLC v. Johnson, 137 S. Ct. 1407 (2017)*, Hon. John E.
   Hoffman, Jr. (Bankr. S.D. Ohio) and Laura Atack (law clerk) ..............................................26

National Conference of Bankruptcy Judges
The Best Show in Vegas: Broken Bench TV

Las Vegas, Nevada
October 2017

# Technology Drives Trends in Car Repo

Professor Katherine Porter
UC Irvine School of Law

In recent years as subprime car loans have become more common, dealers have used new technology to reduce losses from nonpayment. For a good overview of the subprime auto market, see the three-part series in the Los Angeles Times on "buy-here, pay-here" car dealers, Ken Bensinger, *Wheels of Fortune: A Vicious Cycle in the Used Car Business*, L.A. TIMES (Oct. 30–Nov. 2, 2011), http://www.latimes.com/projects/la-fi-buyhere-payhere/.

## I. The Technology of Electronic Repossession

### a. Engine Disablers/Starter Interrupt Systems

This technology permits the lender to disable the car. It is the electronic equivalent of the parking meter person's "boot." The car cannot be operated. The manufacturers assert that the devices cannot cause a car to stall or stop while in motion, although at least one consumer has testified to the contrary before the Nevada legislature.

Prominent companies include DealerSecure 3G, PassTime GPX and AutoTrack GPS SmartBox.

PassTime GPX provides GPS tracking for Auto Finance Companies with a flexible and cost effective entry into the PassTime platform. GPX arrives complete with the full functionality of the Elite product line including ACT already built in yet at a reduced cost until GPS and wireless other functionality is activated.

GPX Functionality Includes:

- Automotive grade wireless module
- Firmware upgradeable over the air
- Text / email communication
- Starter interrupt
- Anti theft
- Up to 6 geo-fences
- Low power notification
- Right to cure compliant
- Web based command management
- Scheduled payment reminders
- Command override
- On demand payment reminders
- Tamper detection
- Tow detection

The devices can be activated remotely by a dealer's computer or smart phone. The devices also can be programmed to turn on automatically, for example upon a car debtor being a certain number of days delinquent in payment. Most commonly they render the engine unable to be started. In some cases, the devices require a new code to be entered after each payment due date to "activate" the use of the car for the period following payment. The devices also emit warnings, such as persistent beeps during the car's operation, when a debtor is behind on payments. The goal is to prompt the debtor to pay.

The devices are installed in used cars by dealers/lenders—who are often one and the same at "buy-here, pay-here" car lots. The devices are often fairly inconspicuous and may not be noticed by debtors. One company advertised that its new device could be "installed under the car dash for an even more covert operation." The devices often come with tamper resistant features, similar to those used in car alarms.

b. GPS Tracking Systems

The devices often include built-in GPS systems. When the car is disabled, the lender knows its exact location so that a tow truck can be immediately dispatched. The GPS also permits the lender to disable the car at a particular location, such as the debtor's work or a retail parking lot where the debtor will be unlikely to notice the tow truck and object to the repo, thereby avoiding a potential breach of peace.

The GPS devices permit lenders to get warning notices when the car is driven outside a particular area, such as the state or county. The lenders can also program debtor-specific "geo-fences" that, for example, notify the lender if the car is not taken to the debtor's place of employment on an expected pattern.

With GPS, the most time consuming part of repo—locating the car—is eliminated. The picture and caption below is from Michael Corkery & Jessica Silver-Greenburg, *Miss a Payment? Good Luck Moving that Car*, N.Y. TIMES (Sept. 24, 2014, 9:33 PM), https://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/.

**A Virtual Repo Man**

"I have disabled a car while I was shopping at Walmart," said Lionel M. Vead Jr., the head of collections at First Castle Credit Union in Covington, La., who said that starter interrupt devices and GPS tracking technology had made his job easier. Cheryl Gerber for The New York Times

From his office outside New Orleans, Mr. Vead can monitor the movements of about 880 subprime borrowers on a computerized map that shows the location of their cars with a red marker. Mr. Vead can spot drivers who have fallen behind on their payments and remotely disable their vehicles on his computer or mobile phone.

c. License Plate Recognition Technology

This technology is widely used to enforce parking, such as on university campuses or in workplace lots. Tow trucks use it to drive streets and identify cars that a lender has issued a repo request for. They troll lower-income neighborhoods or parking lots in low-income areas to find cars subject to repossession.

Some leading providers are PlateScan, MVTRAC, Westminster APLR, and Digital Recognition Network.

## II. Legal Issues Outside Bankruptcy

The use of electronic repossession may give rise to multiple claims related to consumer protection. Some relate to the consumer's purchase of a car with an electronic repossession device, while others relate to the lender's later deployment of the device. U.C.C. § 9-609 governs repossession of personal property, and it explicitly mentions "render[ing] equipment unusable."

The following is a short list of possible legal claims that may arise

- Unfair or Deceptive Acts or Practices (particularly if the debtor is not given notice of the installation and operation of the device. All 50 states have a statute with a private right of action)
- Truth in Lending claims (if the debtor is charged for a device and that fee is not disclosed)
- Usury (if the cost causes the interest rate to exceed the permissible limit)
- Notice violations (if the contract fails to disclose the existence of the device and its tools)
- Constructive repossession. If the activation of the electronic device falls under the U.C.C. § 9-609 repossession statute, then all the other repossession rules apply:

    - No breach of peace in repossession
    - Duty of care after repossession
    - Disposition within 90 days if the consumer has paid 60% of the principal
    - Notice of sale
    - Right to redeem
- Servicemembers Civil Relief Act
- Fair Debt Collections Practices Act

Connecticut, Colorado, and California all have specific state regulations that address electronic repossession of cars.

## III. Violation of Bankruptcy Automatic Stay

Existing law has grappled with whether a lender's continued retention of a repossessed vehicle after a debtor files bankruptcy is a violation of the automatic stay. *WD Equip., LLC v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. 2017); *Nissan Motor Acceptance Corp. v. Baker*, 239 B.R. 484 (Bankr. N.D. Tex. 1999). *See generally* W. Homer Drake, Jr., et al., CHAPTER 13 PRACTICE & PROCEDURE § 15:12 (June 2017). The issue has recently arisen with regard to cities that impound cars for unpaid parking tickets and refuse to release them when the consumer files bankruptcy. *In re Avila*, 566 B.R. 558 (Bankr. N.D. Ill. 2017).

There are a handful of cases that consider how an electronic disable device may change the analysis. Generally, violations seem more likely when the creditor fails to provide a new code to permit continued operation after the bankruptcy (despite the debtor being behind).

- *In re Horace*, No. 14-30103, 2015 WL 5145576, 2015 Bankr. LEXIS 2886 (Bankr. N.D. Ohio Aug. 28, 2015)

  The Horaces bought a Chevy Trailblazer that was fitted with a "PassTime payment assurance device" designed to alert the owner with a beeping sound when payment is due on the vehicle loan. If payment is not received by the day it is due, the alerts become more frantic. The vehicle automatically became inoperable unless the creditor entered a code to keep it running. The debtor had to pay at the dealer. When the debtors filed bankruptcy, they were current on the auto loan. They notified the creditor, Universal Acceptance, of the bankruptcy and continued to make payments outside the plan. The debtors later amended to pay Universal Acceptance through the plan. There was a gap between the direct pay and conduit pay period in which the creditor did not receive timely payment and the car was rendered inoperable through the PassTime device. Repeatedly, and despite the debtors' lawyer's request to Universal Acceptance, the debtors were forced to make a payment directly to UA to restart the car.

  The Horaces filed a motion for damages for violation of the automatic stay. The court found that the PassTime device was comparable to sending the debtors an invoice with a payment coupon, and that by its use, the creditor exercised control over the vehicle in violation of sections 362(a)(3) and (6). The creditor's conduct was willful because it knew of the bankruptcy and failed to take affirmative steps to disable the device.

  The debtor testified that she suffered pain when she was unable to operate her car after physical therapy appointments and that she was embarrassed by the beeping of the warning system. Although the debtors did not quantify their damages, they sought a "sanction" in the amount of $2,500 to compensate Mrs. Horace for "stress." The court denied damages for emotional injury,

noting that they are not typically permitted for a stay violation. The court did order the creditor, at the debtors' request, to remove the device from the vehicle at its own expense.

- *Crawford v. Credit Acceptance Corp. (In re Crawford)*, No. 08-3095, 2008 WL 5427713, 2008 Bankr. LEXIS 3531 (Bankr. S.D. Ill. December 24, 2008)

  Debtor brought an adversary proceeding against the auto creditor alleging that the creditor violated the automatic stay by failing to repair a disabling device installed on the vehicle by the creditor. The debtor sought damages and attorney fees under 11 U.S.C. § 362(k) for the creditor's willful violation of the stay.

  The debtor's plan provided for retention of the vehicle and full payment to the creditor, and the creditor installed the disabling device to allow the creditor to render the vehicle inoperable in the event the debtor failed to make payments under the plan. The debtor made all required plan payments related to the car, but the device caused problems with the vehicle's reliable starting. The creditor did not take any action to repair the device.

  The bankruptcy court held that the creditor's inaction in failing to repair the device constituted a willful violation of the automatic stay and that punitive damages were warranted because the creditor clearly had knowledge of the debtor's bankruptcy and the creditor ignored the debtor's repeated requests for repairs.

## IV. Bibliography for Further Reading


Doug Aamoth, *Repossession Going Electronic with Remote Vehicle Disablers,* TECH CRUNCH (Apr. 17, 2009), https://techcrunch.com/2009/04/17/reposession-going-electronic-with-remote-vehicle-disablers/.

Ken Bensinger, *Wheels of Fortune: A Vicious Cycle in the Used Car Business*, L.A. TIMES (Oct. 30–Nov. 2, 2011), http://www.latimes.com/projects/la-fi-buyhere-payhere/.

Carolyn L. Carter, John Von Alst & Jonathan Sheldon, *Repossessions*, NAT'L CONSUMER LAW CTR. DIGITAL LIBRARY, https://library.nclc.org/repo (paid subscription).

Michael Corkery & Jessica Silver-Greenburg, *Miss a Payment? Good Luck Moving that Car*, N.Y. TIMES (Sept. 24, 2014, 9:33 PM), https://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/.

Thomas B. Hudson, *Best Practices for the Use of Starter Interrupter Devices*, F&I AND SHOWROOM (Apr. 2009), http://www.fi-magazine.com/channel/special-finance/article/story/2009/04/best-practices-for-the-use-of-starter-interrupt-devices.aspx.

Working Cars for Working Families, http://www.workingcarsforworkingfamilies.org (advocacy site run by the National Consumer Law Center).

National Conference of Bankruptcy Judges
The Best Show in Vegas: Broken Bench TV

Las Vegas, Nevada
October 2017

# Current Developments in the Saga of Sunnyslope Housing

Susan M. Freeman
Lewis Roca Rothgerber Christie LLP

## Current Developments in the Saga of Sunnyslope Housing

Susan M. Freeman
Lewis Roca Rothgerber Christie LLP
SFreeman@LRRC.com[1]

Sunnyslope Housing Limited Partnership owns and operates an affordable housing apartment complex. It confirmed a bankruptcy reorganization plan under which its secured lender is paid the prepetition loan amount over 40 years, despite the lender having an offer in hand to buy the property at a price that would net the lender a quick $2.5 million profit. The property's market value upon foreclosure would significantly exceed its value under the plan. The lender was not amused. Litigation has proceeded since 2009 in state trial and appellate courts regarding the pre-bankruptcy receivership, and in the bankruptcy court, bankruptcy appellate panel, district court, and Ninth Circuit. Most recently, the Ninth Circuit *en banc* reversed a Circuit Panel and held that the bankruptcy court properly valued the collateral and upheld the plan as feasible, affirming other rulings as well.

### Critical Facts

- The project was built and financed as an affordable housing project. In an integrated, simultaneous 2005 transaction, (a) Capstone loaned $8.5 million which in turn was funded through the sale of industrial development authority bonds that required recordation of affordable housing restrictive covenants, payable over 40 years at 5.35% interest, secured by a senior deed of trust senior to the restrictive covenants, and guaranteed by HUD; (b) the City of Phoenix and State of Arizona loaned $3.5 million more secured by junior deeds of trust and with their own additional affordable housing restrictive covenants; and (c) limited partners contributed equity to receive $5.4 million in federal tax credits over 10 years, as well as project ownership, with additional restrictive covenants recorded as a condition of tax credit commencement.

- All of the restrictive covenants ("CC&Rs") run with the land and bind any owner or purchaser of the project until and unless the senior deed of trust is foreclosed.

- The project was finished in 2008 when the housing bubble burst and property values cratered. Sunnyslope defaulted. HUD satisfied the bond debt and sold the Capstone loan to First Southern National Bank for $5 million, releasing a HUD regulatory agreement but not foreclosing to strip off the CC&Rs.

- First Southern noticed a foreclosure sale, and its receiver found a buyer willing to pay $7.65 million at a foreclosure sale, and started renting the project at market rates. Sunnyslope filed a Chapter 11 bankruptcy case to block the foreclosure and reinstitute affordable rentals.

---

[1] I am appellate counsel for Sunnyslope, along with Justin Henderson. Credit for the analysis and evidentiary record to support the appellate decisions lies with Sunnyslope's bankruptcy counsel, David Engelman, Scott Cohen, Patrick Clisham and Bradley Pack of Engelman Berger, P.C. in Phoenix, Arizona.

- New management turned the project's financial performance around, and new investors committed to fund $1.2 million of equity, whereupon they would benefit by the remaining federal tax credits.

- First Southern exercised § 1111(b) rights. Sunnyslope's plan provided for it to retain its lien, and receive 40 years of payments equal to the project value plus a balloon payment, with a *Till*-determined interest rate of 4.4%. The City and State liens were extinguished, but not their CC&Rs, and their claims were to be paid at the end of the 40-year term.

- The bankruptcy court valued the project at $2.6 million in light of its use as affordable housing under the plan. Upon a remand of the first plan confirmation order appeal, it later added $1.3 million for tax credits to the secured claim collateral value.

- The confirmation order was stayed through the first district court appeal. After the remand to add tax credit value and re-confirmation, no stay was granted and the investors funded the plan using money from a 26 U.S.C. § 1033 exchange, which was used in accordance with the plan. If the confirmation order were to be reversed, the investors would not only lose their $1.2 million, but also suffer a $1.5 million tax liability.

**The Ninth Circuit Panel Decision, *In re Sunnyslope Hous. Ltd. P'ship*, 818 F.3d 937 (9th Cir. 2016)**

Equitable Mootness

The Panel rejected Sunnyslope's argument of equitable mootness, relying on and expanding *In re Transwest Resort Properties, Inc.*, 801 F.3d 1161, 1168–73 (9th Cir. 2015). It held that a new equity investor "is not the kind of innocent third party the doctrine of equitable mootness is intended to protect." 818 F.3d at 945. That position conflicts with decisions in multiple circuits that plan investors must be protected. *E.g. In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015) ("Who are the 'third parties' that equitable mootness is meant to protect? *Continental* singled out investors as the 'particular' beneficiaries of equitable mootness," citing *In re Cont'l Airlines*, 91 F.3d 553, 562 (3d Cir. 1996)). Because an investor had testified at the confirmation hearing on feasibility, knew of the appeal, and decided to fund anyway, the Panel held that no equitable mootness protection was available.

The Panel also discounted the impact of reversal upon the claims (and interest in affordable housing) of the State and City creditors, because those creditors "made no additional investment" – just negotiated claim treatment. 818 F.3d at 945. And third, it held that a consummated plan with multiple implemented transactions and payments could be unwound because the transactions were not that complex, without explaining how payments to vendors or the purchase of property improvements could be reversed.

Secured Claim Valuation

On the merits, *Associates Commercial Corporation v. Rash*, 520 U.S. 953 (1997) holds that when collateral is used in a reorganization plan, valuation must be based upon "actual use," not a hypothetical "foreclosure sale that will not take place." *Id.* at 964; 11 U.S.C. § 506(a) (determine "the value of such creditor's interest in the estate's interest in such property…in light of the purpose of the valuation and of the proposed disposition or use of such property.").

However, the Panel majority (Judges Clifton and Kozinski) held that a secured claim should be valued from the creditor's perspective, without a reduction on account of the CC&Rs because they are subordinate and can be foreclosed out. Fundamentally, the majority did not want to "shortchange the creditor" when foreclosure value is substantially higher than replacement value. 818 F.3d at 948. The Panel held that "use" in *Rash* simply meant the alternative to "surrender," and did not require that replacement value be measured by the income that could be generated when the property was used in the specific way the debtor elected to use it. Rather, it said that a buyer of the property would not take into account the CC&Rs.

<u>The Dissent</u>

Judge Paez dissented only on the valuation holding. He explained that *Rash* directs determining value by what a willing buyer in the debtor's business would pay for "like" property. In his words, "No willing buyer would purchase similar property for a price that does not reflect the restrictive covenants because…those covenants burden how future buyers could use the property." 818 F.3d at 954. He noted that affordable housing was and remains the only permissible use of the property because of the CC&Rs unless and until there is a post-confirmation default and foreclosure.

**The *En Banc* Opinion, *In re Sunnyslope Hous. Ltd. P'ship*, _ F.3d _, 2017 WL 2294746 (May 26, 2017)**

<u>Equitable Mootness</u>

After devoting much of the oral argument to the subject, the Court declined to address equitable mootness in the exercise of its discretion.

<u>Secured Claim Valuation</u>

The *en banc* majority, in an opinion by Judge Hurwitz, held that the bankruptcy court and district court were correct on valuation: *Rash* forbids using a hypothetical value derived from the foreclosure that the reorganization was designed to avoid. It noted that the essential inquiry under *Rash* is to determine the price that a debtor in Sunnyslope's position would pay to obtain an asset like the collateral for the particular use proposed in the plan of reorganization.

First Southern argued that the property should instead be valued at its "highest and best use"— housing without any low-income restrictions. But absent foreclosure, no one could use the property except as affordable housing. The CC&Rs might be subordinate to First Southern's lien, but it is undisputed the restrictions they impose continue to run with the land absent foreclosure, so the Court held they were properly considered in determining collateral value. It pointed out that First Southern had no ability to sell the property free and clear of the CC&Rs absent a foreclosure.

The Court noted that *Rash* implicitly recognized that foreclosure value is not always greater than replacement value, and nonetheless adopted a replacement-value standard instead of requiring that collateral be valued at the higher of its foreclosure value or replacement value. The opinion recognized that the case was "atypical" in that the foreclosure value exceeded the replacement value because foreclosure would vitiate covenants requiring that the complex be used for low-income housing. "But we take the Supreme Court at its word and hold,

as *Rash* teaches, that Section 506(a)(1) requires the use of replacement value rather than a hypothetical value derived from the very foreclosure that the reorganization is designed to avoid." 2017 WL 2294746 *2.

<u>The Dissent</u>

The *en banc* dissent written by Judge Kozinski accused the majority of cramped formalism and fetishizing a selection of the Supreme Court's words when interpreting *Rash.* Cramdown valuation is supposed to limit a secured creditor's risk of a future default and deterioration from extended use by protecting creditors with the typically higher replacement value over the typically lower foreclosure value. The dissent said the majority adopted a test contrary to the reasoning of *Rash* and not required by its words. The dissent said valuation should not be held hostage to the debtor's particular, idiosyncratic use. The dissent did not directly address the binding nature of the CC&Rs, but analogized that a conservation-minded property owner may adopt an easement to keep his land wild, despite the resulting drastic reduction in the commercial value of the property.

<u>Remaining Issues on Appeal</u>

The Court addressed other issues raised in the appeal, with no dispute from the dissent.

<u>Fair and Equitable; *Till*</u>

The Court held that the bankruptcy court's finding that the plan was fair and equitable was not clearly erroneous; the plan provided for payments equal to the present value of the secured claim.

The Court approved the bankruptcy court's determination that 4.4% was an appropriate interest rate. In addition to a formulaic computation under *Till v. SCS Credit Corp.*, 541 U.S. 465, 469 (2004), the bankruptcy court made further findings to support that conclusion, affirmed on appeal.

The 4.4% rate is lower than the original rate on the loan held by First Southern. But interest rates had declined significantly since the loan was made and as of plan confirmation, the national prime rate was 3.25%. And the Court noted that the risk to the lender had similarly decreased because when the loan was made, the apartment complex had not yet been built, and at plan confirmation it was not only completed but operationally stabilized.

The Court also approved market rate testing of the *Till*-derived rate. It noted that the bankruptcy court heard testimony that the market rate for similar affordable housing property loans was 4.18%.

And importantly, the Court acknowledged the validity of the bankruptcy court's conclusion that the chance of a second default should be discounted when determining *Till* adjustments to the prime rate because, like a [guaranty or insurance] credit enhancement, "if Sunnyslope defaults a second time, First Southern can foreclose and obtain a property worth more than the court's § 506(a)(1) valuation." 2017 WL 2294746 *7, n.4, citing *Till*, 541 U.S. at 479 (noting that risk can be evaluated in light of "the nature of the security").

Feasibility

The Court held that the bankruptcy court did not abuse its discretion in finding the Sunnyslope plan to be feasible, based on the evidence. Sunnyslope's projections showed

that it would be able to make plan payments, and its expert confirmed that the collateral would remain useful for the 40 year plan term.

As with the interest rate determination, the Court upheld the bankruptcy court's finding that the balloon payment was feasible because it was secured by property whose value exceeded the value of the remaining First Southern claim. At the end of the plan term or upon foreclosure in the event of a plan default, the CC&Rs would be extinguished and the market value of the collateral would spring up with market-rate rentals.

Withdrawing an § 1111(b) Election

The Court affirmed the bankruptcy court's rejection of First Southern's effort to change its § 1111(b) election after its secured claim was increased on remand after the first district court appeal. In the absence of a contrary order by the bankruptcy court, the creditor must make this election before the end of the disclosure statement hearing. Bankruptcy Rule 3014. First Southern made its § 1111(b) election "7 calendar days after the court issue[d] a ruling on valuation," as authorized by such a court order.

The Court upheld the bankruptcy court's discretionary determination that there was no "cause" to modify that order under Bankruptcy Rule 9006(b)(1). It "assume[d] without deciding that a court should modify a scheduling order to allow a creditor to change its § 1111(b) election after a material alteration to the original plan." 2017 WL 2294746 *7. But the only alteration in the Sunnyslope plan, increasing the collateral value, was deemed not material to the election decision. The bank's plan treatment remained the same, with the only difference being larger monthly payments over the 40 year period and a smaller balloon payment at the end. The Court found it significant that the amended plan of reorganization did not alter the treatment of unsecured claims.

The Court recognized that allowing a second election would give First Southern a second chance to object to the plan, this time both as a secured and unsecured creditor and, given the potential size of its deficiency claim, to block plan approval. First Southern chose to forego that option initially, and the bankruptcy court did not err when rejecting its effort to "torpedo the plan of reorganization." 2017 WL 2294746 *8.

National Conference of Bankruptcy Judges
The Best Show in Vegas: Broken Bench TV

Las Vegas, Nevada
October 2017

# *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017)

Hon. John E. Hoffman, Jr.
United States Bankruptcy Judge
Southern District of Ohio

Brian L. Gifford, Law Clerk

## I. Introduction

There are several possible outcomes in any Chapter 11 case. In addition to confirmation of a Chapter 11 plan of reorganization or liquidation and the conversion of the case to Chapter 7, another possible outcome is dismissal. The effect of dismissal is set forth in § 349(b) of the Bankruptcy Code, which provides that "[u]nless the court, for cause, orders otherwise," the dismissal of a case:

> (1) reinstates—
>
> (A) any proceeding or custodianship superseded under section 543 of this title;
>
> (B) any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or preserved under section 510(c)(2), 522(i)(2), or 551 of this title; and
>
> (C) any lien voided under section 506(d) of this title;
>
> (2) vacates any order, judgment, or transfer ordered, under section 522(i)(1), 542, 550, or 553 of this title; and
>
> (3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

11 U.S.C. § 349(b).

In a "plain dismissal," the bankruptcy court simply enters an order dismissing the case, restoring the prepetition financial status quo by operation of § 349(b). By contrast, a "structured dismissal" does not restore the status quo ante, because the bankruptcy court "orders otherwise." *Id*. Among other things, orders granting structured dismissals have authorized distributions to creditors made in connection with asset sales and/or compromises. Structured dismissals sometimes have even given effect to distributions that are inconsistent with the priorities set forth in § 507(a) of the Bankruptcy Code. In *Official Committee of Unsecured Creditors v. CIT Group/Business Credit Inc. (In re Jevic Holding Corp.)*, 787 F.3d 173 (3d Cir. 2015), the Third Circuit affirmed the bankruptcy court's approval of such a structured dismissal. In *Czyzewski v. Jevic Holding Corp.*, 580 U.S. —, 137 S. Ct. 973 (2017), however, the Supreme Court reversed the approval of the structured

dismissal, holding that bankruptcy courts do not have the authority to approve nonconsensual structured dismissals that give effect to distributions in derogation of the Bankruptcy Code's priority scheme.

## II. Background

Jevic Transportation, Inc. ("Jevic") was a trucking company acquired in 2006 by an affiliate of the private equity firm Sun Capital Partners, Inc. ("Sun") in a leveraged buyout (the "LBO") financed by a group of lenders led by The CIT Group/Business Credit, Inc. ("CIT") with a loan secured by the assets of Jevic. Shortly after the LBO, Jevic refinanced the acquisition debt with an $85 million revolving credit facility and an approximately $16 million term loan from the CIT-led lending group. After Jevic defaulted on the loan, CIT obtained a guarantee from Sun and entered into a forbearance agreement with Jevic, which remained in default when the forbearance agreement expired and Jevic ceased operations in May 2008. Upon ceasing operations, Jevic notified its employees that they were being terminated. The next day, Jevic filed a Chapter 11 petition in the Delaware bankruptcy court. As of the petition date, Jevic owed CIT and Sun, which held liens on substantially all of Jevic's assets, approximately $53 million. Jevic also owed tax creditors and general unsecured creditors more than $20 million. An unsecured creditors committee (the "Committee") was appointed in Jevic's Chapter 11 case.

Because Jevic failed to provide its employees with 60 days' notice of their termination, certain truck drivers filed a class action against Jevic and Sun in the bankruptcy court on behalf of more than 1,000 of their fellow drivers (collectively, the "Drivers"), alleging violations of the federal Worker Adjustment and Retraining Notification Act (the "Federal WARN Act") and an analogous New Jersey law (the "New Jersey WARN Act" and, together with the Federal WARN Act, the "WARN Acts"). The bankruptcy court granted Sun summary judgment on the Drivers' claims under the WARN Acts because Sun was not their employer. The court, however, held Jevic liable on the New Jersey WARN Act claim. Although the Drivers did not have the opportunity to present a damages case in the bankruptcy court, they estimated that their New Jersey WARN Act claims totaled $12.4 million and that $8.3 million of this amount was entitled to priority under § 507(a)(4) as an employee wage claim.

In the meantime, the Committee commenced an adversary proceeding against Sun and CIT on behalf of the bankruptcy estate, asserting that the LBO resulted in a transfer of Jevic's value to Sun, leaving Jevic unable to pay its other creditors. The Committee asserted fraudulent transfer claims under both § 544 and § 548 of the Bankruptcy Code, seeking to avoid the liens Sun and CIT obtained on Jevic's assets through the LBO and to recover the value of the property that Jevic transferred to CIT and Sun to finance the buyout, which was potentially more than $100 million.

Jevic, Sun, CIT, the Drivers and the Committee engaged in settlement negotiations with respect to the Committee's fraudulent transfer lawsuit. Because all of Jevic's tangible assets had been liquidated to make payments to the lender group led by CIT, the only remaining assets that the bankruptcy estate owned at the time the settlement negotiations began was $1.7 million in cash (which was subject to Sun's lien) and the claims against Sun and CIT that the Committee had brought on behalf of Jevic's bankruptcy estate. If a plan had been confirmed or the case converted to Chapter 7, the priority wage claims held by the Drivers clearly would have entitled them to be paid ahead of the holders of general unsecured claims. Yet Jevic, Sun, CIT and the Committee—but not the Drivers—ultimately reached a settlement under which the Drivers would receive nothing and instead: (1) mutual releases would be exchanged among the settling parties and the Committee's adversary proceeding would be dismissed with prejudice; (2) CIT would pay $2 million to cover Jevic's and the Committee's legal fees and other administrative expenses; (3) Sun would assign its lien on Jevic's remaining $1.7 million in cash to a trust,[1] which would be used first to pay certain priority claims, including tax claims (but not the claims held by the Drivers), with the remaining cash then to be distributed to general unsecured creditors on a pro rata basis;[2] and (4) Jevic's Chapter 11 case would be dismissed.

Why were the Drivers left out in the cold? According to the Third Circuit, "[i]t seems that the Drivers and the other parties were unable to agree on a settlement" of the claims under the WARN Acts, and "Sun was unwilling to pay the Drivers as long as the WARN Act[s] lawsuit continued because Sun was a defendant in those proceedings and did not want to fund litigation against itself."[3] *Jevic*, 787 F.3d at 177. It also was undisputed that "it was the paramount interest of the Committee to negotiate a deal under which the [Drivers] were excluded because a settlement that paid the Drivers' priority claim would have left the Committee's constituents with nothing." *Id.* at 177–78 (internal quotation marks omitted). Regardless of the reason, the settlement effectuated by the structured dismissal provided for no distribution to the Drivers even though they held priority claims that would have needed to be paid before general unsecured claims in a liquidation or

---

[1]In the aggregate, the claims that the Committee asserted against CIT and Sun had a settlement value of $3.7 million (the total of the $2 million paid by CIT and the $1.7 million of cash on which Sun released its lien).

[2]As the Third Circuit noted, "[t]his component of the agreement originally would have paid all $1.7 million to the general unsecured creditors, but the United States Trustee, certain priority tax creditors, and the Drivers objected," resulting in a distribution to the priority tax creditors and still allowing the general unsecured creditors to receive a dividend of almost four percent on their claims." *Jevic*, 787 F.3d at 177 n.1.

[3]The bankruptcy court later granted Sun summary judgment on the Drivers' claims under the WARN Acts.

reorganization. The Drivers and the United States Trustee (the "UST") therefore objected to the settlement, arguing that it violated the Bankruptcy Code's priority scheme because unsecured creditors who did not have priority claims would receive a distribution while the Drivers would receive nothing on their priority claims. The UST also argued that the Bankruptcy Code does not permit structured dismissals.

## III. The Lower Court Decisions

The bankruptcy court overruled the objections and approved the settlement in an oral opinion in which it recognized that the Bankruptcy Code does not expressly authorize structured dismissals. The court, however, found that "dire circumstances" justified the relief requested because there was no prospect of a confirmable plan and because Chapter 7 was not a viable option in light of (1) the lack of resources available to fund the litigation against Sun and CIT in Chapter 7 and (2) Sun's and CIT's insistence that they would not have agreed to the settlement in a Chapter 7 case. The bankruptcy court also held that settlements approved under Rule 9019 of the Federal Rules of Bankruptcy Procedure and structured dismissals giving effect to those settlements need not conform to the priorities set forth in § 507(a). In addition, the court held that the Drivers were not prejudiced by being cut out of the distribution, because the funds available for creditors would have been paid entirely to the secured creditors in the absence of a settlement. Finally, the bankruptcy court applied the factors that courts use to evaluate settlements under Rule 9019, "highlight[ing] the complexity of the litigation and express[ing] its skepticism that new counsel or a Chapter 7 trustee could be retained to continue the fraudulent conveyance suit on a contingent fee basis." *Id.* at 179. "Faced with, in its view, either 'a meaningful return or zero,'" the bankruptcy court decided that "'[t]he paramount interest of the creditors mandates approval of the settlement' and nothing in the Bankruptcy Code dictated otherwise." *Id.* The bankruptcy court therefore approved the settlement and dismissed Jevic's Chapter 11 case with the conditions imposed by the settlement.

After the district court affirmed the bankruptcy court's decision, the Drivers and the UST appealed to the Third Circuit. The court of appeals addressed two issues: (1) whether the Bankruptcy Code permits a structured dismissal at all; and (2) if so, whether a settlement reached in the context of a structured dismissal must follow the Bankruptcy Code's priority scheme.

The Third Circuit answered the first question in the affirmative. The court of appeals reasoned that, while § 349(b) "contemplates that dismissal will typically reinstate the pre-petition state of affairs by revesting property in the debtor and vacating orders and judgments of the bankruptcy court, it also explicitly authorizes the bankruptcy court to alter the effect of dismissal 'for cause'—in other words, the Code does not strictly require dismissal of a Chapter 11 case to be a hard reset." *Id.* at 181. Declining to answer the question of whether a structured dismissal would be permissible if a Chapter 11 plan could potentially be confirmed or a distribution made to creditors in Chapter 7, the Third Circuit held that "absent a showing that a structured dismissal has been contrived to evade the procedural protections and

safeguards of the plan confirmation or conversion processes, a bankruptcy court has discretion" to order a structured dismissal. *Id.* at 182.

Addressing the second question—whether a structured dismissal may ever effectuate a settlement that "skip[s] a class of objecting creditors in favor of more junior creditors"—the Third Circuit held that "in a rare case" a structured dismissal may deviate from the priority requirements of the Bankruptcy Code. *Id.* at 175. The court acknowledged that the Fifth Circuit (in a case that did not involve a structured dismissal) had "rejected a settlement of a lawsuit against a Chapter 11 debtor that would have transferred $5.3 million in estate assets to an unsecured creditor despite the existence of outstanding senior claims," holding that the settlement must be "compliant with the priority system." *Id.* at 183 (citing *United States v. AWECO, Inc. (In re AWECO, Inc.)*, 725 F.2d 293 (5th Cir. 1984)). But the Third Circuit declined to follow *AWECO*, instead adopting the standard the Second Circuit established (also in a case not involving a structured dismissal) in *Motorola, Inc. v. Official Committee of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452 (2007). The *Iridium* standard is a multi-factor, "flexible" approach under which compliance with the Bankruptcy Code's distribution scheme is the most important factor to be considered in determining whether "a settlement is 'fair and equitable,'" but which would allow for approval of "a noncompliant settlement . . . when 'the remaining factors weigh heavily in favor of approving a settlement[.]'" *Jevic*, 787 F.3d at 183 (quoting *Iridium*, 478 F.3d at 464).[4]

The Third Circuit held that settlements distributing estate assets but deviating from § 507's priorities may be approved under Rule 9019 if the bankruptcy court has "'specific and credible grounds to justify [the] deviation.'" *Id.* at 184 (quoting *Iridium*, 478 F.3d at 466). While acknowledging that "[s]ettlements that skip objecting creditors in distributing estate assets raise justifiable concerns about collusion among debtors, creditors, and their attorneys and other professionals," the majority concluded that the bankruptcy court "had sufficient reason to approve the

---

[4]The "remaining factors" to which the *Iridium* court referred are:

> (1) the balance between the litigation's possibility of success and the settlement's future benefits; (2) the likelihood of complex and protracted litigation, with its attendant expense, inconvenience, and delay, including the difficulty in collecting on the judgment; (3) the paramount interests of the creditors, including each affected class's relative benefits and the degree to which creditors either do not object to or affirmatively support the proposed settlement; (4) whether other parties in interest support the settlement; (5) the competency and experience of counsel supporting, and [t]he experience and knowledge of the bankruptcy court judge reviewing, the settlement; (6) the nature and breadth of releases to be obtained by officers and directors; and (7) the extent to which the settlement is the product of arm's length bargaining.

*Iridium*, 478 F.3d at 462 (internal quotation marks omitted).

settlement and structured dismissal of Jevic's Chapter 11 case" and that it was the "least bad alternative," because "there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order.'" *Id*. at 184–85. According to the majority, the dissent's "contrary view rests on the counterfactual premise that the parties could have reached an agreeable settlement that conformed to the Code priorities." *Id*. at 185.

The dissent, by contrast, saw the possibility of a settlement that respected the Drivers' priority as anything but counterfactual:

> [I]t is not clear to me that the only alternative to the settlement was a Chapter 7 liquidation. An alternative settlement might have been reached in Chapter 11, and might have included the [Drivers]. The reason that such a settlement was not reached was that one of the defendants being released (Sun) did not want to fund the [Drivers] in their ongoing litigation against it. As Sun's counsel explained at the settlement hearing, "if the money goes to the WARN [Acts] plaintiffs, then you're funding someone who is suing you who otherwise doesn't have funds and is doing it on a contingent fee basis." Sun therefore insisted that, as a condition to participating in the fraudulent conveyance action settlement, the [Drivers] would have to drop their WARN [Acts] claims. Accordingly, to the extent that the only alternative to the settlement was a Chapter 7 liquidation, that reality was, at least in part, a product of [Sun's and CIT's] own making.

*Id.* at 186 (Scirica, J., concurring in part and dissenting in part).

Thus, although Judge Scirica would have joined the majority in adopting the *Iridium* standard and permitting a bankruptcy court to approve a settlement that deviated from the priorities established by § 507(a) in "extraordinary circumstances," *id*., he concluded that extraordinary circumstances were not present and that the structured dismissal was "an impermissible end-run around the carefully designed routes by which a debtor may emerge from Chapter 11 proceedings." *Id*. at 188.

## IV. The Supreme Court's Decision

The Drivers filed a petition for *writ of certiorari* in which they asked the Supreme Court to decide "[w]hether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme," citing *Iridium* and *Jevic* as supporting the authority of bankruptcy courts

to do so and *AWECO* as disapproving the practice. The Supreme Court granted *certiorari* on the question presented, but the Drivers then restated the question to ask "[w]hether a Chapter 11 case may be terminated by a 'structured dismissal' that distributes estate property in violation of the Bankruptcy Code's priority scheme." In reliance on the Supreme Court's rule prohibiting parties from changing the substance of the question presented, Sun and CIT declined to brief the restated question and argued that the Supreme Court should not answer it. Without reaching the merits, Justice Thomas and Justice Alito noted in their dissenting opinion that "[a]lthough both questions involve priority-skipping distributions of estate assets, the recast question is narrower—and different—than the one on which we granted certiorari" and that "[i]t is also not the subject of a circuit conflict," *Jevic*, 137 S. Ct. at 987–98 (Thomas, J., dissenting), because neither *Iridium* nor *AWECO* involved a structured dismissal. In the dissent's view, the writ should have been dismissed as improvidently granted because (1) the Supreme Court "would greatly benefit from the views of additional courts of appeals on this question [and] also would have benefited from full, adversarial briefing" and (2) "deciding th[e] [restated] question may invite future petitioners to seek review of a circuit conflict only then to change the question to one that seems more favorable." *Id.* at 998. While not addressing the points raised by the dissent, the majority effectively rejected them when it answered the restated question.

In another attempt to keep the Supreme Court from answering whether priority-skipping structured dismissals may be approved over the objection of the creditor whose priority is not being observed, Sun and CIT argued that the Drivers had suffered no injury (or at least no injury that would be remedied if the structured dismissal was undone) and therefore lacked Article III standing to appeal. According to Sun and CIT, the Drivers would have received nothing even if the bankruptcy court had not approved the structured dismissal and would receive nothing if the structured dismissal were unwound. The Supreme Court concluded that the lack-of-standing argument rested upon two propositions that were not supported by the record: (1) the assertion that there could be no settlement consistent with the Drivers' priority; and (2) the position that, without a settlement, the fraudulent-transfer lawsuit had no value. As to the first proposition, the Supreme Court found in the record an indication that a settlement providing for a payment to the Drivers was possible:

> Sun insisted upon a settlement that gave [the Drivers] nothing only because it did not want to help fund [their] WARN [Acts] lawsuit against it. But, Sun has now won that lawsuit [on summary judgment]. If Sun's given reason for opposing distributions to [the Drivers] has disappeared, why would Sun not settle while permitting some of the settlement money to go to [them]?

*Id.* at 983.[5]

Disagreeing as well with the lower courts on the viability of the fraudulent-transfer lawsuit being taken on a contingency fee basis, the Supreme Court addressed the argument that the lawsuit had no value absent a settlement:

> [T]he record indicates that the fraudulent-conveyance claim could have litigation value. CIT and Sun, after all, settled the lawsuit for $3.7 million, which would make little sense if the action truly had no chance of success. The Bankruptcy Court could convert the case to Chapter 7, allowing a Chapter 7 trustee to pursue the suit against Sun and CIT. Or the court could simply dismiss the Chapter 11 bankruptcy, thereby allowing petitioners to assert the fraudulent-conveyance claim themselves. Given these possibilities, there is no reason to believe that the claim could not be pursued with counsel obtained on a contingency basis. Of course, the lawsuit—like any lawsuit—*might* prove fruitless, but the mere *possibility* of failure does not eliminate the value of the claim or petitioners' injury in being unable to bring it.

*Id.*

The Supreme Court accordingly held that the bankruptcy court's approval of the structured dismissal cost the Drivers the "chance to obtain a settlement that respected their priority" and "the power to bring their own lawsuit on a claim that had a settlement value of $3.7 million." *Id.* Thus, the Court concluded that the Drivers had been injured and that a decision in their favor might redress that injury, meaning that they had standing to appeal. *Id.*

Having addressed the standing argument, the Supreme Court turned to the question of whether a bankruptcy court may "approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent." *Id.* In short, the Court's answer was "no."

---

[5]In his Third Circuit dissent, Judge Scirica discussed the potential for an alternative settlement in the context of deciding whether extraordinary circumstances would have warranted approval of a structured dismissal giving effect to a nonconsensual priority-skipping settlement. By contrast, the Supreme Court made its similar observations while analyzing standing and then went on to hold that nonconsensual structured dismissals providing for distributions that do not follow the Bankruptcy Code's priority rules are impermissible under any circumstances.

The Supreme Court began "with a few fundamentals," including by noting that a debtor has three possible exits from Chapter 11: (1) obtaining confirmation of a Chapter 11 plan and making payments to creditors under the plan; (2) converting to Chapter 7, in which case the trustee will liquidate the debtor's assets and distribute them to creditors; and (3) having its case dismissed. The Court then pointed out that the first two exits clearly require compliance with the Bankruptcy Code's priority rules, because a court "cannot confirm a [Chapter 11] plan that contains priority-violating distributions over the objection of an impaired creditor class" and because "distributions of assets in a Chapter 7 liquidation must follow [a] prescribed order." *Id*. at 978–79. By contrast, the Court noted, the Bankruptcy Code "does not explicitly state what priority rules—if any—apply to a distribution" ordered in connection with the dismissal of a Chapter 11 case. *Id*. at 980.

The Bankruptcy Code's silence in this regard could lead to the conclusion—as it did for the lower courts—that Congress did not intend to impose an ironclad requirement that priorities be respected in the context of dismissal. But the priority system, which the Supreme Court stated "has long been considered fundamental to the Bankruptcy Code's operation," led the Court "to expect more than simple statutory silence if, and when, Congress were to intend a major departure" from that system. *Id*. at 984. Rather than silence, the Court would have expected "to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans." *Id*.

As the Supreme Court observed, nothing "about distributing estate value to creditors pursuant to a dismissal appears in any relevant part of the Code," and § 349(b)(3) provides that "dismissal ordinarily 'revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case.'" *Id*. And while the Court conceded that § 349(b)(3) "also says that a bankruptcy judge may, 'for cause, orde[r] otherwise,'" it concluded that "read in context, this provision appears designed to give courts the flexibility to 'make the appropriate orders to protect rights acquired in reliance on the bankruptcy case,'" such as orders declining "to reinstate a debtor's claim against a bank that gave up a lien in reliance on the claim being released in the debtor's reorganization plan." *Id*. In the Court's view, nonconsensual violations of the Bankruptcy Code's priority rules are not what Congress had in mind when it included the "orders otherwise" language in § 349(b).

The remainder of the Supreme Court's reasoning raises interesting questions. The Court distinguished *Iridium* on the basis that the Second Circuit's decision did not involve a structured dismissal, but instead "addressed an interim distribution of settlement proceeds to fund a litigation trust that would press claims on the estate's behalf," noting that the court of appeals had "observed that, when evaluating this type of preplan settlement, '[i]t is difficult to employ the rule of priorities' because 'the nature and extent of the Estate and the claims against it are *not yet fully*

*resolved*.'" *Id.* at 985 (quoting *Iridium*, 478 F.3d at 464). The Supreme Court also pointed out that *Iridium* did not "suggest that the Code authorizes nonconsensual departures from ordinary priority rules in the context of a dismissal—which is a *final* distribution of estate value—and in the absence of any further unresolved bankruptcy issues." *Id*. These statements have led commentators to observe that *Jevic* "leaves the Second Circuit's *Iridium* decision perfectly intact and, if anything, appears to endorse a key element of its reasoning" with respect to priority-skipping settlements outside the structured dismissal context. Steven K. Kortanek & Patrick A. Jackson, *Jevic Holding Corp.: Supreme Court Shoots Down Non-Consensual, Priority-Skipping Structured Dismissals 6-2* (March 29, 2017), http://www.drinkerbiddle.com/insights/ publications/2017/03/jevic-holding-corp (hereinafter "Kortanek").

The Supreme Court also acknowledged that bankruptcy courts have entered orders outside the structured dismissal context that could be considered inconsistent with bankruptcy priorities, but noted that in such instances "one can generally find significant Code-related objectives that the priority-violating distributions serve." *Jevic*, 137 S. Ct. at 985. By way of example, the Court mentioned "'first-day' wage orders that allow payment of employees' prepetition wages, 'critical vendor' orders that allow payment of essential suppliers' prepetition invoices, and 'roll-ups' that allow lenders who continue financing the debtor to be paid first on their prepetition claims." *Id*. Unlike those orders, the Supreme Court explained, an order granting a structured dismissal that gives effect to a priority-skipping settlement is "a final disposition" and "does not preserve the debtor as a going concern, . . . make the disfavored creditors better off, . . . promote the possibility of a confirmable plan," or have any other "significant offsetting bankruptcy-related justification." *Id*. at 986. The Court's statements in this regard might signal that it would approve of orders entered outside the dismissal context that promote one of the purposes of a bankruptcy case. *See* Kortanek at 2 ("[E]mployee wage orders, critical vendor orders, and roll-ups . . . were expressly recognized—for the first time in a Supreme Court opinion—and distinguished from the impermissible 'final' distributions in the structured dismissal context. That will be at least worthy of a "*cf.*" cite in the applicable first-day motions going forward."); Anna Haugen, Courtney A. McCormick & Kathryn Z. Keane, *Re-"Structuring" Dismissal Flexibility: An Analysis of the Supreme Court's Jevic Decision*, 36-MAY Am. Bankr. Inst. J. 12, 72 (Westlaw May 12, 2017) (hereinafter, "Haugen") ("[T]he decision might be seen as impliedly condoning the continued use of interim-distribution mechanisms (such as pre-petition employee-wage and critical-vendor orders and DIP financing 'roll-ups'") under certain circumstances—*e.g.*, so long as they foster a potential for a successful reorganization.").

The Supreme Court contrasted employee wage orders, critical vendor orders and roll-ups with "proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards." *Id*. at 986. Along those lines, the Court cited *In re Braniff Airways, Inc*., 700 F.2d 935 (5th Cir. 1983), for its prohibition of "an attempt to short circuit the requirements of Chapter

11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets" and *In re Lionel Corp.*, 722 F.2d 1063 (2d Cir. 1983), for its disapproval of an asset sale on the basis that § 363 does not "swallo[w] up Chapter 11's safeguards." *Jevic,* 137 S. Ct. at 986. By comparison, the Supreme Court mentioned *In re Chrysler LLC*, 576 F.3d 108 (2d Cir. 2009) (later vacated as moot), noting that the approval of a § 363 asset sale in that case was affirmed because "the bankruptcy court demonstrated 'proper solicitude for the priority between creditors and deemed it essential that the [s]ale in no way upset that priority.'" *Id*. at 986. According to one commentator, "[t]he Court's salutary citation to *Braniff Airways*, coupled with its citation and distinguishment of *Chrysler*, will result in a resurgence of 'sub rosa plan' objections to § 363 sales." Kortanek at 2. And according to another, the opinion may cut both ways for the practice of "gifting." *See* Daniel Bussel, *Opinion Analysis: Bankruptcy Priority Rules May Not Be Evaded in Chapter 11 Structured Dismissals* (Mar. 23, 2017), http://www.scotusblog.com/2017/03/opinion-analysis-bankruptcy-priority-rules-may-not-evaded-chapter-11-structured-dismissals ("Although the court's opinion never refers to the practice of 'gifting' . . . *Jevic*'s reasoning, especially the primacy it places on the code's distributional provisions, is in serious tension with that practice. On the other hand, the court's embrace of *Iridium*, which approved an interim priority-deviating settlement on a gifting theory, may give gifting proponents heart.").

Finally, the Supreme Court explained that the Third Circuit's "rare case" limitation was not workable, because "once the floodgates are opened, debtors and favored creditors can be expected to make every case that 'rare case.'" *Id*. at 986 (quoting Frederick Rudzik, *A Priority Is a Priority Is a Priority—Except When It Isn't*, 34 Am. Bankr. Inst. J. 16, 79 (2015)). "The consequences are potentially serious," the Court said, including "departure from the protections Congress granted particular classes of creditors," such as the employees that Congress granted a wage priority in order "'to alleviate in some degree the hardship that unemployment usually brings to workers and their families' when an employer files for bankruptcy." *Id*. at 986–87 (quoting *United States v. Embassy Rest., Inc.*, 359 U.S. 29, 32 (1959)). The Supreme Court concluded that a "rare case" exception injects uncertainty over what is and is not a rare case, "making settlement[s] more difficult to achieve," because "the ratio of lawsuits to settlements is mainly a function of the amount of uncertainty, which leads to divergent estimates by the parties of the probable outcome." *Id*. at 987 (quoting William Landes & Richard Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J. Law & Econ. 249, 271 (1976)).[6]

Whether the certainty provided by the Supreme Court's *Jevic* decision will lead to more settlements will be put to the test in the Jevic Chapter 11 case itself.

---

[6]In his commentary on *Jevic* cited above, Daniel Bussel has argued that "[w]hatever law and economics theory might otherwise maintain . . . the history of bankruptcy law suggests that the 3rd Circuit was not wrong in thinking that some degree of flexibility, ambiguity and uncertainty . . . best facilitates pragmatic resolution of complex Chapter 11 cases."

After the Supreme Court remanded the case for further proceedings consistent with its opinion, the Third Circuit vacated its prior opinion as well as the district court's opinion. *See Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (In re Jevic Holding Corp.)*, No. 14-1465, 2017 WL 1880820 (3d Cir. May 9, 2017). The district court entered an order vacating the bankruptcy court's order approving the structured dismissal. On remand from the district court, the bankruptcy court reopened the case and held a status conference at which the possibility of mediation was discussed. Counsel for Jevic has informed the bankruptcy court that all the relevant parties are amenable to a mediation of the issues. *See In re Jevic Holding Corp*., No. 08-11006-BLS (letter dated June 15, 2017). Because the Supreme Court did not opine on the propriety of fully consensual priority-violating structured dismissals or "the legality of structured dismissals in general," *Jevic*, 137 S. Ct. at 985, a fully consensual structured dismissal is one potential outcome of the mediation.[7]

If Sun and CIT were to ask why any of the value they are providing should be paid to the Drivers given that the Drivers have no WARN Acts claims against them, the answer would be that the fraudulent-transfer action (the impetus for Sun and CIT to provide the value) belongs to the bankruptcy estate in its entirety, not just to the general unsecured creditors. On the other hand, if the Drivers were to ask why they should not receive full payment before the general unsecured creditors receive anything, the answer would be that the Committee is unlikely to agree to settle the fraudulent-transfer action if the general unsecured creditors receive nothing and that Sun and CIT will not pay the estate anything until the claims under the potential $100 million fraudulent-transfer action are settled. In the end, CIT and Sun may have to provide more than $3.7 million of value or else face a $100 million fraudulent-transfer action. And the Drivers may have to accept less than full payment on their priority claims or face the possibility that CIT and Sun will decide to take their chances on a lawsuit that, as the bankruptcy court feared, potentially could result in no recovery for anyone, including the Drivers. As a result of the Supreme Court's decision in *Jevic*, everyone may come away with something while no one is entirely happy, which is the nature of settlements. *Jevic* also illustrates why settlements play such a pivotal role in the resolution of complex, business bankruptcy cases.

[7]As one group of commentators has observed, *Jevic* "leaves open the question of what type of consent is sufficient to depart from the Bankruptcy Code's priority scheme," including potentially "some form of solicitation and voting" or "impute[d] consent following the expiration of a notice and objection period." Haugen at 72.

National Conference of Bankruptcy Judges
The Best Show in Vegas: Broken Bench TV

Las Vegas, Nevada
October 2017

# *Midland Funding, LLC v. Johnson*, 137 S. Ct. 1407 (2017)

Hon. John E. Hoffman, Jr.
United States Bankruptcy Judge
Southern District of Ohio

Laura F. Atack, Law Clerk

## I. Background

The Fair Debt Collection Practices Act (the "FDCPA")[1] prohibits debt collectors[2] from using "any false, deceptive, or misleading representation or means" or "unfair or unconscionable means to collect or attempt to collect any debt." 15 U.S.C. §§ 1692e–f (2012). Courts have routinely held that a debt collector violates the FDCPA when it files or threatens to file a lawsuit on a time-barred debt.[3] But the following question has recently generated a spate of litigation in bankruptcy courts and has divided the circuits: Does a debt collector violate the FDCPA when it files a proof of claim in a debtor's bankruptcy case on a time-barred debt?

## II. Decision

On May 15, 2017, the Supreme Court, in a 5-3 decision,[4] answered that question in the negative. Justice Breyer, writing for the majority, first held that it is "reasonably clear that [a time-barred] proof of claim [is] not 'false, deceptive, or misleading.'" *Midland Funding v. Johnson*, 137 S. Ct. 1407, 1411 (2017). The

---

[1] 15 U.S.C. §§ 1692–1692p.

[2] With certain exceptions, "[t]he term 'debt collector' means any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another. . . [or] any creditor who, in the process of collecting his own debts, uses any name other than his own which would indicate that a third person is collecting or attempting to collect such debts." 15 U.S.C. § 1692a(6). The Supreme Court in *Henson v. Santander Consumer USA Inc.* recently limited the scope of this definition as applied to debt buyers, holding that an entity collecting a debt it acquired from an originating lender (or that lender's transferee) does not fall under the FDCPA definition of "debt collector" as an entity who "regularly collects or attempts to collect . . . debts owed or due . . . another." 137 S. Ct. 1718 (2017).

[3] *See, e.g.*, *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1259 (11th Cir. 2014) ("Federal circuit and district courts have uniformly held that a debt collector's threatening to sue on a time-barred debt and/or filing a time-barred suit in state court to recover that debt violates §§ 1692e and 1692f."); *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013) ("[The consumer's lawsuit] charges that Asset Acceptance sued her after the statute of limitations on the creditor's claim had run. If this is true, Asset Acceptance's suit violated the [FDCPA]."); *Dudek v. Thomas & Thomas Attys. & Counselors at Law, LLC*, 702 F. Supp. 2d 826, 833 (N.D. Ohio 2010) ("Filing a lawsuit to collect upon a time-barred debt, 'without first determining after a reasonable inquiry that the limitations period is due to be tolled, constitutes an unfair and unconscionable practice offensive to § 1692f.'" (quoting *Kimber v. Fed. Fin. Corp.*, 668 F. Supp. 1480, 1487 (M.D. Ala. 1987))); *Goins v. JBC & Assocs., P.C.*, 352 F. Supp. 2d 262, 272 (D. Conn. 2005) ("As the statute of limitations would be a complete defense to any suit, however, the threat to bring suit under such circumstances can at best be described as a 'misleading' representation, in violation of § 1692e.").

[4] Justice Gorsuch did not participate in the decision.

majority based its decision on the fact that a stale claim—at least in jurisdictions in which the statute of limitations merely extinguishes the remedy rather than the claim itself—nonetheless "falls within the Bankruptcy Code's definition of the term 'claim,'" even if it is subject to disallowance. *Id.* According to the majority, a proof of claim is merely "a statement by the creditor that he or she has a right to payment subject to disallowance." *Id.* at 1413. Because the creditor still has a right to payment on a time-barred debt under state law, its act of filing a proof of claim for that debt cannot be false, deceptive, or misleading. *Id.* at 1415.

The Court next addressed whether filing a proof of claim on a time-barred debt was "unfair" or "unconscionable" within the meaning of the FDCPA, which the Court characterized as a "closer" question. *Id.* at 1413. Acknowledging that multiple lower courts have held or suggested that filing a lawsuit on a time-barred debt in "ordinary civil litigation" is "unfair" under the FDCPA, the Court nevertheless was "not convinced . . . by this precedent."[5] It found these authorities to be unpersuasive given the differences it saw between civil suits and bankruptcy proceedings. *Id.* Justice Breyer concluded his majority opinion by expressing the concern that applying the FDCPA in this context would create a "new significant bankruptcy-related remedy" and might put "ordinary civil courts" in the difficult position of deciding "bankruptcy-related questions." *Id.* at 1414–15.

Justice Sotomayor, joined by Justices Ginsburg and Kagan, dissented, reasoning that the systematic practice of filing proofs of claim on time-barred debts is both unfair and unconscionable under the FDCPA. *Id.* at 1416. The dissent maintained that the perceived differences between civil litigation and bankruptcy, which allegedly "reduce the risk that a stale debt will go unnoticed," have little effect in reality. *Id.* at 1420 (noting that "there is virtually no evidence that the majority's position holds true in practice"). Rejecting the majority's argument that the bankruptcy trustee always plays a "gatekeeping role" for debtors, the dissent noted that the U.S. government and the trustees themselves (as amici curiae) assert that they cannot possibly be expected to catch every stale claim filed in every bankruptcy and that the debt collectors' practice is "wasteful" and "exploit[ative]." *Id.* According to the dissent, the proposition that debtors in bankruptcy are more sophisticated than the "average consumer debtor" merely because they initiated the

---

[5] The Court merely "assume[d], for argument's sake, that the precedent is correct" but emphasized that it "has not decided and does not now decide" the issue in the context of "ordinary civil litigation." *Id.* Accordingly, whether filing a lawsuit on a time-barred debt violates the FDCPA is still an open question. *See Kaiser v. Cascade Capital LLC*, No. 3:16-CV-00744-AC, 2017 WL 2332856, at *9 (D. Or. May 25, 2017) (noting that *Midland Funding* has no impact on the "persuasive weight of the cases" holding that a debt collector violates the FDCPA when it sues on a clearly time-barred debt).

process is similarly subject to doubt. Suggesting that the majority opinion creates a "trap for the unwary," Justice Sotomayor concluded: "It does not take a sophisticated attorney to understand why the practice I have described in this opinion is unfair. It takes only the common sense to conclude that one should not be able to profit on the inadvertent inattention of others." *Id.* at 1421.

## III. Implications

### A. *Midland Funding* and State Law

The majority's holding that filing a proof of claim on a stale debt is not "misleading" relies heavily on the fact that "Alabama's law, like the law of many States, provides that a creditor has the right to payment of a debt even after the limitations period has expired." *Id.* at 1411–12 (citing numerous state court decisions holding that their states' statutes of limitations do not extinguish the creditor's right to payment, only its remedy). The Court reasoned that a claim is a right to payment, and if a creditor has a right to payment after the statute of limitations has run, it still has a claim and there is nothing misleading about asserting that claim.

But what about those few states in which the expiration of the statute of limitations extinguishes not just the remedy, but the right to payment? *See* Miss. Code Ann. § 15-1-3(1) ("The completion of the period of limitation prescribed to bar any action, shall defeat and extinguish the right as well as the remedy."); Wis. Stat. § 893.05 ("When the period within which an action may be commenced on a Wisconsin cause of action has expired, the right is extinguished as well as the remedy."). The Court's opinion leaves open the possibility that filing a proof of claim on a time-barred debt in one of these jurisdictions *would* be deceptive or misleading because the creditor would be asserting that it has a claim when, in fact, it does not.[6]

At least one commentator, however, has expressed doubt as to whether this distinction in the law would have any impact:

> Wisconsin is different [from those states with statutes of limitations that bar actions to collect but do not extinguish the claim], at least on the surface. As Justice Breyer noted in his *Midland*

[6] It appears, however, that the Court's holding that filing a stale proof of claim is not "unfair" or "unconscionable" under § 1692f would be unaffected.

> *Funding* opinion, slip op. at 3, Wis. Stat. § 893.05 provides that "[w]hen the period within which an action may be commenced . . . has expired, the right is extinguished as well as the remedy." The statute codifies Wisconsin's common law. *See Maryland Cas. Co. v. Beleznay*, 245 Wis. 390, 14 N.W.2d 177 (1944). Nevertheless, the practical significance of Wisconsin's minority view on extinction of debt as well as remedy is difficult to assess, for the statute of limitations is an affirmative defense that must be raised in an answer or motion, Wis. Stat. §§ 802.06(2)(a)9, 802.06(8)(b), and failure to raise it waives it. *See Johnson v. Heintz*, 73 Wis. 2d 286, 298–99, 243 N.W.2d 815 (1976).

Thomas L. Shriner, Jr., *Midland Funding Highlights Peculiar Feature of Wisconsin's Statute-of-Limitations Law*, FOLEY & LARDNER LLP (May 15, 2017), https://www.wiappellatelaw.com/2017/05/15/midland-funding-highlights-peculiar-feature-of-wisconsins-statute-of-limitations-law/.

If litigation in Mississippi and Wisconsin develops this potential distinction, the Supreme Court may eventually have to revisit the FDCPA's applicability to time-barred proofs of claim, and either find that such conduct violates the FDCPA or else rethink its basis for finding no FDCPA violation.[7]

### B. Sanctions Under Bankruptcy Rule 9011

Multiple courts have held that an attorney (or pro se party) who files a lawsuit on an obviously time-barred claim may be subject to Rule 11 sanctions. *See, e.g.*, *Parrish v. Patel*, No. 92-1197, 1993 WL 24785, at *6 (7th Cir. Feb. 3, 1993) ("[S]anctions are appropriate where the validity of an affirmative defense was so apparent that a plaintiff could not have advanced his or her position in good faith . . . ."); *Brubaker v. City of Richmond*, 943 F.2d 1363, 1385 (4th Cir. 1991) ("Where an attorney knows that a claim is time-barred and has no intention of

---

[7] Some commentators, noting Justice Sotomayor's plea for legislative reform, instead urge an "alternative, and potentially more fruitful, legislative option": to "pursue legislation in the States to switch timeliness of consumer debts from an affirmative defense (i.e., a statute of limitations) to a more definitive liability bar (i.e., a statute of repose)." Kenneth N. Klee & Whitman L. Holt, *Supreme Court's Holding in* Midland Funding, LLC v. Johnson, LexisNexis Emerging Issues Analysis, 2017 Emerging Issues 7560 (June 2017), http://www.ktbslaw.com/media/publication/24_Klee-Holt%20on%20Midland.pdf.

seeking reversal of existing precedent, as here, he makes a claim groundless in law and is subject to Rule 11 sanctions."); *White v. Gen. Motors Corp.*, 908 F.2d 675, 682 (10th Cir. 1990) ("Part of a reasonable attorney's prefiling investigation must include determining whether any obvious affirmative defenses bar the case.").[8] And at least one court has held that filing a proof of claim on a debt that was clearly time-barred can subject the filer to sanctions under Bankruptcy Rule 9011. *In re Sekema*, 523 B.R. 651, 654 (Bankr. N.D. Ind. 2015). *But see, e.g.*, *In re Freeman*, 540 B.R. 129, 144 (Bankr. E.D. Pa. 2015) ("[G]iven the split in the case law, it is difficult to see how sanctions under Rule 9011(b)(2) can be imposed on claimants filing stale proofs of claim . . . . Unless and until the Supreme Court resolves the issue, a rational argument exists for the practice of filing stale proofs claims and compelling debtors and trustees to object to their allowance.").

Although it did not decide the issue, the majority in *Midland Funding* called into question whether Bankruptcy Rule 9011 would apply in this context:

> To find the Fair Debt Collection Practices Act applicable here . . . would require creditors (who assert a claim) to investigate the merits of an affirmative defense (typically the debtor's job to assert and prove) lest the creditor later be found to have known the claim was untimely. The upshot could well be added complexity, changes in settlement incentives, and a shift from the debtor to the creditor the obligation to investigate the staleness of a claim.
>
> Unlike the United States, we do not believe that the Advisory Committee on Rules of Bankruptcy Procedure settled the issue when it promulgated Bankruptcy Rule 9011. The Committee, in considering amendments to the Federal Rules of Bankruptcy Procedure in 2009, specifically rejected a proposal that would have required a creditor to certify that there is no valid statute of limitations defense. See Agenda Book for Meeting 86–87 (Mar. 26–27, 2009). It did so in part because the working group did not want to impose an affirmative

[8] S*ee also Tura v. Sherwin-Williams Co.*, 933 F.2d 1010 (6th Cir. 1991) (citing *White* with approval); *cf. Campana v. Muir*, 786 F.2d 188 (3d Cir. 1986) (awarding attorneys' fees and costs to defendant in action filed with knowledge of unqualified immunity defense that defeated all claims).

> obligation on a creditor to make a prefiling investigation of a potential time-bar defense. *Ibid.* In rejecting that proposal, the Committee did note that Rule 9011 imposes a general "obligation on a claimant to undertake an inquiry reasonable under the circumstances to determine . . . that a claim is warranted by existing law and that factual contentions have evidentiary support," and to certify as much on the proof of claim. *Id.*, at 87. The Committee also acknowledged, however, that this requirement would "not addres[s] the statute of limitation issue," but would only ensure "the accuracy of the information provided." *Ibid.*

*Midland Funding*, 137 S. Ct. at 1415. The Court "recognized that one Bankruptcy Court has held that filing a time-barred claim without a prefiling investigation of a potential time-bar defense merits sanctions under Rule 9011," but also noted that "others have held to the contrary." *Id.* (comparing *In re Sekema*, 523 B.R. 651, 654 (Bankr. N.D. Ind. 2015) (imposing Rule 9011 sanctions) with *In re Freeman*, 540 B.R. 129, 143–44 (Bankr. E.D. Pa. 2015) (declining to impose Rule 9011 sanctions); *In re Jenkins*, 538 B.R. 129, 134–36 (Bankr. N.D. Ala. 2015) (same); *In re Keeler*, 440 B.R. 354, 366–69 (Bankr. E.D. Pa. 2009) (same); and *In re Andrews*, 394 B.R. 384, 387–88 (Bankr. E.D.N.C. 2008) (same)).

Some commentators have suggested that the Supreme Court's decision in *Midland Funding* calls into question the applicability of Bankruptcy Rule 9011 sanctions to stale claims. *See* Diane Davis, *Supreme Court Debt Collection Ruling Problematic, Attorneys Say*, BNA'S BANKR. LAW REPORTER (May 18, 2017), https://www.bna.com/supreme-court-debt-n73014451577/ (*Midland* "ought to be the death knell of sanctions under Rule 9011." (quoting Craig Goldblatt of WilmerHale)); Louis Robin, *Supreme Court Says No FDCPA Liability for Time-Barred Claims*, CLLA BANKR. BLOG (June 3, 2017), http://clla-ba.blogspot.com/2017/06/supreme-court-says-no-fdcpa-liability.html ("Justice Breyer also ruled that Rule 9011 standards[] may not be applicable to filing of stale claims.").

Other commentators, however, suggest that *Midland Funding* provides no bar to seeking Bankruptcy Rule 9011 sanctions for this practice. *See* Adam Levitin, *Midland Got It Right (Sort Of)*, CREDIT SLIPS (May 15, 2017), www.creditslips.org/creditslips/2017/05/midland-got-it-right-sort-of.html ("Even if the FDCPA doesn't apply to time-barred debts in Chapter 13, nothing prevents courts from applying Rule 9011 sanctions. There's no language in

the *Midland* opinion that would be an obstacle to such sanctions, but they would presumably have to be fact-and-circumstance specific, rather than a blanket rule of time-barred=sanctionable."); Hunton & Williams LLP, *U.S. Supreme Court Narrowly Holds that Filing of Time-Barred Proof of Claim Does Not Violate FDCPA, But Leaves Door Open to Application of the Act in Other Circumstances* (May 2017), https://www.hunton.com/images/content/3/0/v3/30825/us-supreme-court-narrowly-holds-that-filing-of-time-barred-proof.pdf ("[T]he Court stopped short of holding that the Bankruptcy Code supplants the FDCPA in bankruptcy proceedings, leaving the door open for courts to apply the FDCPA to different facts or to impose sanctions under Bankruptcy Rule 9011.").

Of course, even if sanctions under Bankruptcy Rule 9011 are available, debtors and/or trustees may be unable to take advantage of the remedy. Bankruptcy Rule 9011 includes a "safe harbor":

> [A] motion for sanctions may not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected, except that this limitation shall not apply if the conduct alleged is the filing of a petition in violation of subdivision (b).

Fed. R. Bankr. P. 9011(c)(1)(A). Faced with an objection, the debt collector can simply attempt[9] to withdraw its proof of claim.[10]

---

[9] Bankruptcy Rule 3006 permits a creditor to withdraw a claim to which an objection has been filed only on court order, so if a creditor does respond to an objection by withdrawing the offending proof of claim, it is possible for the debtor or trustee to seek to strike the withdrawal.

[10] *See, e.g.*, *In re Jenkins*, 538 B.R. 129, 131 (Bankr. N.D. Ala. 2015) ("[T]he plaintiff-debtor objected to Midland's claim . . . . Midland then withdrew its proof of claim, and the court entered an order mooting the objection."); *Martel v. LVNV Funding, LLC (In re Martel)*, 539 B.R. 192, 197 (Bankr. D. Me. 2015) ("Exercising their rights under the Code and the Rules, the [debtors] contacted the [creditors] to raise their dispute and the claims, which would have been subject to disallowance in the normal course of the bankruptcy proceedings, were withdrawn."); *Brown v. Midland Credit Mgmt., Inc. (In re Brown)*, No. 14-40530-JJR13, 2015 WL 5735190, at *2 (Bankr. N.D. Ala. Sept. 29, 2015) (dismissing adversary proceeding on FDCPA claim when offending proof of claim was withdrawn prior to objection or filing the complaint); *In re Claudio*, 463 B.R. 190, 196 (Bankr. D. Mass. 2012) (declining to impose sanctions because "[e]ven if the Court were to hold that it is wrongful to file claims, which, albeit valid, are stale, it has been *repeatedly* held in this District that

### C. Resurrecting Zombie Debt?

In her dissent, Justice Sotomayor noted that, "given the high rate at which debtors are unable to fully pay off their debts in Chapter 13 proceedings, most debtors who fail to object to a stale claim will end up worse off than had they never entered bankruptcy at all: They will make payments on stale debts, thereby resuscitating them and may thus walk out of bankruptcy court owing more to their creditors than they did when they entered it." *Midland Funding*, 137 S. Ct. at 1421 (Sotomayor, J., dissenting) (citations omitted). The basis for this statement is that in many jurisdictions, partial payment can revive a time-barred debt.[11]

Although Justice Sotomayor stated this conclusion unequivocally, there is authority for the proposition that a partial payment to a time-barred creditor under a Chapter 13 plan will not revive the debt:

- *In re Washington*, No. CV 16-02667-JW, 2017 WL 1130144, at *8 (Bankr. D.S.C. Mar. 24, 2017) ("In the context of a chapter 13 case, Courts have been reluctant to revive the statute of limitations upon a chapter 13 trustee payment because the payments are not 'voluntary.'").

- *Hope v. Quantum3 Grp. LLC (In re Seltzer)*, 529 B.R. 385, 389 (Bankr. M.D. Ga. 2015) ("[P]ayments must be voluntary in order to reflect the debtor's acknowledgment of his obligation. For this reason, other courts have rejected the notion that payments made by trustees in bankruptcy qualify as partial payments reviving the statute of limitations." (quoting *United States v. Lorince*, 773 F. Supp. 1082, 1092 (N.D. Ill. 1991))).

- *In re Robertson*, No. 11-10354, 2014 WL 6967935, at *3 (Bankr. M.D. La. Dec. 8, 2014) ("A debtor's unilateral actions after a bankruptcy filing, including providing for payments on a claim through a confirmed plan, cannot alone revive an unenforceable prepetition debt. The logical implication of GC's argument is that debtors essentially could incur debt post-petition unintentionally simply by prosecuting a chapter 13 plan. That result is not consistent with the Bankruptcy Code or underlying policy.").

---

. . . Rule 9011 sanctions can be sought by a party *only* after the opponent has been afforded 21 days advance notice and an opportunity to withdraw or correct the allegedly offending allegation" and the debtor failed to do so).

[11] *See* 4 WILLISTON ON CONTRACTS § 8:31 (4th ed. May 2017) (noting that "partial payment of a debt is regarded as equivalent to an admission of the current vitality of the debt and, therefore, gives rise to a new, implied promise to pay it" and listing state statutes and case law that so provide).

*See also*:

- *Biggs v. Mays*, 125 F.2d 693, 697–98 (8th Cir. 1942) ("It is next contended that the bankrupt revived the barred debt by listing it in his schedules. . . . The listing of a debt in the bankrupt's schedules is not such an acknowledgment as implies an intention to pay it. On the contrary it signifies an intention by the bankrupt not to pay the debt. The listing of the debt does not take the claim out of the statute of limitations. The acknowledgment of a debt in the ordinary course of business takes it out of the statute of limitations because when the acknowledgment is voluntarily made it is an admission of the debt and of the liability of the debtor to pay. From this the law implies a promise to pay. No such inference can be drawn when the very purpose of listing the debt, as in a bankruptcy proceeding, is to secure the discharge of that very debt.").

- *In re Povill*, 105 F.2d 157, 160 (2d Cir. 1939) ("The listing of a claim in a bankrupt's schedules, without notation that it is disputed or barred, is an acknowledgment of the debt in a literal sense. . . . The listing is not, however, an acknowledgment that implies an intention by the bankrupt to pay the debt . . . . [and therefore it] is not an acknowledgment that revives an outlawed debt.").

- *Dubois v. Atlas Acquisitions LLC (In re Dubois)*, 834 F.3d 522, 529 (4th Cir. 2016), *cert. denied*, No. 16-707, 2017 WL 2216948 (May 22, 2017) (noting the "persuasive authority that a debtor does not revive a time-barred debt by listing it in his bankruptcy schedules").

- *In re Shippy*, No. 314-09865, 2016 WL 1178351, at *2–3 (Bankr. M.D. Tenn. Mar. 23, 2016) (citing multiple cases and "agree[ing] that the listing of [a] claim in the debtor's schedules [does] not create an acknowledgment by the debtor sufficient to revive [a] time barred claim").

- *In re Tragopan Props., LLC*, 164 Wash. App. 268, 277–78, 263 P.3d 613, 618 (2011) ("Washington law requires more than a mere literal acknowledgment of a debt to revive a creditor's ability to pursue an action otherwise barred by the statute of limitations. . . . [An] acknowledgment must be coupled with circumstances implying an intent to pay in order to avoid the bar of the statute of limitations. But there can be no such implication where, as here, the very purpose of listing the debt in his schedules under the Bankruptcy Code is to obtain relief from that debt.").

*But see*:

- *United States v. Quinones*, 36 B.R. 77, 79 (D.P.R. 1983) (finding that partial payment ordered by bankruptcy court as final distribution was sufficient to revive time-barred debt owed to United States).

It will remain to be seen what—if any—effect Justice Sotomayor's statement has on debt collectors who may try to pursue time-barred debt after partial payment through bankruptcy and on the courts that must decide whether such debts are in fact resurrected.

### D. Hopes for New Legislation?

Justice Sotomayor ended her dissent by suggesting that "[i]f Congress wants to amend the FDCPA to make explicit what in my view is already implicit in the law, it need only say so." *Midland Funding*, 137 S. Ct. at 1421. And indeed, Justice Sotomayor "take[s] comfort . . . in the knowledge that [*Midland Funding*] need not be the last word on the matter." *Id.* It seems unlikely, however, that new FDCPA legislation will be in the works in the near future, given Congress's focus on other issues.

Another option may be to look to the Consumer Financial Protection Bureau ("CFPB") and the Federal Trade Commission ("FTC"), the agencies tasked with interpreting and enforcing the FDCPA. The CFPB and the FTC, noting that "a consumer may not realize that a debt collector is collecting on a time-barred debt and that it is unlawful under the FDCPA for collectors to sue on such debts," have issued advance notice of potential rulemaking seeking comments on "the need for and costs and benefits of requiring debt collectors to provide consumers with information relating to time-barred debts."[12] While the focus of the current rulemaking proposals is suing or threatening to sue on time-barred debts,[13] it is

---

[12] *See* Debt Collection (Regulation F), 78 Fed. Reg. 67,848, 67,875–76 (proposed Nov. 12, 2013) (to be codified at 12 C.F.R. pt. 1006).

[13] *Id.* The agencies have also engaged in their own enforcement actions against debt collectors that have sought to collect on time-barred debts. *See, e.g.*, *United States v. Asset Acceptance, LLC*, No. 8:12-cv-182-T-27EAJ (M.D. Fla. 2012), https://www.ftc.gov/enforcement/cases-proceedings/052-3133/asset-acceptance-llc (resulting in a consent decree by which the debt collector must make a disclosure: "The law limits how long you can be sued on a debt. Because of the age of your debt, we will not sue you for it."); *see also FTC, Repairing A Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration* (July 2010), at 30–31 ("[B]ecause increased enforcement actions against collectors who violate the FDCPA by threatening to file or filing time-barred lawsuits would deter such practices, the Commission intends to focus more of its enforcement efforts on those who engage in such conduct."), http://1.usa.gov/buF50z.

possible that an effort to proscribe the filing of proofs of claim on such debts will make its way onto the CFPB's agenda.

Finally, as noted briefly above in note 7, one possible path for consumer advocates is to push for reform at the state level. If courts in states like Mississippi and Wisconsin find that *Midland Funding* is distinguishable based on their state statutes of limitations, consumer advocates may consider lobbying other state legislatures to pass statutes that similarly extinguish not only the remedy, but also the debt itself.