AMERICAN BANKRUPTCY TRUSTEE JOURNAL

THE OFFICIAL PUBLICATION OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES

IN THIS ISSUE

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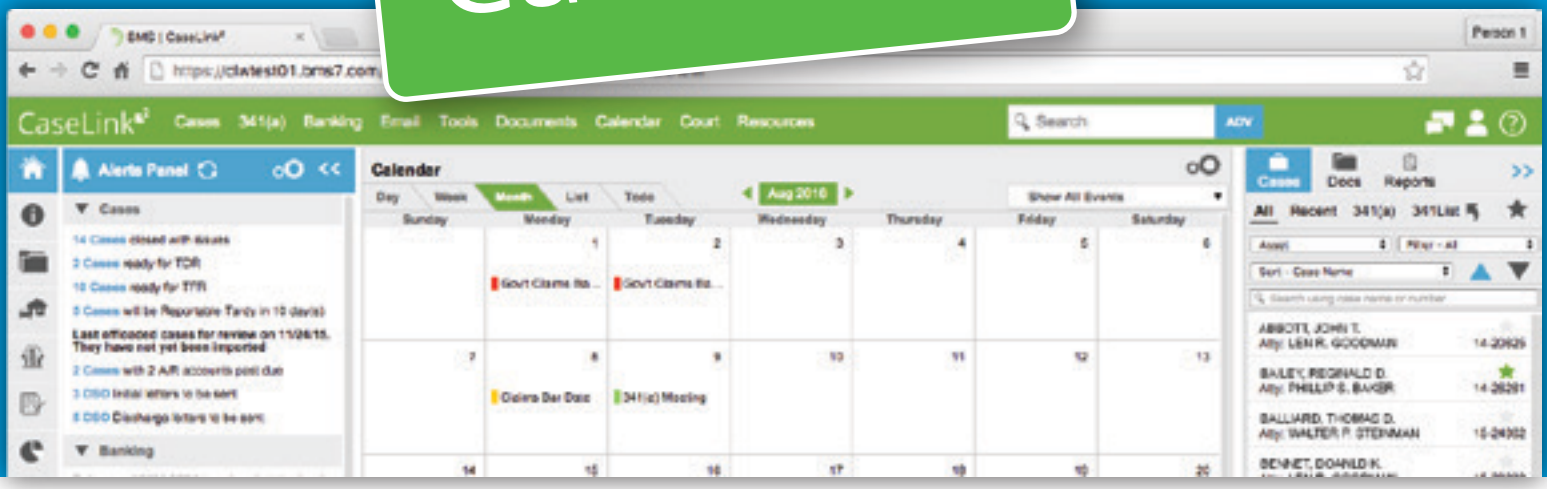

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FROM THE EDITOR'S DESK

N. Neville Reid

Greetings to all of our NABT members and readers! For our Summer issue, made possible by the continued excellent work of the NABT Journal Staff and Assistant Editors (Christina Hicks, Raymond Keyes, Andrea Dobin and Brian Wilson) and our contributing authors, we have principally explored select topics on analysis of creditor claims, one of a trustee's main responsibilities in asset cases. Proper evaluation of the amount and priority of claims ensures that the pro-rata dividend to creditors is not distorted by the trustee's failure to reduce a faulty claim or lower a claim's priority in accordance with applicable law. The articles in this issue are intended to help you identify and resolve certain claim issues that may arise in special contexts, such as tax claims and claims related to the WARN Act. We hope the information in this issue will help you reduce the time and cost of claim analysis and thereby enhance the dividends to creditors in your bankruptcy cases.

At the time of the preparation of this publication, we have all heard the horrifying news about the devastating floods in the Houston area. Please do all that you can to help those affected by the flooding, including our NABT members in Texas and Louisiana and their respective families, and keep all of them in your prayers.

Very best regards,

Neville Reid

Neville Reid
Editor and NABT Board Member

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The editor reserves the right to edit or not publish any submission. Items published in *American Bankruptcy Trustee Journal* do not necessarily reflect the official position of NABT, and publication does not constitute an endorsement of views which may be expressed.

2017 Submission Deadlines: Vol. 33, No. 2 - **March 1**; Vol. 33, No. 3 - **June 1**; Vol. 33, No. 4 - **September 1**; **2017 Publication Dates:** May 1, August 1, November 1.

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Contact: Christina Hicks, christina@jee.com or (800) 445-8629.

PRESIDENT'S PAGE

Dwayne M. Murray

A Farewell...but, definitely not a goodbye.

[I]f we are to "Bring out the best in NABT," we must be bold and willing to equip the association with the tools necessary that it might be more useful tomorrow.

Time surely does pass fast. It seems like it was only yesterday when Paul Swanson and Louis Phillips nudgingly suggested I consider serving the association in some capacity. I can vividly hear Richard "Dick" Kipperman's encouraging voice as I considered the idea of a leadership role. My term will come to an end at the conclusion of the 35th Anniversary Celebration in September. A year has quickly come and gone without a moment's regret. Serving as NABT's president has been an honor that I will forever cherish.

My tenure commenced with the unveiling of my mantra to *"Bring out the best in NABT."* Ambitious efforts to put this plan into action swiftly followed. An integrated approach was used. Efforts centered on creating and adopting a strategic plan, focusing on our mission, getting legislation before Congress to compensate trustees adequately for services rendered, adhering to our bylaws and operating through best practices. Considering the things we have achieved, I am pleased, but there is still more to do.

NABT is in need of an enterprise, a new partner, which can lead beyond the boundaries and limitations of the association. We need a foundation dedicated to academic issues regarding bankruptcy, the ability to endow chairs and professorships at institutions of higher learning, provide scholarships and grants, and sponsor educational seminars for our membership. There are 501 (c) (3) dollars, research grants, and particularly cy-près funds that would yield a new revenue stream to support NABT initiatives through means yet to be realized. If we are to *"Bring out the best in NABT,"* we must be bold and willing to equip the association with the tools necessary that it might be more useful tomorrow. I will be calling upon our board to take this courageous step so that NABT might live brilliantly ever after.

As the guard changes, a heartfelt "thank you" to an outstanding Executive Director, Christina Hicks, is owed. Christina's institutional knowledge and event planning skills are remarkable. Our Monday morning telephone calls were truly motivating. I must also salute Ronald Peterson, Brian Budsberg, Ray Obuchowski, H. Jason Gold, Richard D. Nelson, N. Neville Reid and Yann Geron, an outstanding executive team. Collec-

SUMMARY ACCOMPLISHMENTS FOR 2016 - 2017

Approved Actions of the Board:

- Adopted NABT Strategic Plan focusing on Policy Development, Infrastructure, Operational Management, Financial Management, and Communications.
- Appointed a Management Task Force to create an RFP to look at various association management operations to determine whether NABT is receiving the best available management services to meet its needs and to report its findings with recommendations, if any.
- At least annually the executive board will meet exclusively with associate board members as our relationship with our partners is a key fiduciary responsibility.
- Activities of Treasurer: Initiated steps to review integrity of NABT's financial records through an independent consultant, including recommendation for a change of the by-laws to converting the Treasurer position to a three-year position.

tively, we seized upon the opportunities that were presented and accomplished together what we certainly could not have done individually.

Marc Barmat, Leslie Gladstone, Jason Pettie, William Rameker, William "Bill" Schwab, Darcy Williamson, Brenda Zeddun and Roberta Kickbush, our time together planning for a better NABT was well spent. Jill Bauer, Kristi Singal, Sara DeJarnette, Dave Watkins and George Adams, proved to be true partners to NABT. As a board, your support and wise counsel was a major factor in the successful outcomes achieved this year.

Clifford White, Doreen Solomon, Suzanne Hazard, Neil Gordon, Sam Crocker, and Judges Douglas D. Dodd and Alan Stout are mentioned as excellence is their only standard. These bankruptcy professionals have been a source of tremendous inspiration to me. I am very grateful for their investment in me and NABT.

Special thanks is extended to Gene Crane, Robert Waldschmidt, Jenice Dunlap, Robert Furr, Tamera Ogier, Judge James Boyd, Marty Sheehan, Robert "Bob" Anderson, Andrea Dobin, Brian Wilson and Thomas Tibble who selflessly give to NABT. Past Presidents Richard Nelson and Kelly Hagan operated as my advisors and I thank them for their tireless efforts and incalculable contributions.

While acknowledgements of some are memorialized here, there remain many other nameless volunteers who aided in the growth and success of our association. Their work and partnership is no less cherished or valuable. I appreciate all the help and support from all who partnered, named and unnamed, for the common goal, *"Bring out the best in NABT."*

My final expression of gratitude is reserved for Lisa, my wife of twenty-nine years whose support and devotion humbles me. It is because of Lisa that I have been able to be away from the office to serve NABT. Without Lisa, I could not have achieved what I have in or out of the association. Lisa is a gift and one that I greatly cherish.

Rest assured ~~a~~ stable organization and one with a sound vision for the future now changes hands. NABT, I hereby extend my farewell as president and I grant my assurance as a member that this is in no way a goodbye. I will remain active and involved in what I deem to be a great professional organization. I stand ready to continue my work on behalf of NABT and I ask for your joined hand.

All the best,

Dwayne Murray

- Appointed NABT Task Force on Consumer Bankruptcy to study bankruptcy-related matters and to develop talking points for presentation and participation in conjunction with the ABI Commission on Consumer Bankruptcy.

- Activities of Treasurer: Pursued efforts to standardize the monthly financial reporting on a timely basis from the Management Association for the use of the Treasurer and Board.

- Approved Recommendation to Treasurer: Explore opportunity for NABT to secure its own credit card(s) for the payment of expenses of the association while creating the opportunity for creation of rewards/points and or other benefits to be used to reduce cost of the association.

See next page…

SUMMARY ACCOMPLISHMENTS FOR 2016 - 2017 – Approved Actions of the Board (continued):

- Approved Recommendation to Treasurer: Update fiscal responsibility policy of the board and present further ideas to executive committee for deliberation.
- Recommendation to Strategic Planning Committee: Implement joint meeting of board executives and strategic planning committee to review Vision and Mission of association.
- Implemented executive session with executive staff to further develop vision and mission of association.
- Employed Executive Director's Report and Recommendations as an agenda item.
- Finalized Trustee Succession Awareness Program with EOUST.
- Implemented executive session with executive staff to further develop vision and mission of association.
- Implemented two site visits to Management Company to better understand operations.
- Continued Listening Sessions and Membership Call-ins.
- Instituted archival initiative to preserve history of NABT.
- Explored opportunity for business manager for ABTJ.
- Broadened scope of work of NABT through research, grants, endowments, etc.
- Recommended that each board member provide a one-time gift to NABT to support the 35th Anniversary Celebration.

SUMMARY ACCOMPLISHMENTS FOR 2016 - 2017 – Committee Action:

Amicus: Addressed 13 requests for NABT amicus involvement and support, and approved the submission of amicus briefs on behalf of the NABT in 5 cases currently pending in the United States Supreme Court, and in the First, Second, Third and Eleventh Circuits.

Associate Directors: Assisted in the development of seminar/conference budgets and consulted on the production of these events. Contributed financial support. Marketed the NABT and its events to the trustee community. Joined and contributed to various NABT committees as appropriate.

Bylaws: Revised bylaws to change the Treasurer's position to one appointed by the Board for a three year term, maximum of two terms with emphasis on selecting someone with accounting/corporate finance background; updated the bylaws to reflect changes made in the organizations by the Board such as the change in the name of the organization's Journal from *NABTalk* to *American Bankruptcy Trustee Journal*. Codified within bylaws the Council of Past Presidents.

Convention and Seminar Chairs: Established timely, creative and conventional educational topics and secured new and familiar speakers to present the same to benefit the practice of small and large trustee offices. Promoted the seminar and convention topics in a new and traditional fashion.

Editorial Board of ABTJ: Produced timely substantive journals for publication.

Ethics: Working on revision of Chapter 7 Trustees Canons to include social media.

Legislative: Successfully sought the filing of H.R. 3553 in the 115th Congress, a bill to compensate trustees for services rendered in no asset cases. Recommended Washington Hill Day for NABT. Built alliances with American Bankers Association.

Marketing: Created successful marketing campaigns for Puerto Rico Seminar and New Orleans Convention. Developed a sponsorship initiative to enhance the brand and visual identity of businesses associated with NABT by marketing all aspects of our seminars and conventions. Continued social media campaign to brand NABT.

Membership and President Circle: Increased in membership base in all categories; Establishment of Ambassador Program; Expansion of President Circle benefits.

Nomination: Amended Article 6 of the NABT ByLaws revising nomination schedule so Board Candidates could be available in person at the Spring Seminar, resulting in more qualified candidates identified and nominated. This revision was also tailored to be used efficiently with an electronic voting process.

PAC: Raised funds for NABT's political action committee.

Rules/Forms: Monitored and reported on rule changes.

Past Presidents: Established Listserv for past presidents to capture available institutional knowledge to facilitate and encourage continued involvement in the affairs of the association.

Tax: Established a new relationship with Treasury liaison counsel to improve successful tax refund intercept procedures and to resolve IRS clawbacks of tax refunds from Trustee bank accounts. Solved other tax related problems on behalf of trustees. Contributed tax articles to ABTJ.

Technology/Best Practices: Continued presentation of "Trustee Tips", participated in Best Practices Seminar with EOUST, NACTT, NACBA & NABT.

Trustee Assistants: Created opportunity for member benefits program for NABT.

Website: Updated aspects of the Website to make it an information center for the association.

See next page…

SUMMARY ACCOMPLISHMENTS FOR 2016 - 2017 – Policy Development of the Board:

NABT POLICY# 17-001 Board Orientation
The NABT Board should provide an orientation to all newly elected or appointed board members at each annual convention. It is suggested that the orientation include a discussion of board policies, association financials, board responsibilities, bylaws, the Strategic Plan, committee responsibilities, membership benefits, and other matters deemed relevant.

NABT Policy # 17-002 Acknowledgement of Members and Others
The association shall allocate sufficient time at designated major events (as determined by the President or board) to acknowledge and honor all members who have provided extraordinary assistance to the vision and mission of NABT in a given fiscal year.

NABT BOARD POLICY# 17-003 Convention and Seminar Budgets
The executive committee, with input from the executive director, associate board members, convention and seminar chairs, shall have the responsibility for developing preliminary budgets for all conventions and seminars. Budgets should include revenue and expense projections for sponsorships, including revenue from companies represented by associate board members (board vendors). Final decisions should rest with the executive committee.

NABT BOARD POLICY# 17-004 Circulation of the *American Bankruptcy Trustee Journal*
The board will utilize cost saving measures in the circulation of the ABTJ. The board may consider online circulation and a reduction in the number of journals issued annually.

NABT BOARD POLICY# 17-005 Annual Performance Review of Management Company and Executive Director
Where the day to day operations of the association are delegated to a management company and/or executive director, the board will conduct an annual review of the performance of the management company and any executive director serving in the capacity of Chief Operating Officer. The review should be conducted as early as practical during the fiscal year. The goal of the performance review will be to determine year-to-date what has been achieved and how effective were operations and performances since a prior evaluation.

NABT BOARD POLICY# 17-006 Credit Card Policy
The association will accept credit card transactions in the ordinary course of business. Members, vendors and others will be encouraged to transact business with NABT by check or money order. All fees and expenses paid by credit card, where NABT will incur a fee, will include a convenience fee to be paid by card user, excepting association members.

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HUMOR

"Son, you're all grown up now. You owe me two hundred and fourteen thousand dollars."

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Jon Porter and Dan Mauer, NABT Legislative Liaisons

In the past few months, we have been working to get our bill formally introduced before the Congress leaves DC for the month of August. It has been a frustratingly slow process but we could not be happier to report that we have had a major breakthrough since our last legislative update. A bill was, in fact, introduced in July by Chairman Tom Marino (PA) that would raise the compensation for Chapter 7 trustees by $60 for "no-asset" cases (for a total fee of $120) and index it to inflation. What's more, we made our bill bipartisan by having Cong. Ed Perlmutter (CO) also sign on. We still have work to do but this is a significant step in the right direction and with Chairman Marino's full support, as well as support from our allies like the American Bankers Association, this should be an encouraging development for the trustee community. Now, we will focus on getting additional cosponsors for our bill and work with staff to find a time where our bill can be acted upon by the House Judiciary Committee.

The good news continues as it was heartening when, on June 8th, the Director of the US Trustee's Office, Cliff White, testified before the House Judiciary Committee and verbalized his support for our raise. In particular, I have pasted the relevant portions of his testimony below, as well as a germane portion of the hearing's question and answer segment.

USTO Director Cliff White written testimony:

With chapter 7 cases representing about 63 percent of all bankruptcy cases, chapter 7 trustees play an indispensable role in the bankruptcy system. Despite this, in recent years, they have seen a decline in their overall compensation. Chapter 7 trustees receive $60 per case from the fees paid by the debtor upon filing a bankruptcy petition (an amount that has not increased since 1994), and may receive an additional amount in cases with assets based upon a percentage of the distributions made to creditors and when they serve as a professional in a case.

Total chapter 7 trustee compensation from all sources – including no-asset case fees, commissions on distributions in asset cases, and fees to the trustee as professional in a case – declined by over 10 percent cumulatively from FY 2012 through FY 2015 (when one anomalous case is excluded). Though compensation did rise in FY 2016, the USTP supports an increase in the $60 basic fee, but does not endorse any specific proposal for achieving this increase.

Director White in an oral exchange with Judiciary Committee Ranking Member John Conyers:

Rep. Conyers: Thank you Mr. Hubbard. Let me turn now, for my last question, to Mr. Clifford White III, the Director of the Trustee Program. With respect to the sixty-dollar fee that a chapter seven trustee receives from administering a no-asset case, you note that the United States Trustee Program supports increasing this fee. Now, it's known that the chapter seven trustee administers a bankruptcy case primarily for the benefit of the creditors with respect to investigating any fraud and the availability of any assets. Accordingly, should the creditor pay for this fee increase for chapter seven trustees? What say you, Director White?

Dir. White: Well Mr. Conyers, our position on that has been as a general proposition that the no-asset fee, which is what the sixty dollars is- it's provided in every case, as you said- hasn't been increased for more than twenty years, and as a general proposition ought to be increased. How that can be done in a way that is fair to all stakeholders is a debate that has been had in Congress for some period of time, so we're not endorsing any particular proposal. I'll just make one additional point, however, Mr. Conyers and that is that with regard to most of the trustees- when you say most of the trustees' work is liquidating assets and so forth- in fact, they are dealing with thousands and thousands- 95% of all of the cases

continued on page 16

About the Author

Congressman Jon Porter (Ret.) possesses a unique set of skills formed during his 30-plus years of experience in business, public policy and politics. He built and ran a multi-million dollar insurance business and was elected to a variety of government and private sector leadership positions, including three-terms as a United States Congressman. He understands the pressures and challenges of running a business and, at the same time, possesses sharp political instincts based on his many years in office. This differentiated set of experiences gives him the ability to see a path to a solution with far greater clarity than others.

Scott Myers, Attorney/Advisor, Bankruptcy Judges Division

News from the Advisory Committee on Bankruptcy Rules

Bankruptcy Rules and Forms effective December 1, 2017

My summer/fall column typically provides a brief preview of upcoming bankruptcy rule and form changes. This year there are 12 rule amendments (Rules 1001, 1006, 1015, 2002, 3002, 3007, 3012, 3015, 4003, 5009, 7001 and 9009), one new rule (Rule 3015.1), and 10 official form amendments (Official Forms 25A, 25B, 25C, 26, 101, 113, 309F, 309G, 309H and 309I) on track to go into effect on December 1, 2017.

- *The Chapter 13 Plan Form (Official Form 113) and related rules (Rules 2002, 3002, 3007, 3012, 3015, 3015.1, 4003, 5009, 7001 and 9009).*

Most of the rule and form changes coming this December are part of the Chapter 13 Plan Form package. At its fall 2015 meeting, the Advisory Committee approved the plan form (Official Form 113), and amendments to eight of the related rules—Bankruptcy Rules 2002, 3002, 3007, 3012, 4003, 5009, 7001, and 9009—but voted to defer submitting those items to the Standing Committee.[1] As a result of the comments received during the 2014 publication, the Advisory Committee proposed and the Standing Committee agreed to republish for comment one of the initial nine rules, Rule 3015, and new Rule 3015.1. Rules 3015 and 3015.1 introduced the possibility of a district-by-district opt-out from the national form plan concept, as long as the opt-out district adopts a local district-wide form plan that meets the requirements set forth in new Rule 3015.1.

Scott Myers is an attorney with the Rules Committee Support Office of the Administrative Office of the United States Courts. He provides staff support for the Judicial Conference's Committee on Rules of Practice and Procedure and its Advisory Committee on Bankruptcy Rules. (**Scott_Myers@ao.uscourts.gov**)

Rules 3015 (Filing, Objection to Confirmation, Effect of Confirmation, and Modification of a Plan in a Chapter 12 or a Chapter 13 Case) and 3015.1 (Requirements for a Local Form for Plans Filed in a Chapter 13 Case), were published for comment for a three-month period—July 1, through October 3, 2016. The Advisory Committee approved these two rules and the opt-out concept after the comment period, and recommended final approval of the full chapter 13 plan form package at its fall 2016 meeting. The Standing Committee approved the package at its January 2017 meeting, and the Judicial Conference approved it at its March 2017 meeting. The rules have been approved by the Supreme Court and the full package is on track to go into effect on December 1, 2017, if Congress takes no action to the contrary.

As approved, the chapter 13 package requires use of Official Form 113 for chapter 13 plans filed in the district *unless* the district adopts a district-wide local plan form that meets the requirements in new Rule 3015.1. One requirement in the new rule is that adoption of a local plan must be preceded by "public notice and an opportunity for public comment." Rule 3015.1(a). The rule does not specify the time or process for the notice and comment period. Most courts will likely follow the same process used for the adoption of local rules. Information about the use of the national form or a local court variant will be posted on local court websites.

Some of the rule amendments apply outside the context of chapter 13 cases; notable examples follow.

The changes to Rule 3002 (Filing Proof of Claim or Interest) clarify that a creditor, *including a secured creditor*, must file a proof of claim in order to have an allowed claim in a case. The rule also alters the claims bar date (i.e., date by which the creditor must file a claim) in chapter 7, 12 and 13 cases from 90 days after the § 341 meeting of creditors to 70 days after the petition date.

The changes to Rule 3007 (Objections to Claims) make clear that Rule 7004 does not apply to most claims objections. In addition, the rule no longer will require that a hearing be scheduled or held on every objection. Rather, as amended, the rule permits local practices that require a claimant to timely request a hearing or file a response in order to obtain a hearing.

The changes to Rule 9009 (Forms) are also not limited to chapter 13 cases. Current Rule 9009 requires only substantial compliance with official forms and expressly provides that "[f]orms may be combined and their contents rearranged to permit economies in their use." As amended, Rule 9009 is more restrictive and would require the use of official forms "without alteration, except as otherwise provided in these rules or in a particular Official Form." The changes are designed to limit and define the types of modifications that can be made to official forms. In particular, the chapter 13 plan form requires that nonstandard provisions appear only in one portion of the form, and it would defeat the purpose of this feature if the form could be rearranged freely.

Amended Rule 9009 does not require pixel by pixel reproduction of official forms. Rather, the rule allows for deviations from an official form if permitted by the national instructions for the form or by instructions on the form itself. It would also allow "minor changes not affecting wording or the order of presenting information" on a form.

- *Rules 1001, 1006(b) and 1015(b)*

Rule 1001 (Scope of Rules and Forms; Short Title) is the bankruptcy counterpart to Civil Rule 1, and it generally tracks the language of the civil rule. As amended December 1, 2016, Civil Rule 1, states:

"[These rules] should be construed, administered, and employed by the court and the parties to secure the just, speedy, and inexpensive determination of every action and proceeding." The proposed amendment to Rule 1001 changes the last sentence of the rule to conform to the language of Civil Rule 1.

Rule 1006(b) (Filing Fee) governs the payment of the bankruptcy filing fee in installments, as authorized for individual debtors by 28 U.S.C. § 1930(a). In evaluating a suggested amendment to the rule, the Advisory Committee became aware that some courts refuse to accept a petition or summarily dismiss a case if an installment payment is not made at the time the case is filed. The Advisory Committee concluded that such a practice is inconsistent with Rules 1006(b)(1) and 1017(b)(1). The latter provision allows for dismissal of a case for the failure to pay any installment of the filing fee only "after a hearing on notice to the debtor and the trustee."

In order to clarify that courts may not refuse to accept petitions or summarily dismiss cases for failure to make initial installment payments at the time of filing, amended Rule 1006(b)(1) requires that an individual debtor's petition must be accepted for filing so long as the debtor submits a signed application to pay the filing fee in installments—even if a required initial installment payment is not made at the same time. The committee note explains that dismissal of the case for failure to pay any installment must proceed according to Rule 1017(b)(1).

Rule 1015(b) (Cases Involving Two or More Related Debtors) provides for the joint administration of bankruptcy cases in which the debtors are closely related. Among the debtors covered by the rule are "a husband and wife." In light of the holdings and reasoning in *United States v. Windsor*, 133 S. Ct. 2675 (2013) and *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015), the Advisory Committee replaced both instances of "husband and wife" in the rule with "spouses."

• *Rule 7004(a)(1)*

Rule 7004 (Process; Service of Summons, Complaint), incorporates by reference certain components of Civil Rule 4. In 1996, the Advisory Committee amended Rule 7004(a) to incorporate by reference the provision of Civil Rule 4 addressing a defendant's waiver of service of a summons. At that time, the provision was set forth in Civil Rule 4(d)(1).

In 2007, Civil Rule 4(d) was amended to change, among other things, the language and placement of the waiver provision, renumbering it as Civil Rule 4(d)(5). The amendment to Rule 7004(a) updates the reference to Civil Rule 4(d)(5).

• *Official Forms 25A, 25B, 25C and 26, (Business forms)*

Most official bankruptcy forms were renumbered on December 1, 2015, as part of the Advisory Committee's Forms Modernization Project that began in 2008. Work on Official Forms 25A, 25B, 25C and 26, however, was deferred to allow for review and consideration by the Advisory Committee's Business Subcommittee. As amended, the forms are renumbered 425A, 425B, 425C and 426. Official Forms 425A and 425B set forth an illustrative form plan of reorganization and disclosure statement, respectively, for small business debtors under chapter 11 of the Bankruptcy Code. Official Form 425C is the monthly operating report for small business debtors, and Official Form 426 is used to disclose information on the "value, operations, and profitability of any closely held corporation, partnership, or of any other entity in which the debtor [in a chapter 11 case] holds a substantial or controlling interest."

The revised forms incorporate stylistic and formatting changes to conform to the general structure of the modernized forms. Certain changes have also been made to clarify the information requested and to make them easier for the debtor to complete.

• *Official Form 101*

Official Form 101 (Individual Debtor Petition) Part 2, line 11, is amended to accurately reflect the requirements of § 362(*l*) of the Bankruptcy Code. All debtors against whom an eviction judgment has been entered with respect to their residence must fill out Official Form 101A (Initial Statement About an Eviction Judgment Against You), whether or not they want to remain in their residence. Form 101A is deemed to be part of the petition.

• *Official Form 309F*

Official Form 309F (Notice of Chapter 11 Bankruptcy Case—For Corporations or Partnerships) revises the instructions at lines 8 and 11 of the form. The instructions currently require a creditor that seeks to have its claim excepted from the discharge under section 1141(d)(6)(A) of the Bankruptcy Code to file a complaint by the stated deadline. The applicability of the deadline is in some circumstances unclear, however, so the proposed revision leaves it to the creditor to decide whether the deadline applies to its claim.

• *Official Form 309G, 309H and 309I*

Official Forms 309G, 309H and 309I are the official form notices that are sent to creditors upon the filing of a chapter 12 or chapter 13 case. The proposed form amendments conform to a pending change to Rule 3015 scheduled to take effect on December 1, 2017, absent contrary congressional action.

Rule 3015 governs the filing, confirmation and modification of chapter 12 and chapter 13 plans. The pending amendment to the rule eliminates authorization for a debtor to serve a plan summary, rather than a copy of the plan itself, on the trustee and creditors. The changes to Official Forms 309G, 309H and 309I accordingly remove conditional language that indicates that a "plan summary" may be included with the notice or otherwise served, as that option will no longer be available.

• *Rules and Forms Published for Comment*

Bankruptcy rule and forms amendments are generally published for public comment for approximately six months from mid-August to mid-February. Five rules and one official form are out for public comment this cycle: Rules 2002, 4001, 6007, 9036 and 9037 and Official Form 410.

• *Rule 4001*

The proposed amendment to Rule

4001(c) (Obtaining Credit) governs the process for a debtor in possession or a trustee to obtain credit outside the ordinary course of business in a bankruptcy case. Among other things, the rule outlines eleven different elements of post-petition financing that must be explained in a motion for approval of a post-petition credit agreement. The suggestion was made that because Rule 4001(c) is designed to provide needed information for approval of credit in chapter 11 business cases, its application in chapter 13 consumer bankruptcy cases was unhelpful, where typical post-petition credit agreements concern loans for items such as personal automobiles or household appliances. The Advisory Committee agreed and proposed an amendment to Rule 4001(c) that removes chapter 13 from the bankruptcy cases subject to the rules' requirements.

- *Rule 2002, Rule 9036 and Official Form 410*

The proposed amendments to Rules 2002(g) (Addressing Notices), 9036 (Notice by Electronic Transmission) and Official Form 410 (Proof of Claim) are part of the Advisory Committee's ongoing review of noticing matters in bankruptcy. The proposed amendments would enhance the use of electronic noticing in bankruptcy cases in a number of ways. The amendment to Official Form 410 would allow even creditors who are not registered with the court's case management/electronic case files (CM/ECF) system the option to receive notices electronically instead of by mail by checking a box on the form. The proposed change to Rule 2002(g) would expand the references to "mail" to include other means of delivery and delete "mailing" before "address," thereby allowing a creditor to receive notices by email. And the amendment to Rule 9036 would allow the clerk or any other person to notice or serve registered users by use of the court's electronic filing system and to other persons by electronic means that the person consents to in writing.

- *Rule 6007*

The proposed amendment to Rule 6007(Abandonment or Disposition of Property) addresses a suggestion that the Advisory Committee received concerning the process for abandoning estate property. The suggestion highlights the inconsistent treatment afforded notices to abandon property filed by the bankruptcy trustee under subdivision (a) and motions to compel the trustee to abandon property filed by parties in interest under subdivision (b). Specifically, Rule 6007(a) identifies the parties that the trustee is required to serve with its notice to abandon, but Rule 6007(b) is silent regarding the service of a party in interest's motion to compel abandonment. In order to more closely align the two subdivisions of the rule, the proposed amendment to Rule 6007(b) would specify the parties to be served with the motion to abandon and any notice of the motion, and establish an objection deadline. In addition, the proposed amendment would clarify that, if a motion to abandon under subdivision (b) is granted, the order affects the abandonment without further notice, unless otherwise directed by the court.

- *Rule 9037*

Proposed new subsection (h) to Rule 9037 (Privacy Protection for Filings Made with the Court) responds to a suggestion from the Committee on Court Administration and Case Management that a uniform national procedure is needed for belated redaction of personal identifiers. The amendment sets forth a procedure for a moving party to identify a document that needs to be redacted and for providing a redacted version of the document. Upon the filing of such a motion, the court would immediately restrict access to the original document pending determination of the motion. If the motion is ultimately granted, the court will permanently restrict public access to the originally filed document and provide access to the redacted version in its place.

Readers are encouraged to review the proposed amendments and new rules and forms that make up the August Preliminary Draft of Proposed Amendments and to submit comments. Copies of the proposed amendments will be available on the judiciary's public website beginning August 15, 2017 at the following link: **http://www.uscourts.gov/RulesAndPolicies/rules/proposed-amendments.aspx**.

Comments can be submitted by email at *rules_comments@ao.uscourts.gov*. The deadline for submitting comments addressing the amendments in the Preliminary Draft is February 15, 2018.

FOOTNOTES:

[1] Links to the pending rules can be found on the Pending Rules and Forms Amendments page at uscourts.gov (**http://www.uscourts.gov/rules-policies/pending-rules-and-forms-amendments**). The forms will be available on the pending bankruptcy forms page on **uscourts.gov** (**http://www.uscourts.gov/rules-policies/pending-rules-and-forms-amendments/pending-changes-bankruptcy-forms**).

The Word From Washington

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> *they are assigned in fact have no assets, there will be no distribution. But it takes some fair degree of review of the papers filed in the case before they can come to that conclusion. For so many of these cases that are no assets and that no money goes to creditors at all-that's primarily where the rub comes with regard to the economics of not having changed that sixty-dollar fee for more than twenty years.*

Having the Mr. White verbally support our raise certainly helps us communicate the need to get this issue taken care of soon and we will leverage his support during conversations on Capitol Hill

With all this being said, our goal is still achievable and there is still plenty time to get this done during this session of Congress. Even though it has not followed our preferred timeline, the fact that our bill is now official was, perhaps, the largest hurdle to get over. Now, the legwork and preparation we have done, and continue to do, will certainly pay dividends as we move forward.

As always, if you have questions or concerns about this issue, the legislative team would love to hear from you.

NABT Membership Application

Trustee ..... **$350** ❒
Bankruptcy Trustee appointed or elected under the U.S. Bankruptcy Code.

Governmental

Bankruptcy Judges ..... **No Fee** ❒

Employees of the U.S. Government Trustee Program ..... **$75** ❒

Associate ..... **$350** ❒
Those who work directly with or for Trustees, i.e., Law Partners, Partners of Accounting Firms,etc.

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Staff of trustee member, non-lawyer, i.e., secretary, legal assistant, paralegal, etc.

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Those who service Trustees, i.e., Realtors, Auctioneers, Banks, etc.

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Auctioneer Member ..... **$350 each** ❒

President's Circle ..... **$350** ❒
Special contributors who give $350 in addition to their regular dues.

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Company/Firm _____

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E-Mail Address _____

Type of Member (see above) _____Dues Amount $ _____

How Long on Panel? _____

Payment Method: ❒ Check ❒ Visa ❒ Mastercard ❒ Amex

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Return to: National Association of Bankruptcy Trustees • One Windsor Cove, Suite 305, Columbia, S.C. 29223
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Doreen Solomon, Assistant Director for Oversight, Executive Office for U.S. Trustees

Chapter 7 Trustees Play Important Role in Enforcement Against Bankruptcy Crimes

Introduction

Chapter 7 trustees can play a vital role in the identification and referral of bankruptcy-related crimes. The United States Trustee program strives to foster greater collaboration between trustees and the Department of Justice as we address these critical issues.

For example, at the NABT's Annual Convention in September 2016, we arranged for a special agent from the Federal Bureau of Investigation to discuss the threats to businesses posed by cybercrimes such as the use of "ransomware" – malicious software that blocks access to a computer system until a ransom is paid – as well as hacking schemes. And an upcoming issue of the *USA Bulletin*, which reaches prosecutors and investigators throughout the Department of Justice, will feature articles on bankruptcy fraud written by authors from DOJ components including the Executive Office for United States Trustees, various United States Trustee Program field offices, United States Attorneys' Offices and the Criminal Division. (Issues of the *USA Bulletin* are available on the Department's website at **https://www.justice.gov/usao/resources/united-states-attorneys-bulletins**.)

This article briefly reviews the chapter 7 trustee's duty to refer suspected criminal violations as set forth in 18 U.S.C. § 3057(a).

Trustee's Duty to Refer Violations

Pursuant to 18 U.S.C. § 3057, trustees with reasonable grounds to believe that a violation of Federal law has occurred have a duty to report the facts and circumstances to the appropriate United States Attorney. A similar duty is imposed on the United State Trustee by 28 U.S.C. § 586(a)(3)(F). Section 4.N.9 of the *Handbook for Chapter 7 Panel Trustees* describes the trustee's duty to report criminal conduct, the referral procedure and the importance of coordinating with the United States Trustee. The Handbook also provides guidance regarding the most common bankruptcy crimes, sources of information for referrals and criminal enforcement procedures regarding panel trustee employees.

There are three primary reasons why it is important for trustees to make criminal referrals. First, making referrals fulfills the trustee's statutory duty and is an integral part of the trustee's commitment to uphold the integrity of the bankruptcy system.

Second, the information provided in a referral is not only relevant to the criminal activity identified but may prove helpful to other pending investigations, not related to the bankruptcy case, that may involve the subject. The referral of suspected wrongdoing also positions the United States Trustee Program to detect systemic misconduct and respond through taking appropriate civil enforcement actions and referring the criminal conduct to law enforcement.

Third, trustees are the front line of the bankruptcy system and often have more direct contact with debtors and other participants in the bankruptcy system than either judges or United States Trustee personnel. The United States Trustee Program depends on trustees' experience and skill as bankruptcy professionals to identify suspicious conduct and to provide information about suspected criminal activities in a timely manner.

Partnership with United States Trustee Program

As in so many other matters, the most effective way for trustees to carry out the duty to refer suspected bankruptcy crimes is to work in partnership with the Program. Communication is key. We encourage trustees to contact their United States Trustee's office if they have any suspicion that a crime has occurred. A simple phone call or email is sufficient to start the referral process. Sometimes "something just doesn't feel right" about a debtor's testimony at the 341 meeting or an attorney's fee declaration. That "gut feeling" that a trustee develops through experience is invaluable in detecting criminal activity where, for example, a debtor is concealing an asset or counsel is not truthfully disclosing the full amount of the fees charged to clients.

Once a trustee refers a suspected crime to the United States Trustee, the United States Trustee will review the matter, make a criminal referral under 28 USC § 586 and provide support to law enforcement. This support may include assistance from our field office personnel regarding bankruptcy procedure and details of the bankruptcy case at issue. It may also include the expertise in bankruptcy fraud-related prosecution provided by the United States Trustee Program's Office of Criminal Enforcement, which consists of Regional Criminal Coordinators as well as approximately 25 Special Assistant United States Attorneys around the country.

Successful Criminal Prosecution

A recent criminal prosecution in the Northern District of Illinois illustrates the value of coordination among the Program, the chapter 7 trustee and law enforcement. This successful prosecution began when the chapter 7 trustee contacted the United States Trustee's Chicago

About the Authors

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office with his concerns after the section 341 meeting. Based on the debtor's testimony, the trustee suspected the debtor had lied about his assets and might be concealing valuable property. As it turned out, the trustee's "gut feeling" was spot on and led to the discovery that the debtor had failed to disclose seven luxury cars, including a 1966 Corvette, a 1971 Corvette, a 1978 Pontiac Firebird Trans Am, a 1981 DeLorean, a 1989 Pontiac Firebird Trans Am, a 1997 Dodge Viper and a Lamborghini.

The debtor was initially charged with concealing ownership of seven vehicles with a total value of approximately $294,000 by failing to disclose them in his bankruptcy petition, and with lying under oath about his ownership of the cars in testimony he provided during the section 341 meeting, a Rule 2004 examination and a hearing before the bankruptcy court. According to the criminal information, after filing bankruptcy the debtor allegedly sold the Lamborghini for $122,000 and kept the proceeds. He stored the other six vehicles in a garage to hide them from the trustee. Although the bankruptcy court issued an order directing him to turn over five of the cars, the debtor kept them. After learning that the bankruptcy trustee was seeking court authorization to access the garage, the debtor moved the cars in the middle of the night to various locations to keep them hidden.

The immediate referral of the debtor's actions to law enforcement by the United States Trustee's office and the chapter 7 trustee contributed to the FBI's successful efforts in locating the hidden vehicles and provided evidence resulting in the debtor's prosecution. The debtor ultimately pleaded guilty and in January 2016 he was sentenced to 18 months in prison followed by 36 months of supervised release. The United States Trustee also obtained the waiver of the debtor's chapter 7 discharge of $1.7 million in unsecured debt. Throughout, the chapter 7 trustee coordinated with the Program's Trial Attorney and with law enforcement to achieve justice through both criminal and civil enforcement.

Conclusion

Private trustees are on the front lines in detecting suspected bankruptcy crimes and have a duty to report such matters. I encourage you to contact the office of the United States Trustee if you suspect that a crime has been committed. Successful criminal prosecutions arising from such efforts help to protect the integrity of the bankruptcy system for all participants.

WARNING TO ALL TRUSTEES:

THE WORKER ADJUSTMENT RETRAINING AND NOTIFICATION ACT ("WARN") MAY BE LURKING IN YOUR CORPORATE CASES

Michael Jakowsky, Esq., Jackson Lewis P.C., White Plains, NY
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Warning to all Trustees, the Worker Adjustment Retraining and Notification Act ("WARN") may be lurking in your corporate cases. This article will give a general review of the WARN Act and the claim issues arising therefrom.

Employers suffering from financial issues must pay close attention to federal and state law requirements which, under assorted fact patterns, may require advance written notice of layoffs and plant closings to various recipients. One of those laws is the WARN Act. Generally, WARN requires employers which employ 100 or more full time employees in the United States to provide 60 days advance written notice of a "plant closing" or a "mass layoff" to affected non-union employees, local and international unions (if any or all of the workforce at the affected employment site is unionized), the chief elected official of the local governmental unit and the state dislocated workers unit. This will without question become implicated once such a company is contemplating and ultimately filing for bankruptcy.

Compliance with WARN also requires the employer to navigate through a myriad of nuanced procedural requirements before finalizing involuntary terminations, including wholesale or partial business closures or liquidations, that may trigger WARN obligations. These hurdles include unique definitions and calculation methods, requirements for the employer to aggregate "employment losses" at a "single site of employment" during rolling 90-day periods to determine whether WARN notices will be necessary, and careful drafting of required written notifications. Moreover, while exceptions to WARN's notice requirements exist due to "unforeseen business circumstances," a "faltering company" or a "natural disaster," *none* of these exceptions excuse an employer from providing WARN notices altogether. Instead, the exceptions require an employer to provide as much advance written WARN notice as is practicable under the attendant circumstances, and to include in those notices detailed descriptions of the reasons why the employer could not provide timely WARN notices. The most common asserted defense to WARN claims in bankruptcy proceedings is the faltering company exception. To demonstrate the applicability of the faltering company exception, a company must demonstrate that it was actively seeking capital, financing or a buyer that would have permitted the business to continue as a going concern. It is also noteworthy that this exception does not excuse notice, but rather permits shortened notice. Moreover, if an aggrieved employee, a union or a chief elected official of a local government challenges an employer's reliance on a WARN exception, the United States Department of Labor's WARN regulations charge the employer with the burden of proving that it met the requirements of the exception.

A number of states have also enacted WARN-type laws which have a far greater reach than the federal WARN Act. Many of these "mini-WARN" state laws apply to employers with fewer than 100 full time employees. In addition, some mini-WARN laws require covered employers to provide longer periods of advance notice to notice recipients than the 60 day period established by the federal WARN Act. Various state mini-WARN statutes also affect the content of the information that must be included in the written notices disseminated by employers conducting workforce reductions or relocations within the states.

The New York WARN Act currently is the most onerous mini-WARN law in the United States, and we anticipate that other states will follow New York's lead. In contrast to the federal notice threshold which may be triggered when 50 or more employees are affected by a "plant closing' or a "mass layoff," the New York law establishes a threshold of 25 employees. Shutdown of a facility which causes 25 full time employees to suffer employment losses in New York will result in a "plant closing." A layoff at a facility in New York which results in employment losses for 25 full time employees who constitute at least 33% of the workforce in the facility will constitute a "mass layoff." Both of these scenarios will trigger New York's WARN Act notice obligations. And perhaps the most daunting difference between the New York and federal WARN statutes is the New York requirement that covered employers provide *90, rather than 60, days of advance written notice*.

Some other states and U.S. territories which have WARN-type statutes are: California; Illinois; Iowa; Hawaii; Maine; Maryland; Massachusetts; New Hampshire; New Jersey; Ohio; Oregon; Tennessee; Wisconsin; Puerto Rico, and the U.S. Virgin Islands. Although some of the state laws have definitions and concepts which are similar to or the same as those included in the federal WARN Act, none of the state laws are identical to the federal WARN Act. For example, the California WARN statute does not recognize the "sale exception" which exists under the federal WARN Act. Not all of the state laws recognize the "faltering company" and "unforeseen business circumstances" exceptions that are available under the federal WARN Act. Additionally, the contents of the written notice requirements and the recipients of the notices vary significantly among the state and federal WARN laws. For instance, California and New York require employers to provide WARN notices directly to affected unionized employees, while the federal WARN Act does not include a similar notice requirement. In addition, New York requires covered employers to provide a very detailed notice to the Commissioner of Labor containing the names, addresses and job titles of impacted employees. New York and California also require employers to provide WARN notices to local workforce investment boards.

While there are not many defenses to a WARN Act claim, they tend to focus on whether the entity is a covered employer, had the requisite number of layoffs during the pertinent period of time and/or whether an exception applies. For example, when a dispute arises over whether the relevant entity constitutes an

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employer under the WARN Act, the dispositive issue is whether the company "was operating as an ongoing business enterprise, or whether it was merely engaged in the liquidation of assets." *In re United Healthcare Sys., Inc.*, 200 F.3d 170, 177 (3d Cir. 1999). A finding of the latter may allow a company to argue it is a "liquidating fiduciary" versus an "employer," and thus not subject to any WARN Act obligations, or at least only limited obligations.

In Chapter 7 cases, the Trustee may be stuck with a Debtor/employer who did not adequately contemplate the ramifications of the federal and applicable mini-WARN statutes that may dramatically influence the timing and execution of their business decisions. Failure to do so could result in costly and protracted litigation or investigations at the state administrative agency or court level, as well as federal court litigation under the federal WARN Act. This is particularly significant since WARN damages for employees are considered wages under the law and therefore receive priority in bankruptcy proceedings.

WARN is enforced through lawsuits commenced either by aggrieved employees, a union on behalf of employees and/or or the local government official and/or in administrative proceedings before Departments of Labor. Most WARN lawsuits arise as class actions under Rule 23 of the Federal Rules of Civil Procedure. Courts construing claims for damages and penalties under WARN have held that an aggrieved employee is entitled to all amounts the employee would have received during the WARN notice period along with the actual benefits the employee would have received. The employer may also be liable for civil penalties (which vary from law to law) and the opposing party's attorneys' fees.

If a Trustee finds herself dealing with a proof of claim based on the WARN Act, the following things should be examined:

1. Was the debtor an "employer" as defined by the applicable statute;
2. Did the debtor order a plant closing or mass layoff as defined by the WARN Act;
3. Did the debtor give the 60 days' notice of a plant closing or mass layoff;
4. What is the appropriate calculation of damages for civil penalties (is it 60 calendar days or 60 working days? there is a split in the circuits);
5. Did the debtor qualify under the exemptions such as a "natural disaster" or "faltering company";
6. Is this a class action claim or individual claim;
7. If individual claim, does the individual have standing to pursue the claim (some employees are not entitled to pursue a claim, i.e., partners and consultants);
8. Does the individual have a priority wage claim;
9. Review the claim for damages; generally, they are 60 days' pay per employee, civil money penalties and attorney fees and costs; and
10. Are the directors and officers liable to the estate for breach of fiduciary duty? 🏛

UPDATED

Policy for Approving the Filing of Amicus Briefs by NABT

Requests for an Amicus Brief

A request for an amicus brief should be made to the chair of the amicus committee, who will then circulate the request to all members of the committee. A request will not be considered unless it contains the following information:

1. The style of the case, and the state, district, and circuit involved.
2. The name of the trustee involved.
3. A brief description of the underlying facts of the case.
4. The legal issue to be briefed by NABT.
5. The national significance of this issue to all trustees.
6. The name and address of the person who will be preparing the brief, if an author has been identified.
7. The nature and amount of any fees or expenses to be paid to the author, if any, and the proposed source of those funds. (An author is expected to provide services on a pro bono basis. NABT will reimburse authors for reasonable and necessary expenses, including the printing, filing, and service of briefs and related pleadings.)
8. The timetable for the filing of briefs.

Consideration by the Committee

The amicus committee shall consider all proper requests as soon as practicable. The committee will make one of three decisions:

1. Approve the request, by consensus.
2. Deny the request, by consensus.
3. Refer the matter to the executive board or full board for its consideration and comment, after which the request shall be returned to the amicus committee for its final approval or denial by consensus.

Factors to be Considered by the Committee

In its consideration of each request, the amicus committee shall consider, among all relevant factors, including (but not limited to) the following:

1. Whether the requesting party is a member in good standing with NABT.
2. Whether the issue involved is legal, or whether it is fact-sensitive.
3. Whether the pleadings are "clean" and whether there are any procedural impediments to a determination of the legal issue.
4. Whether the legal issue is of national significance to all trustees.
5. Whether the decision will hinge on state law, or other matters which may only be relevant to trustees in certain districts.
6. Whether the fees and costs being requested, if any, are appropriate.

Do You Need Help

Convincing a Colleague or Industry Professional Without an NABT Membership to Join Us?

HERE ARE THE TOP TEN REASONS!

MEMBER BENEFITS LIST

1. OUR MEMBERS

By becoming a member of NABT, the largest organization of chapter 7 trustees in the U.S., you'll join nearly 1000 of this country's approximately 1200 active panel trustees and many others, including attorneys, auctioneers, and service providers.

2. LISTSERV

If you need to find a realtor in another state or would like input on an interpretation of the Code, you can ask for assistance from your fellow NABT members (including trustees, attorneys, suppliers, auctioneers, and others) throughout the country using the Listserve.

3. A PLACE TO SELL ASSETS

For those unusual items, or assets that are desirable to buyers outside your district, list the asset on the NABT website and set your own terms of sale.

4. HELPLINE

If you have a question of a sensitive nature, or one you'd just prefer to discuss with an experienced trustee from outside your district, give the NABT Helpline a call and a trustee will contact you within 24 hours to offer assistance.

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MAKING SENSE OF ADMINISTRATIVE TAX CLAIMS IN A CONVERTED CASE

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In my 12 years as a chapter 7 trustee I had never received any administrative tax claims arising from a converted chapter 11 case. That all changed recently when I found that I had not one but two converted chapter 11 cases with administrative tax claims. What I soon discovered is a circular and opaque example of the Bankruptcy Code at its worst. I was confronted with a series of four cross-referencing and contradictory Code sections that seemed to lead in circles. This article has three goals. First, to identify the key difference between administrative tax expenses and other administrative expenses. Second, to set forth the relevant sections of the Code that reference administrative tax expenses. Third, to

KEY POINTS

1. As soon as the case converts to chapter 7 the trustee should review the docket for existing orders authorizing the payment of administrative claims. This is a good way to become familiar with the issues in the case. Additionally, the combined amount of the claims will allow the trustee to determine how much money the estate must recover to be administratively solvent.
2. Governmental units that generate tax claims are not required to file with the court a request for payment of administrative expenses. See 11 U.S.C. §503(b)(1)(D).
3. The Code sections that reference administrative tax claims are sections 503(b)(1)(B)(i), §507(a)(8), 502(i) and 348(d), with the former two being determinative and the latter two being advisory.
4. The seminal case in this area is *City of White Plains v. A & S Galleria Real Estate, Inc. (In re Federated Department Stores, Inc.)*, 270 F.3d 994 (6th Cir. 2001). It sets forth all of the most useful tests and is well worth reading.

provide tools of analysis derived from relevant case law that concentrate on the most relevant Code sections and assist in avoiding any misdirection that may be caused by the less relevant sections.

For a trustee, payment of administrative expenses such as claims for attorney's or accountant's fees is a simple and strait forward process of following the terms of a court order. This is so because most administrative claims cannot be allowed by the court until an entity has filed a request for payment of an administrative expense along with an attendant notice providing an opportunity to be heard. See 11 U.S.C. §503(a),(b). The key difference here is that unlike other administrative expense claimants, governmental units that generate tax claims are not required to file with the court a request for payment of administrative expenses. 11 U.S.C. §503(b)(1)(D); see also Ginsberg & Martin on Bankruptcy, §10.09[D][3] (5th ed. 2008) and Collier on Bankruptcy, ¶ 503.02[3], p. 503-11 (16th ed. 2011). When no request is made to the court, the unfortunate result is that there is no well-reasoned and easy to follow court order. This leaves all of the intellectual heavy lifting for the chapter 7 trustee.

In drafting the Bankruptcy Code, Congress deemed some claims to be more important than other claims and as such are to be paid as a higher priority following a strict hierarchy of claims set forth in 11 U.S.C. §507. Administrative expenses are defined in 11 U.S.C. §503(b)(1)(A) as: "the actual, necessary costs and expenses of preserving the estate." Some typical examples of administrative expenses are compensation of professionals, reimbursement of expenses approved by the court, payment of trustee fees and of course taxes incurred by the estate. These expenses generally arise post-petition because before the petition is filed, there is no estate. An administrative expense is the second highest priority assigned by §507 and as a result it gets paid before every other type of claim except for child support. 11 U.S.C. §507(a)(2). This elevated status can be a source of contention because a successful request for payment of administrative expenses can have the effect of bumping the claims of creditors to a lower position resulting in lower or even no payment to creditors.

The starting point for an analysis of administrative expenses is 11 U.S.C. §503, which is aptly titled "Allowance of administrative expenses," and which authorizes payment of "any tax - incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507(a)(8) of this title…." 11 U.S.C. §503(b)(1)(B)(i). The point that stands out clearly is that sections 503(b)(1)(B)(i) and 507(a)(8) are mutually exclusive. Thus, any tax that qualifies as an eighth priority pursuant to section 507(a)(8) is automatically excluded from the higher second priority status granted to administrative expenses.

As is so often the case, the definition of one or two key terms is determinative. Here the words "incurred" versus "assessed" are the key terms that determine if a claim is an administrative expense or a lower eighth level priority claim. The former accepts and the later rejects. Section 503(b)(1)(B)(i) allows as administrative expenses, taxes that were **incurred** by the estate. On the other hand, section 507(a)(8) acts to disqualify claims from administrative status if any of its terms are met. It states in pertinent part, "allowed unsecured claims of governmental units, only to the extent that such claims are for . . . a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition . . . for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition; **assessed** within 240 days before the date of the filing of the petition . . ." 11 U.S.C. §507(a)(8) (emphasis added). This section clearly references pre-petition taxes that are assessed before the date of filing. It is helpful to think of section 503(b)(1)(B)(i) as a sorting bin. In this analogy, claims roll down a metaphorical conveyer belt and any taxes **incurred** by the estate are pushed into bin number 2 to be paid first. Income taxes due and **assessed** pre-petition are sorted into bin number 8 to be paid later if funds are available. It seems clear enough so far. Post-petition claims qualify as administrative expenses and pre-petition claims do not.

One case illustrates the incurred versus assessed dichotomy quite well. "This case centers on the determination of what date, under the Bankruptcy Code, the City "assessed" the real property taxes under its taxing process and the debtor's estate "incurred" those taxes. Because the date when the real property taxes were "incurred" and "assessed" is critical, the temporal relationship between events in the City's taxing process and the filing of the bankruptcy petition is important in deciding whether the City assessed the tax before the commencement of the case under 11 U.S.C. § 507(a)(8)(B)." *City of White Plains v. A & S Galleria Real Estate, Inc. (In re Federated Depart-*

About the Author

Steven R. McDonald began the practice of law shortly after graduating from Western Michigan University Cooley Law School in 2000 and started his own law firm in 2004. Since 2005, he has served as a Chapter 7 Bankruptcy Trustee in the Eastern District of Wisconsin. He is a member of the National Association of Bankruptcy Trustees and the State Bar of Wisconsin. Steve is currently a member of the board of directors of the Bankruptcy, Insolvency and Creditor's Rights Section of the Wisconsin State Bar. Steve also served in the United States Marine Corps Reserve.

ment Stores, Inc.), 270 F.3d 994, 999 (6th Cir. 2001).

Things turn murky with the addition of two Code sections intended to clarify which specific post-petition claims shall be allowed or disallowed.

Section 502(i) states "A claim that does not arise until after the commencement of the case for a tax entitled to priority under section 507(a)(8) of this title shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition". 11 U.S.C. §502(i). This one had me turning in circles because at first glance, it seems to treat all post-petition taxes like a pre-petition claim, but that is not the case. I turned to my old friend Collier's for help. "Certain taxes accrue prepetition but the tax return and payment on the tax claim are due post-petition. Section 502(i) makes it clear that if these taxes are entitled to priority status under section 507(a)(8), they shall be treated as prepetition priority claims under section 507(a)(8), and not allowed as administrative expenses under section 503(b)(1)." Collier on Bankruptcy, ¶ 503.07[2], p. 503-63 (16th ed. 2011). This means is that even though certain taxes may be assessed post-petition, that fact alone is not enough to grant it the status of an administrative expense. Even the Ninth Circuit Court of Appeals found this provision to be baffling. They noted that §502(i) is circuitous when read together with other sections. *See Miller v. United States*, 363 F.3d 999 (9th Cir. 2004).

There is of course an exception to the exception. Some courts have held that taxes that only become payable post-petition for tax years that began pre-petition were not actually "incurred" until they became payable and thus qualified for administrative priority. *City of White Plains v. A & S Galleria Real Estate, Inc. (In re Federated Department Stores, Inc.)*, 270 F.3d 994 (6th Cir. 2001)
.

Sadly, the Code is not done messing with your mind yet because §348(d) adds the following brain buster: "A claim against the estate or the debtor that arises after the order for relief but before conversion in a case that is converted under section 1112, 1208, or 1307of this title, other than a claim specified in section 503(b) of this title, shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition." 11 U.S.C. §348(d). Section 348(d) requires very careful reading to fully grasp the "other than a claim specified in section 503(b) of this title" clause. At first blush it seems to indicate that in a converted case, tax claims are treated as if they arose pre-petition like those specified in §507(a)(8) and therefore are excluded from qualifying as an allowed administrative expense. This is a false impression and at least one case does provide clarity.

> "Section 348(d) has the effect of generally treating creditors' claims incurred during a Chapter 11 proceeding the same as prepetition debts, where the proceeding is subsequently converted to one under Chapter 7. The purpose of the statute is equality of treatment of claims before the Chapter 7 court. But the important exception is made by § 348(d) for administrative expenses incurred during the pendency of a subsequently converted Chapter 11 case. We therefore hold that an administrative expense claim for withholding taxes incurred during the pendency of a Chapter 11 proceeding retains its character as an administrative expense after a subsequent conversion to a liquidation case."

In *In re Blue Ribbon Delivery Service, Inc.*, 31 B.R. 292, 293 (Bankr. W.D. Ky., 1983), the Court also spelled out the purpose of section 502(i). "The fact of conversion alone does not alter the character of an administrative expense claim. If allowable in a Chapter 11 proceeding, it is equally allowable if the case thereafter changes chapters. Section 348(d) of the Bankruptcy Code mandates that result." *Id*.

Two cases that I recently had provide good examples of administrative tax claims in converted cases.

In one case, the debtor was a landlord who owned a fractional interest in more than a dozen limited liability companies ("LLCs") that owned a series of residential apartment buildings. The LLCs did not file for bankruptcy but the debtor did and acted as the debtor-in-possession ("DIP") during his personal chapter 11 case. The Internal Revenue Service filed a request for payment of an administrative expense in the debtor's personal bankruptcy for over $41,000.00. The IRS stated correctly that the debtor was personally liable for withholding taxes owed by the LLCs. It took the position that because the debtor was personally liable for the LLC's taxes and was also acting as DIP in his own personal bankruptcy, that therefore the bankruptcy estate that he controlled must have also incurred these taxes. While this can be true under some circumstances it is not always true. Judge Robert Martin provided excellent guidance in a similar case:

> "To be entitled to administrative expense priority, the taxes must fall within the language of § 503(b)(1)(B) which requires that the tax be 'incurred by the estate.' Although this language is typically invoked to distinguish prepetition claims from postpetition claims, it may also be interpreted to distinguish taxes incurred by the individual debtor from taxes incurred by the debtor in possession through his administration of the bankruptcy estate."

In re Felland, 153 B.R. 835 (Bankr. W.D. Wis., 1993). I attached this case to a letter to the IRS and requested that they withdraw the claim on the basis that the bankruptcy estate did not incur the debt. To the contrary, I argued, two LLCs owned fractionally by the debtor incurred this debt. In other words correlation does not equal causation. The IRS agreed and withdrew the claim.

Another one of my cases involved a debtor/corporation that owned all of the assets, and generated all of the income from which the taxes arose during the pendency of the chapter 11 case. Those facts created a much better argument that any taxes were incurred by the bankruptcy estate and additionally were necessary for the preservation of the estate. "Under section 1399 of the Internal Revenue Code,… In a non-individual case, all of the assets and income become part of the bankruptcy estate and all taxes incurred during the administration of the case, except those treated as unsecured priority claims under section 507(a)(8), are treated as administrative expenses." Collier on Bankruptcy, ¶ 503.07[2][a], p. 503-65 (16th ed. 2011)

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The Conflict Between Bankruptcy Code Sections 364(c)(1) and 726(b)

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KEY POINTS

1. Courts disagree on whether claims entitled to a super-priority under section 364(c)(1) of the Code have priority over claimants entitled to priority under section 726(b).
2. Trustees must scrutinize DIP financing orders to determine whether priorities have been granted which may trump chapter 7 administrative expense claims.
3. If it appears that there will be insufficient assets to fund chapter 7 administrative expenses and make a meaningful dividend, Trustees should seek to negotiate an agreement with any 364(c)(1) super-priority claimant prior to incurring the expense of administration.

It is commonplace in a chapter 11 bankruptcy case for a debtor-in-possession's lender ("DIP Lender"), under a post-petition financing arrangement, to be granted certain protections pursuant to section §364(c) ("Section 364(c)") of the Bankruptcy Code in exchange for funding a DIP's reorganization efforts. One such protection is the grant of a "super-priority" claim under Section 364(c)(1). The Bankruptcy Code states that such a claim is superior to "all administrative expenses of the kind specified in section 503(b) or 507(b) of this title[.]" The intriguing question is just how "super" is the "super-priority" claim? More specifically, following conversion of the case to a chapter 7, does such claim always get paid ahead of administrative expenses incurred in the chapter 7 case? The answer lies in a court's interpretation of the language in Sections 364(c)(1) and 726(b) ("Section 726") of the Bankruptcy Code.

Section 364(c)(1) states that if a "[DIP] is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt— (1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title." The relevant portion of Section 726(b) states that "…a claim allowed under section 503(b)[1] of this title incurred under [chapter 7] after such conversion has priority over a claim allowed under section 503(b) of this title incurred under any other chapter of this title or under this chapter before such conversion…"

A number of bankruptcy courts have considered the conflict between a chapter 7 trustee's administrative expense claim derived from Section 726(b) and a DIP Lender's "super-priority" claim based on Section 364(c)(1) for the purpose of distribution priority. In *In re Summit Ventures, Inc.,* 135 B.R. 478 (Bankr. D. Vt. 1991), the Bankruptcy Court for the District of Vermont held that the policy concerns attendant to a trustee's need to administer a chapter 7 case outweigh the concerns over the encouragement of creditor financing in a chapter 11 case, and thus found that the trustee's claim maintains priority over the super-priority claim created in the chapter 11 case. *Id.* at 483. In *In re Visionaire Corp.*, 290 B.R. 348 (Bankr. E.D. Mo.), *aff'd in part, rev'd in part*, 299 B.R. 530 (B.A.P. 8th Cir. 2003), the Bankruptcy Court for the Eastern District of Missouri reached the same result applying rules of statutory construction and while also giving consideration to policy arguments.[2] The court reasoned that Section 726(b) specifically addresses the priority issue since it refers to its priority in relation to pre-conversion "administrative expense claims" while Section 364(c)(1) only speaks to priority of claims in general terms. *Id.* at 352. Thus, applying the rule of statutory construction that the more specific statute takes precedent over the more general, the Court applied the priority scheme of section 726. The *Visionaire Corp.* court also found, upon conversion of a case, the policy objectives underlying Section 726(b) "override" those of Section 364(c)(1). *Id.* at 352-53.

The Bankruptcy Court for the Southern District of Florida in *In re National Litho, LLC,* 2013 WL 2303786 (Bankr. S.D. Fla. May 24, 2013), came to a different result, holding that Section 364(c)(1) claims maintain their priority of all administrative claims, including a chapter 7 trustee's post-conversion administrative claims. The *National Litho* court, applying a different set of rules of statutory construction than the *Visionaire Corp.* court, reasoned that the language of Section 364(c)(1) is unambiguous and provides for priority "over all section 503(b) claims whenever or however created." *Id.* at *3. The court further reasoned that Section 726(b) is devoid of any reference to Section 364(c)(1) and thus its language cannot dislodge the priority afforded a Section 364(c)(1) claim, irrespective of whether the 364(c)(1) claim is characterized as an "administrative claim" or just a "claim."[3]

In September, 2016, the Bankruptcy Court for the District of New Jersey added its voice to the discussion of the priority question. In the case of *In re Packaging Systems, Inc.*, 559 B.R. 123 (Bankr. D.N.J. 2016), Judge Christine M. Gravelle was confronted with competing interests in funds recovered by a chapter 7 trustee post-conversion, pursuant to the trustee's avoidance powers under Article 5. The DIP Lender asserted a right to the funds pursuant to an order entered during the chapter 11 phase of the case, which granted the DIP Lender a "super-priority" claim under Section 364(c)(1). The trustee asserted a superior right to the funds pursuant to section 726(b) of the Bankruptcy Code.

The facts in *Packaging Systems* are not complex. At case inception, Harborcove Financial, LLC ("Harborcove"), which factored the debtor's accounts receivable and held a security interest in virtually all of the debtor's assets, conditioned its agreement to continue the factoring arrangement on the debtor's assumption


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of the factoring agreement and the granting of a "super-priority" claim under Section 364(c)(1) for any sums owed it.[4] The Court entered an order which granted Harborcove the requested protections under Sections 364(c)(1) and (c)(2).[5]

Approximately one year after entry of the DIP Order, the case was converted. At the time of conversion, Harborcove had a substantial claim against the debtor. Harborcove's involvement in the chapter 7 case was limited. It filed an amended proof of claim asserting that it had a security interest in substantially all of the debtor's assets and that its claim had priority status pursuant to §507(a)(2). Harborcove also entered into a consent order with the trustee granting it relief from the automatic stay as to machinery and equipment subject to its secured claim.

Following conversion, the trustee prosecuted avoidance actions and recovered approximately $92,000. Harborcove was aware of the fact that the trustee was pursuing the claims, but did not advise the trustee of any intent to claim the recoveries in a manner that would deprive the trustee of any compensation by asserting its Section 364(c)(1) claim. After conclusion of his estate administration, the trustee filed his final report, which did not provide for any payment to Harborcove. Harborcove objected to the final report, and separately moved for payment of its alleged administrative claim, wherein it claimed that as the holder of a "super-priority" claim, it was entitled to be paid all of the estate's funds.

Judge Gravelle, analyzing the conflicting Code sections and case law, adopted the reasoning in *National Litho*, concluding that the "super-priority" status granted to Harborcove's claim was superior to the trustee's administrative expense claim. In reaching this decision the court reasoned that Section 364(c)(1) unambiguously granted a Section 364(c)(1) claim priority, and must be followed despite any policy concerns. The court also cautioned trustees to review pre-conversion super-priority claims prior to determining a plan for administration of an estate. However, given the inaction by Harborcove during the chapter 7 case, Judge Gravelle invoked her equitable powers and allowed payment to the trustee's professionals for the reasonable value of the services rendered in the chapter 7 case relating to the avoidance action recoveries, prior to payment on Harborcove's Section 364(c)(1) claim. The court was struck by the fact that Harborcove's recovery was from assets on which it had no lien, i.e., chapter 5 avoidance actions. Thus, the Trustee had no ability to resort to a surcharge under §506(c). The court invoked its §105 powers to avoid a windfall to Harborcove as a result of its inaction.

The clear takeaway from these decisions is that a trustee in a converted case cannot rely upon Section 726(b) to ensure payment of commissions and professional fees in the event that there are pre-existing "super-priority" claims created under Section 364(c)(1). A trustee should, as a matter of course, review financing orders entered during a chapter 11 case to determine if a lender was granted a Section 364(c)(1) claim, and if so, communicate with the lender to resolve any priority issues. Since the lender generally does not have standing to pursue avoidance actions, the lender and trustee would both benefit from a resolution which provides a mutually beneficial arrangement for the trustee to pursue such claims. Absent an agreement, the trustee must determine whether the liquidation of estate assets is likely to benefit the estate, or seek a court determination as to the parties' competing interests in the assets before the trustee incurs any significant expense of administration. Otherwise, the trustee risks "gifting" services which only benefit the DIP Lender.

FOOTNOTES:

1 A trustee's administrative claim status is derived from §§ 503(b) and 507(b) of the Bankruptcy Code. Section 726(b) grants priority to section 503(b) administrative expense claims incurred in a chapter 7 case over §503(b) administrative expense claims incurred in cases under other chapters of the Bankruptcy Code.

2 The 8th Circuit Bankruptcy Appellate Panel affirmed the decision in part and reversed in part. The panel affirmed the bankruptcy court's decision relying on the fact that a final financing order had not yet been entered prior to conversion, but held that Section 364(c)(1) claims for amounts advanced under interim orders maintained priority over the trustee's claims. Thus, it remains to be seen how courts in this district will decide this issue if a final order is entered. *In re Visionaire Corp.*, 299 B.R. 530 (B.A.P. 8th Cir. 2003).

3 *Id.* The distinction is important. Section 726(b) specifically refers to priority amongst other administrative claims under section 503(b). If a Section 364(c)(1) claim is not a §503(b) claim, but rather its own class of claim or an unsecured claim (as some courts interpret it to be), then Section 726(b) would not apply to it, and a Section 364(c)(1) claim would likely be superior. *See In re Mayco Plastics, Inc.,* 379 B.R. 691 (Bankr. E.D. Mich. 2008) (holding that a Section 364(c)(1) claim is necessarily an unsecured claim based on the language of Section 364); *In re Fleetwood Enterprises, Inc.*, 427 B.R. 852 (Bankr. C.D. Cal. 2010) (finding the *Mayco Plastics* court's statutory interpretation of a Section 364(c)(1) claim persuasive).

4 Harborcove also required and was given a lien on all the debtor's post-petition assets under Section 364(c)(2), excluding recoveries under Article 5 actions – a critical fact in the Court's ultimate determination.

5 The Order specifically provided, in relevant parts as follows:

> In accordance with Sections 364(c) and (d)…Harborcove is hereby granted, and all loans, advances, obligation and amounts due…by the Debtor to Harborcove are hereby secured by, valid and perfected first and senior security interests and liens in favor of Harborcove in and on all existing and after acquired assets of the Debtor and the Debtor's estate…excluding recoveries from actions brought pursuant to the provisions of Chapter 5 of the Bankruptcy Code.
>
> ***
>
> Harborcove is hereby granted a super-priority administrative claim under Section 364(c)(1) of the Bankruptcy Code over any and all administrative expenses incurred and priority claims arising in this case for the obligations of the Debtor to Harborcove….

Neil Gordon and Ron Peterson

The following cases have been selected from bankruptcy decisions that have been reported or decided within the last year, because of their relevance to chapter 7 trustees and their chapter 7 practices.

§547(b)(5)

Hypothetical preference action permitted under hypothetical liquidation test

Schoenmann v. Bank of the West (In re Tenderloin Health), 849 F.3d 1231 (9th Cir. 2017)

The bank was a lender to the debtor whose loan was secured by a lien on the debtor's personal property, including its deposit account with the bank. Debtor sold its only real property and used the sale proceeds on the day the sale closed to pay the bank $190,595 to fully satisfy its outstanding loan obligations, and then moved the rest of the net sale proceeds into its deposit account at the bank thereby increasing the balance by $526,402. Debtor filed its chapter 7 petition the following month. The trustee commenced a preference action against the bank, alleging that the $190,595 debt payment was a preferential transfer because under §547(b)(5), the deposit account had contained only $37,713 on the petition date. The bank was granted summary judgment by the bankruptcy court, which concluded that the trustee could not satisfy §547(b)(5) because the debtor's account contained at least $190,595 on the petition date which the bank had a right to setoff. The bankruptcy court rejected the trustee's argument that under the hypothetical liquidation, the trustee would avoid as a preference the deposit of the $526,402 of net sale proceeds, leaving less than $190,595 in the debtor's account (and specifically leaving $37,713). The district court affirmed. On further appeal, the court of appeals for the 9th Circuit reversed and remanded, rejecting the bank's contention that it was impermissible to entertain a hypothetical preference action within a hypothetical liquidation. §547(b)(5)(C) provided that a creditor receive payment of such debt "to the extent provided by the provisions of this title." Thus, the circuit court concluded that this referred to the totality of the Bankruptcy Code, including the preference provisions. Here, had the debt payment not been made, the bank would still have been a creditor because it would be owed $190,595. The deposit made was "for or on account of an antecedent debt." Finally, the deposit constituted a "transfer" under the Code because by depositing the net sale proceeds into the bank account, the funds were subjected to the bank's security interest, thereby depleting the assets available to the debtor's other creditors.

[*Author's comment*: Had the bank's collateral included the real estate, the hypothetical test could not have been satisfied both because (a) the bank would have been oversecured, and (b) it would have merely received the proceeds from the sale of its own collateral.]

§547(e)

Garnished wages not transferred until earned

Tower Credit, Inc. v. Shott (In re Christon Jackson), 850 F.3d 816 (5th Cir. 2017)

Tower Credit had obtained a state court judgment in Louisiana against the debtor. Tower took out a garnishment order and served it on the the debtor's employer on January 19, 2012. Thereafter, Tower began collecting the debtor's garnished wages. The debtor filed a chapter 7 petition on November 17, 2012, whereupon the trustee commenced a preference action seeking to avoid the garnishments collected by Tower within 90 days of the petition. The bankruptcy court granted the trustee summary judgment. The district court affirmed. The United States Court of Appeals for the 5th Circuit likewise confirmed, rejecting Tower's argument that the garnished wages should be considered transferred on the date the garnishment order was served, which was more than 90 days before the petition date. The court first determined that what constitutes a transfer and when it is complete is a matter of federal law, pursuant to *Barnhill v. Johnson,* 503 U.S. 393 (1992). Under §547(e)(2)(B), the transfer was considered made at the time it was perfected. The court noted that in the context of non-real property, perfection would

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History of Bankruptcy in Ancient Societies — Part 2 —

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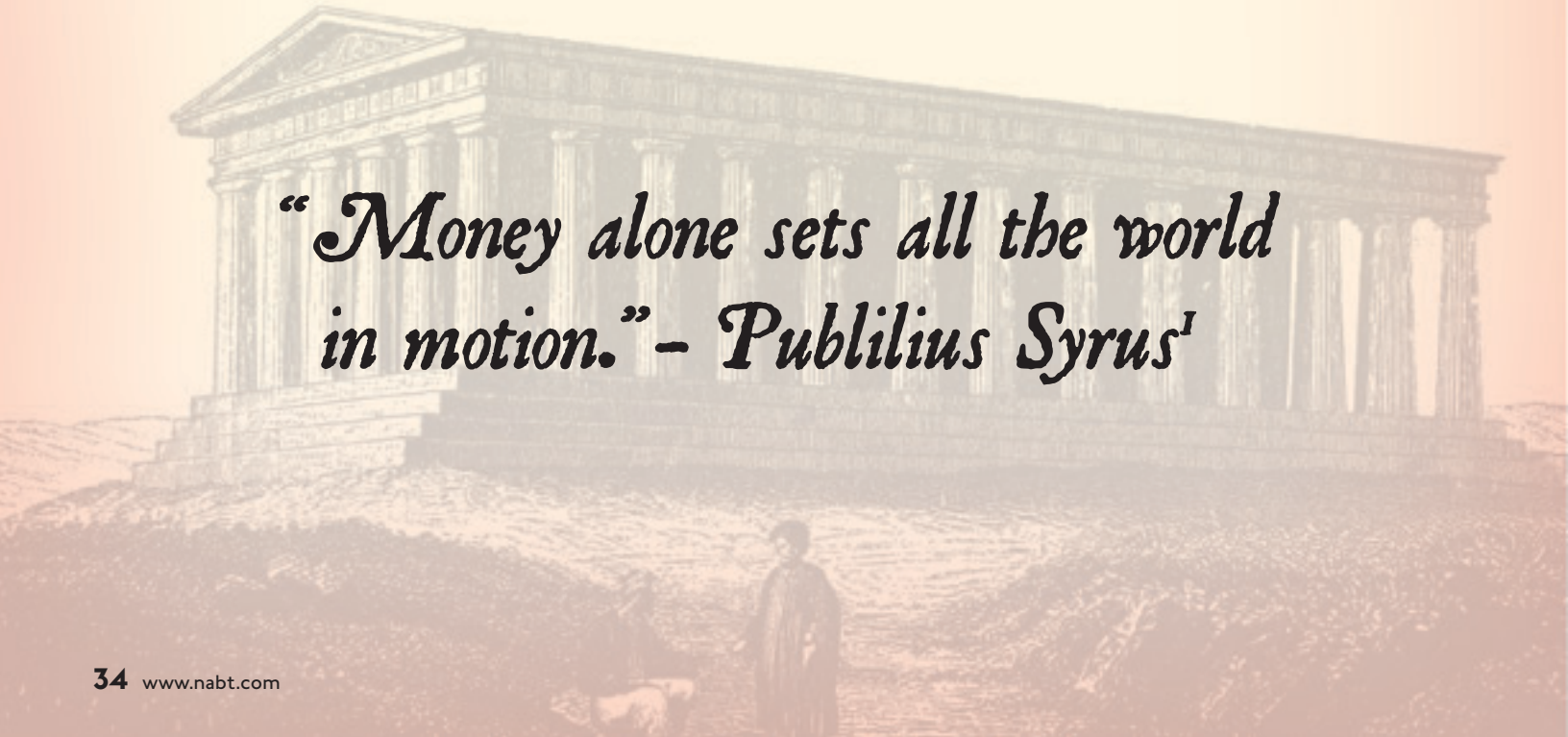
(This is the second part of a two part series about the history of bankruptcy in ancient societies. The first part generally identified the three periods of insolvency and bankruptcy, early (pre-history to 1500 AD), the middle (1500-1914) and modern (1914- Present). The prior part set forth the notion that ancient insolvency jurisprudence was surprisingly similar to that of today – presumption of insolvency, prevent of fraud, notice, an estate, administration and a discharge (sometimes). The remainder of this article will continue to examine the laws of the early period so as to set the stage for the middle and eventually the modern practice of bankruptcy.



"Money alone sets all the world in motion." – Publilius Syrus[1]

One of the earliest known bankruptcy laws was set forth in the Code of Hammurabi decreed in 1750 BC. Almost certainly the ordered and agrarian societies of Babylon had insolvency systems prior to the Code of Hammurabi, it's just that none have survived.

> "If anyone fails to meet a claim for a debt [he may] sell himself, his wife, his son, [or] daughter for money or give them away to forced labor; they shall work for three years in the house of the man who bought them…and in the fourth year be free.

The Code of Hammurabi, No. 117. An estate is created of the person; the estate is administered in the form of slavery; fraud is presumably mitigated with the threat of slavery, but after only three years of slavery one could be released of one's debts.

The bankruptcy code of ancient Rome in 450 BC consisted of the following:

> "When a debt has been acknowledged or a judgment has been pronounced in court, 30 days must be the legitimate grace period. Thereafter, arrest of the debtor may be made by the laying on of hands. Bring him into court. If he does not satisfy the judgment (or no one in court offers himself as surety on his behalf) the creditor may take the debtor with him. He may bind him either in stocks or fetters, with a weight of no less than 15 lbs (or more if he desires)."[1]

After 60 days in custody, the case is returned to the court, and if the debt is not then paid, the debtor can be sold abroad as a slave, or put to death. Indeed this law may have actually been an improvement on some of the earlier and harsher punishments of cutting the debtor's body into pieces and providing to the creditors their requisite number of shares.[2] Although with more procedural protection afforded to the ancient Romans in the form of an adjudication, the fundamental principles are the same. Indeed, time and time again we see variations of these themes repeated throughout ancient history.

In ancient Egypt, "when a debtor failed to repay his debt on time, his creditor could take him to court, where the debtor would be required to promise to pay in full by a specific date. As part of this promise - which was under oath - the debtor also pledged to undergo 100 blows and/or repay twice the amount of the original loan if he failed to pay by the date specified." There was no distinction between perjurer or a thief, they were considered one and the same.[3]

The release granted in Jewish Sabbatical Year, the day of Jubilee, is probably the closest thing to a modern bankruptcy discharge as ever existed in the ancient world.

> "At the end of every seven years you shall grant a release of debts. And this is the form of the release: Every creditor who has lent anything to his neighbor shall release it; he shall not require it of his neighbor or his brother because it is called the Lord's release."

Deuteronomy 15:1. It has been said however that this early "discharge" of sorts was practically non-existent as many people derived ingenious methods of circumvention.

Many cultures created a system based on public shaming. Ancient Hindu custom proscribed a version of punishment called "sitting d'harna." In this instance the creditor would, holding in his hand a weapon of his choosing, "sit *dharna* at the debtors door gate, until some arrangement or installment was extorted by its importunity."[4] If the debtor was to pass or attempt to molest the creditor, the creditor could then deprive the debtor of life (presumably without consequence to the creditor). This practice resulted in a house arrest of sorts. That said it is far more likely the aggressive creditor would act upon his other legal remedies and merely seize and maim the debtor, confine his wife and children, or simply take his property.[5] The Chinese engaged in a somewhat more practical version of this and instead of sitting in the sun and rain, night and day, would simply quarter themselves and their family upon the debtors until the debt was paid off.[6] Similarly in Ireland, the concept of "fasting on" would result in the creditor waiting at the debtor's door for a period of time without food. The law stated – "He who refused to cede what should be accorded to fasting, the judgment on him is that he pay double the thing for which he was fasted upon."[7]

The ancient Saxons had to apply to a shiregemot (court) to affix a date of payment and if the payment was not made only then could levy upon the debtor's property.[8] Ancient Norwegian law provided that a debtor who could not pay would present himself before the "thing" and offer himself and his relatives for the sum, beginning with the nearest relative.[9] If the relatives did not pay off the debt, the debtor belonged to the creditor until the debt was paid off. Interestingly, the debtor was only the slave of the creditor but remained a freeman as to 3rd parties, creating a specific debt caste of slavery. Unfortunately, if the debtor did not live up to the expectations of his new master, he could be killed or mutilated. "[The creditor/master] can cut where he will, high or low " – the creditor estimates the value of the limbs of the debtor and can cut them off, beginning with the smallest, in proportion to the amount of the debt.[10]

In Welsh society, if the debtor died before the time of payment but was survived by a son, the son inherited the fathers debts.[11] Somewhat related in concept, ancient Egypt enacted a law whereby a man may borrow money only if his father's body (a sacred possession) was pledged as security. If the debtor died prior to repayment of the debt, then he and his family would not be permitted internment.[12] Although seemingly trivial to our modern day sensibilities, it cannot be stressed enough the strength of this sanction on the religion-focused world of ancient Egyptians who placed enormous importance on the afterlife and all things divine.

The medieval Russians, in an attempt to establish peace and order, created a code of law called the *Pravda*. If the self-help

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remedy afforded to the creditor did not work, a jury of sorts would be convened to sort out the issue:

> "If somewhere someone seeks from another person the balance [of money owed him], but that person begins to resist, then he is to appear at an investigation before twelve men; and if he wrongfully did not give [the money] back then he is to return the money [to its rightful owner], and [pay] 3 *grivna* for the offense."[13]

In the Middle Ages of Europe, if there was fraud, the consequence was excommunication and the refusal of a religious burial.[14] In the 12th century Italy, it seems that the measure for a "fraudulent" bankruptcy (which in historical terms is synonymous with "criminal") was measured by the number of people who had been financially ruined.[15] This calculation was frequently hard to make but nonetheless important as the punishment for "fraud" would be death of the debtor. Ghengis Khan's set of laws (of which only fragments now survive) permitted two bankruptcies; a third would result in the death penalty. Given the culture of extreme violence and utter indifference to human life of the Khan's Mongols, this result was surprisingly generous.

Aside from the very public "notice" provisions of these laws, all of these ancient laws shared the concept of creation of a bankruptcy estate. Moreover, even if not expressly codified, these ancient systems also had a means to execute upon and administer the estate. The primary difference, however, is that the *corpus* of the estate constituted both the debtor individually (and sometimes his family) in addition to his personal property. Note also that insolvency was an involuntary process; the notion of a voluntary bankruptcy is very recent in human history.

Nonetheless, absent the Code of Hammurabi and the Day of Jubilee (which in many ways were thousands of years before their time), we do not see any meaningful discharge or general release afforded to the debtor other than as a result of full satisfaction. There were attempts to prohibit fraudulent conduct by the debtor with corporal punishment and religious sanctions, but there were no effective means to facilitate equitable distribution among multiple creditors. The result was not so much a race to the courthouse, but a race between creditors to get what they could from the debtor, sometimes quite literally.

Bankruptcy After the Early Period

These primitive systems of bankruptcy and insolvency continued up and until approximately the 16th century. As a result of the aforementioned shortcomings and as western civilization moved into the early modern period, most societies began to do away with such harsh remedies replacing them with something considered to be more modern and humane – the debtor's prison. England, still considering bankruptcy akin to criminal activity and a condition of moral turpitude, passed The Statute of Bankrupts in 1542.

While the debtor was no longer considered the property of the estate, he could still be physically compelled to satisfy the estate with his possessions via imprisonment. The system which developed in Russia, for example, is similar to that of most European versions of the debtor's prison. In Russia insolvent debtors were treated and punished as criminals. Debtors of the state were permitted to work for small wages that were applied to the debt. Debtors to private individuals were imprisoned and called to work on-demand, their sustenance being provided only by charitable passers-by. In southern France, as was typical, upon release from prison a debtor's after-acquired property was also applied to the satisfaction of the debt and sometimes the debtor was required to wear a green cap in order to notify the public of his insolvent condition. A debtor was permitted an exemption of sorts – one garment, but that garment could not be a cloak. [16]

(Painting by William Hogarth, A Rake's Progress, is the 7th of an 8 painting series which shows the decline and fall of Tom Rakewell, the spendthrift son and heir of a rich merchant who comes to London, wastes his money, and is imprisoned (above) in the infamous Fleet Prison.)

As time progressed, the Statute of Bankrupts was amended and supplemented but it wasn't until the 18th century that the laws gradually began to reflect something that is more recognizable to today's practitioner. William Blackstone writing in 1765 commented:

> "A bankruptcy was before defined to be a trader, who secretes himself, or does certain other acts, tending to defraud his creditors…considered merely in the light of a criminal or offender…But at present the laws of bankruptcy are considered as laws calculated for the benefit of trade, and founded on the principles of humanity as well as justice; and to that end they confer some privileges not only on creditors but also on the bankruptcy or debtor himself."[17]

Recognizing the benefits to the economy and to that of justice, Blackstone's writings evidenced the turning point in insolvency laws. In particular, the notion of a discharge was introduced in 1705 with the passage of the Statute of Anne. Though a substantial improvement on the ancients, the statute was very different from what we see today. For example, only creditors could initiate a bankruptcy petition, non-merchants could not avail themselves of bankruptcy, the discharge was conditioned upon cooperation, and creditor consent was required - to some extent negating the practical impact of the discharge. The 1732 Statute of George II which was in effect while the American 1800 Act

was passed, and furthered such notions and even permitted the debtor to retain some property as exempt.

Conclusion

Ancient insolvency systems serve as the root of our modern practice. The notion of punishment notwithstanding, there was notice, the creation of an estate, priority of creditors, security interests, and sometimes even a discharge. More importantly to the modern practitioner are the lessons to be learned by contrasting how humanity handled insolvency for thousands of years with what we do today.

Punitive systems which called for death, slavery, and an entire host of other unpleasant outcomes did very little to encourage entrepreneurial risk-taking. As a result, the already undeveloped economies stagnated and human condition progressed more slowly. When such draconian laws were abolished and reformed, societies began to experience the converse – expansion of wealth, trade, ideas, culture, literature, and generally progress out of the dark ages. A robust credit market, critical to economic prosperity, cannot exist if the participants are afraid of harsh and punitive default penalties.

Today's practitioner works within a modern set of bankruptcy laws with its roots in barter, honor, violence, and punishment. The bankruptcy jurisprudence we know today is in its historic infancy. In no other time of human history have the laws been so generous to debtors yet so carefully crafted to balance the rights of creditors. That is not to say however that all modern notions of insolvency are uniform. There is still a vast disparity of insolvency laws throughout the world. Many Scandinavian countries did not recognize the right of a discharge until the mid-1990's.

Since people will always borrow, debts will always be created, and there will be default. The historical treatment of insolvency has frequently chilled and stunted economic growth. Debtors would be reluctant to borrow given the consequences of default. Creditors would be reticent in lending due to inequitable treatment upon default. Rulers and the ambitious would exploit the inconsistency of insolvency for their own political advantage and cause further chaos, fostering yet more corruption and instability. Yet debt still existed; it always will.

FOOTNOTES:

1 Allen Johsin, Paul Coleman-Norton, and Frank Bourne, *Ancient Roman Statutes: A Translation with Introduction, Commentary, Glossary, and Index*, n. 10 , Table III - Execution and Judgment. (2003).

2 A. Arthur Schiller, *Roman Law: Mechanisms of* Development, n. 208 (1978).

3 James August Becker. *Debt Structure in the West: Money and Gift, and the Influence on Community.* Master of Arts In Anthropology thesis, University of Montana, Missoula, MT. (2011). pdf

4 Horace Williams Fuller, Thomas Tileston Baldwin, Sydney Russell W, Arthur Weightman Spencer, *The Green Bag: An Entertaining Magazine for Lawyers,* no.446 (1899).

5 Framjee R. Vicajee, Esq., *The Rule of Damdupat*, Journal of the Society of Comparative Legislation. Vol 3, n. 465 (1900)

6 *Fuller* at 446.

7 Id.

8 Id.

9 Jean Brissaud, *A History of French Private Law*, The Continental Legal History Series, Vol 3., n. 565 (1912).

10 Id.

11 Id.

12 Thomas Joseph Pettigrew, *History of Egyptian Mummies,* n. 16 (1834); Herodotus, II, 136.

13 Ferdinand Feldbrugge, *Law in Medieval Russia*, n.47 (1933)

14 Brissaud at 561.

15 Id at 563.

16 Id at 569-70.

17 2 William Blackstone Commentaries at 471.

Why We Should Not Allow Non-Attorney Petition Preparers to Practice Law

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One of the most egregious situations resulting from practice under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) is the proliferation of well-meaning petition-preparers "assisting" *pro se* filers.

Non-lawyers now finding a new business or avenue of revenue can easily make a few dollars preparing bankruptcy petitions. However, there is an enormous gap between theory and practice in this area, based on the erroneous belief that lay individuals can mitigate the cost of a bankruptcy filing that would otherwise be prepared by trained attorneys. This misconception comes from academic attempts to solve practical problems (or at worse because we don't really care!).

Significant to the problem is the strong belief that poor, uneducated debtors do not need full legal knowledge or expertise to solve their problems. Lowering the cost per se does not improve the product, or provide the full solution to problems of the needy or debt-ridden.

Human nature being what it is, leads those in control to finding the least prepared and the least committed persons, and results in a solution most lacking in understanding of peoples' rights and needs. Poor people in the process of attempts to alleviate their problems are often injured by the fruits of inadequacy, inexperience, lack of funds, and/or greed.

In his Working Paper No. 15-04, "Legitimizing Bankruptcy Petition Preparers: A Socio-Legal Prescription for Change," Michael D. Sousa, University of Denver Sturm College of Law, makes a scholarly and impassioned argument that formally licensing and regulating bankruptcy petition preparers and allowing them to provide legal advice will help low income people and ease the ever-widening access to justice gap. Unfortunately, what he is inadvertently advocating for is "separate but equal" bankruptcy assistance for poor people.

Let us look at the results of the provision of the Bankruptcy Code authorizing petition preparers (11 U.S.C. §110), to see if the debtor is helped or harmed by a system of petition preparers and *pro se* filings. At least one key question immediately surfaces: who bears the burden of avoiding negative results – the debtor?…the Chapter 7 panel trustee? …the judicial system? …Congress or maybe even the creditors?

Consideration of the principle of *qui bono* ("who benefits?") might enlighten us, or at least lead to a better procedure in the search for a more just bankruptcy system. It is not only the affluent who are entitled to thoughtful and intelligent representation, it is also the indigent, even though they have less financial resources to secure fair results.

Extolling the value and virtue of such preparer provisions may obscure the unintended harm to those most in need of greater and more concerned professional care and representation.

A beginning point of inquiry could well be that of the parties charged with the administration and the effects of such provisions. Specifically, it is the panel trustee entrusted with the conduct of the bankruptcy 341 meetings, who is obligated to determine if the debtor has complied with the Code and is entitled to a "fresh start" (via discharge). *Local Loan Company v. Hunt 292 US 234, 54 S. Ct. 695, 78 L.Ed 1230 (1934)*.

The effects of BAPCPA, the so-called Reform Law

BAPCPA was clearly anything but a "reform law" , as it is often called. While there is no arguing Sousas's point that BAPCPA negatively impacted low-income debtors, he also notes that the law drove this population to low-cost bankruptcy petition preparers. Programs cost money and, of course, attorney's fees rose due in part to the increased demands of the law.

One of the negative effects of BAPCPA has been the proliferation of petition preparers which, while creating a new business opportunity for some, served to take advantage of people struggling with debt and living in crisis. BAPCPA legitimized what had, until then, been a kind of underground industry to help people get automatic stays to stop immediate litigation. Addressing this perceived problem, Congress regulated petition preparers, clarifying that, while they could type petitions and other forms, they were prohibited from providing legal advice. Section 110 of the Bankruptcy Code enumerates the type of advice preparers cannot provide, regulates the fees they can charge and establishes damages for violating the law.

The result of Congress' actions legitimized a business model that caused some people to pay fees they don't have, for inadequate services that don't help, and, in some cases, made things worse.

Who Needs This Help?

Not all no-asset Chapter 7 clients are created equal. While it is true that most filers are in a crisis situation, often involving illness, divorce or the loss of a job, some are capable theoretically of handling a simple bankruptcy case themselves, using commercial self-help products with forms and instructions that walk debtors through their own Chapter 7 cases. These debtors own computers, are literate with at least a high school education, can follow somewhat complex instructions and advocate for themselves. These are not the people who use bankruptcy petition preparers.

As Sousa noted in his working paper, bankruptcy petition preparers serve as typists, filling out forms for people who can't. They are not allowed to answer questions or provide any legal advice. Generally, the people who use these services do not have computers. They tend to be less literate, less able to advocate for themselves and less able to understand the complexity of their situation. They need more than someone filling out forms. They need legal counsel.

About the Author

An NABT past president and Chapter 7 Trustee, Eugene Crane has been practicing law since 1954. Mr. Crane has represented debtors and creditors in reorganization and bankruptcy proceedings in and out of court. His experience in developing plans of reorganization, litigating claims, cash collateral orders, and contested actions in Chapter 11 and Chapter 7 cases has resulted in successful business and personal recovery.

His practice has always been primarily concentrated in the areas of bankruptcy, insolvency and reorganization. He has written extensively for the Illinois Institute of Continuing Legal Education and the Illinois State Bar Association, as well as other legal associations. He has been an instructor in bankruptcy skills courses for the Illinois Institute of Continuing Legal Education as well as a frequent lecturer at seminars given by the Chicago Bar Association, the Illinois State Bar Association, the National Association of Bankruptcy Trustees, the Matrimonial Lawyers Association, the North Suburban Bar Association and various commercial groups.

The need for comprehensive pre-bankruptcy counseling is significant. A Chapter 7 bankruptcy is not a solution for everyone in debt. There are a lot of reasons people shouldn't file and other reasons they should. Questions that may seem simple can easily be misunderstood by ill-educated or unsophisticated people. In addition, even if they think they understand the question, they don't necessarily understand the consequences of not answering honestly or completely

A bankruptcy attorney will typically explain why the questions are being asked at the 341 meeting, and describe the consequences of giving false information under oath, including those that go beyond bankruptcy. For instance, debtors who are contemplating divorce or think they may be getting an inheritance soon need someone who will do more than check off boxes on a form. Even poor people may have obscure assets not easily identified, such as unliquidated claims, an unexpired lease or an executory contract. Consumer debtors need a representative who will question the debtor's reasons for filing, thoroughly describe and ask about assets and then listen carefully to the answers. In addition, a knowledgeable bankruptcy attorney can recognize alternative relief for a debtor or determine a debtor's right to a cause of action against a creditor. Sometimes, an attorney may be in the position to create an asset estate to the debtor's benefit. Preparing a consumer Chapter 7 bankruptcy case is an analytical, strategic process.

Trustees in no-asset cases see unprepared *pro se* debtors every day. When a Trustee conducting a 341 meeting asks: "Who prepared the petition?", most *pro se* petitioners respond vaguely, answering, "I just looked up the forms," or "no one," or "my friend," or the like. Their filings are replete with errors. Commonly, the exemptions section is not completed. When the Trustee asks them about it, these filers look confused and say they don't know what that means. Most can't explain what a discharge is or what will happen if someone objects. They don't know what is dischargeable or how to modify their petition. Their mistakes can be costly. At the very least, the Trustee has to continue the case so they can correct their forms, costing the debtor another lost work day. At the worst, their case is dismissed, leaving them back where they started minus the filing fees and missed time from work.

Alternatives to Licensing Lawyers to Practice Law

While this article can't enumerate all of the possible solutions to the problem identified by Sousa, here are three worth discussing in some detail.

Better efficiency normally means higher profits to attorneys who view law practice solely as a business. Better business practices are always valuable but are not a substitute for providing solutions.

Low Bono. "Low bono" is the principle of increasing access to legal services for people of moderate means who cannot afford to pay standard attorneys' fees under traditional law firm models. Low bono service providers find creative ways to offer their services, including flexible pricing models, sliding-fee scales, flat fees, and payment plans, and unbundling services. Examples of successful low bono practices include law firms developed through the Chicago Bar Foundation's Justice Entrepreneurs Project (JEP), an incubator for newer lawyers to start innovative, socially-conscious law practices that provide affordable services to low and moderate-income people in the Chicago area. The JEP provides training, mentoring, other resources and support to help participants build sustainable law practices that address unmet community legal needs. JEP lawyers are building practices that offer fixed fees and flexible representation options, maximize technology and attorney-client collaboration, and leverage existing but previously untapped referral networks. In the Chicago area, JEP attorneys are able to handle lower income Chapter 7 consumer bankruptcies without the need of petition preparers.

Pro Bono. Of course, there will always be some people who are too poor for even low bono or streamlined bankruptcy practices. Many very low income debtors are elderly, ill-educated, not proficient in English and/or mentally or physically disabled. They are often in crisis and in dire need of free help. These are the clients who are likely to use petition preparers. These are also the people who would benefit most from an attorney's counsel. Unfortunately, free legal services are getting harder and harder to access. Stagnant federal funding, coupled with reduced state and local funding and more competitive private funding means that legal aid programs with limited staff are cutting back on programs, including simple Chapter 7 consumer bankruptcies. They simply are not considered a high priority for their limited budgets.

However, pro bono is a perfect remedy for these types of cases. First of all, the private bar does this type of work so there are attorneys readily capable of taking them. They don't need training and should not need much supervision. Most attorneys could fit a handful of these cases into their practice throughout the year. There really is no reason not to.

This is also a great case type to use to train newer attorneys setting out on their own who need practical experience. The cases are fairly standard and, normally, relatively simple. Attorneys can be trained and supervised by an experienced bankruptcy attorney. The volunteers gain valuable experience while the clients get free help. The legal aid program expands their capacity for limited cost. Win, win, win.

While this may seem simplistic to those who are not in tune with legal aid and pro bono programs in other parts of the country, all they need to do is check out Chicago where legal service programs continue to find innovative and practical ways to help poor clients, including debtors.

The current practice of requiring lawyers who are admitted to the Federal Trial Bar in Illinois Federal District Courts, to accept a pro bono bankruptcy case, can be expanded to apply to members of the bankruptcy bar. Volume filers of bankruptcy cases can be assigned a number of pro bono cases per year as part of their CLE obligations.

In Chicago, there are at least six non-profit agencies that will provide qualified attorneys for debtors whose incomes fall into the range of financial requirements. (Probably the vast majority of *pro se* and petition preparer filers). A licensed, trained, insured and qualified attorney provides protection and fall back to debtors due to professional responsibility and recourse under the law. Many petition preparers seen by debtors for bankruptcy filings cannot be located when needed, have no training, and are not responsible to the debtor; they cannot compensate

debtors for the improper and costly effect of erroneous advice.

Attorneys could even suggest alternative means of relief. Should lesser standards be applied by examining Trustees in unrepresented cases? Does the Trustee become responsible for the inadequate petitioner? How many times must a case be continued until all requirements are complied with by the debtor (or the harassed panel trustee gives up attempting to correct the pleadings and cannot provide a proper hearing for the debtor)?

The actual experience of the Trustee is that the *pro se* cases are not always completed. Very often the Trustee requires continuances and amendments, all of which constitutes more burdens on the debtor and less compensable Trustee time.

To lay the blame on poor, inadequate, or inexperienced bankruptcy lawyers is to overlook the real cause, which is lawyer advertising. *Bates v. Osteen 433 U.S. 350 (1969)*. Since the Supreme Court allowed attorney advertising, commercialism -- not professionalism -- runs rampant.

To say that the choice of attorneys or a "qualified petition preparer" is clear, begs the question: Why must a low-income person have such a poor choice?

A knowledgeable bankruptcy attorney could recognize alternative relief for a debtor, or recognize a debtor's right to a cause of action against a creditor, or perhaps an alternative to bankruptcy, which would stand her in better stead. It is possible that in these days of class action law suits, such a suit may exist and be joined by the debtor for his benefit. Trustees encounter situations where a debtor could have a cause of action against a creditor, third party, institution or private company, and are in the best position to create an asset estate that may benefit the debtor. As a Trustee, it is very rewarding to find such claims and causes of action that benefit both the debtor and creditor.

Looking at cost figures without regard to a debtor's obligations, rights, exemptions, and creditor disputes, only reflects part of a complex problem.

To repeat *ad nauseum*: did the *Bates/Osteen* case take attorneys out of professionalism and strictly into a business? If so, "who benefits"? Trustees, certainly not debtors, the judicial system, and not even the creditors whose lobbyists insisted on the individual cases being subject to an onerous means test.

Preparation of Documents For Filing

The laws and rules of professional conduct affecting attorneys nationally or state by state are pretty clear. If one's legal rights or interests are affected by information required by filling out forms or documents he signs, what is all this nonsense about what is or is not the "practice of law", or the "unauthorized practice of law"? By every reading of the law, lay preparers are not to render legal advice, just to provide typing (TYPING!!).

Also, amazingly and painfully to the point is why are the individuals, the financially needy, the employed poor, the target? Business debtors are exempt from the Chapter 7 means test, and exempt from many burdens imposed on individual debtors.

Now we are concerned with how to regulate the unauthorized practice of law to make it authorized? Who is kidding whom? What is the focus of bankruptcy laws: (i) a lesser law, or (ii) just lesser entitlements, rights or so-called debtor protections?

In Practice

As noted above, trustees conducting 341 meetings often find the debtors ill-informed. Very often, their exemptions are not completed, or the debtors don't understand how to complete the exemptions.

I have yet to find a *pro se* debtor who understands the terms "discharge" "objection to discharge" or "dischargeability," a "bankruptcy crime"; they typically have less understanding of most provisions of the Code.

The knowledge of what is dischargeable or nondischargeable is in another world. An attorney is licensed to practice law after appropriate education and acceptance to the bar of her state. The attorney's livelihood, professional practice and continued legal education is further bolstered by sufficient errors and omissions insurance, the fear of loss of license and professional oversight.

If a petition preparer makes a costly mistake, what is the penalty? Obviously negligible!

For us to understand whether petition preparers are engaged in the unauthorized practice of law, it is helpful to first understand what constitutes the "practice of law". A good definition is set forth in *Houston v. Morrow*, 269 Ky. 1, 106 S.W.2d 81 (Ct. App.1937) which says:

> The practice of law is not limited to the conduct of cases in Court. According to a generally understood definition of the practice of law in this country, it embraces the preparation of pleadings and other papers incident to actions and special proceedings and the management of such actions and proceedings on behalf of clients before Judges and Courts, and, in addition, conveyancing, the preparation of legal instruments of all kinds and, in general, all advice to clients and all action taken for them in matters connected with the law and an "attorney at law" is one who engages in any of these branches of the practice of law.

In addition, in *In State ex rel. The Florida Bar v. Sperry*, 140 So.2d 587, 591 (Fla.1962), rev'd 373 U.S. 379, 83 S.Ct. 1322, 10 L.Ed.2d 428 (1963), the Supreme Court of Florida formulated its definition of what constitutes the practice of law as follows:

> "...[I]f the giving of such advice and performance of such services affects important rights of a person under the law, and if the reasonable protection of the rights and property of those advised and served requires that the persons giving such advice possess legal skill and knowledge of the law greater than that possessed by the average citizen, then the giving of such advice and the performance of such services by or for another as a course of conduct constitutes a practice of law."

Much comment is made regarding the ability of paralegals working in law offices to perform many tasks as well or better than the lawyers. To some extent, it may be so, but there exists a law firm, or lawyers who bear the final responsibility and liability for error and the ability to correct, or, if necessary, compensate the aggrieved client. Debtors have recourse for malpractice,

etc., against the responsible attorney, for paralegal mistakes.

Who "Prepared" the Petition

At the creditor's meeting, conducted by the Trustee, in response to the examination questions, the common answers are revealing, such as "oh, I just looked up the bankruptcy forms and followed them to file my case." "No one helped me or charged me anything; maybe it was my friend or my cousin or whomever; I don't know their name or address or phone number," etc. etc. etc.

When a good percentage of debtors' lawyers may have difficulty understanding the forms or filling them out properly, does it strike one as odd that the uneducated debtor would know exactly what to do? For example, Question: "how did you know what your exemptions are?" Answer: "What's an exemption?"

"Have you listed all your assets and debts," the Trustee might ask. Try it this way instead. "Did you put down or list everything you own and all the bills you owe?" Still not getting across? The Trustee may try this: "property is anything that you own or have, clothes, jewelry, furniture, furnishings, autos, claims (now what could that mean?), insurance, pensions, bank accounts, etc. etc. etc."

Remember, petition preparers cannot render legal advice, but can a non-advising typist help you fill out those draconian forms?

Have those momentous bankruptcy forms made it easier for an unrepresented lay person to fill out and prepare petitions? (Of, course not!) Not to mention knowledge of the Bankruptcy Code and the debtor's duties, rights and remedies.

Has the process endeared the poor debtor to the examining Panel Trustee? (Not hardly!) (Remember, the bankruptcy judge does not conduct these hearings).

Bankruptcy Trustees are generally lawyers and still bound in their practices by the Rules of Professional Conduct in their respective jurisdictions. In Illinois, we have such rules and the American Bar Association has its annotated Model Rules of Professional Conduct (see Rules 4.3 and 5.5, for example). In addition, the various Federal District Courts have Rules of Professional Conduct and the National Association of Bankruptcy Trustees has its own Canons of Ethics (Annotated) (collectively, "Rules").

Most Rules address the unauthorized practice of law and the attorney's duties in respect thereto. Most Rules address how to deal with an unrepresented debtor (*pro se*). As an attorney, how does the Bankruptcy Code's provision for *pro se* debtors and/or petition preparers intersect with these established rules of ethics? How does a Trustee (also attorney) reply to the *pro se* debtor who asks: "what should I do," "how do I proceed," "help me fill out these bankruptcy forms?!"

One Example of What Can Happen

Here is an example taken from an actual *pro se* case:

Following claim exemptions:

Household goods	$8,000
TV and DVD	$2,500
Bikes	$700
Fur Coats	$ 1,300
Jewelry	$15
	$12,515
Auto	$ 7,005
	$19,520
Allowable Exemption under Illinois law	$ 4,000
Debtor's balance	$19,520
Allowed Auto Exemption	$ 2,400
	$13,120
	Available to the estate

Also listed was a $5,786 tax refund (Federal) and $369.69 tax refund (state). If not spent months ago for necessary household expenses, or the earned income credit was allowed, the tax refund may not be an asset.

The debtor could be faced with a Trustee demanding the non-exempt portion of amounts claimed ($13,120) or offer the claimed exemption items for sale after disallowing the overage. Many Trustees would not do that, but some could, and would. The *pro se* debtor or one using a petition preparer (who presumably does not practice law, but only types), could be asked to file amendments to claim proper exemptions or made to return many times for continued hearings, all at the loss of time and earnings.

Does being in debt reduce one to an entity not deserving of proper legal care? (I hope not!)

Do Panel Trustees replace your right to legal representation from your attorney to the Trustee (God forbid!)

Can a debtor untrained in law save their home, their car, or anything else necessary for their well-being? (Maybe, maybe not!)

The Bottom Line

America has a lot of attorneys. We don't need to start licensing attorneys to do their work. Equal access to justice is important. But, the poorer a person is, the more they need a good attorney. Poor people have enough problems just getting through life. Let's not make them sit at the back of the bankruptcy bus. There is no room for "separate but equal" in the law.

occur when a creditor on a simple contract could not acquire a judicial lien that was superior to the interest of the transferee, pursuant to §547(e)(1)(B), but that section was qualified by §547(e)(3), which provides that "a transfer is not made until the debtor has acquired rights in the property transferred." This latter Code section was determined to be dispositive. The court agreed with *In re Morehead,* 249 F.3d 445 (5th Cir. 2001), which held that in the wage garnishment context, a debtor could not logically obtain rights in her future wages until she performed the services that entitled her to receive those wages. Because the transfers were not made until the debtor had acquired rights in the property transferred, and the debtor could not obtain such rights until performing the services that entitled the debtor to receive those wages, the transfers were determined to have occurred within 90 days of the petition date and were therefore avoidable. In reaching this holding, the court specifically rejected three cases (that pre-dated *Barnhill*) that had held that a transfer of garnished wages occurred at the time the garnishment was served on the employer. The court noted that all three of the cases had been roundly criticized, and it declined to follow them. See *In re Conner* 733 F.2d 1560 (11th Cir. 1984); *In re Coppie,* 728 F.2d 951 (7th Cir. 1984); and *In re Riddervold,* 647 F.2d 342 (2d Cir. 1981).

§§502 and 510(b)

Trustee unsuccessful in recharacterizing or subordinating loan

In re Deer Valley Trucking, Inc., 2017 WL 978989 (Bankr. D. Idaho 2017) (Pappas, J.)

The debtor trucking company was founded by Jason Duncan. It took out a "Winch Truck Loan" and "Equipment Loan" from JD Farms, LLC, an entity owned by Jason's parents, the Duncans. JD Farms later assigned the loans to Duncan Limited Partnership ("DLP"), an entity also owned by the Duncans. The debtor began its loan payments to DLP in June 2012, but the debtor fell into default after November 2012. The debtor also entered into a "Factoring Loan" in 2010 when Jason had an opportunity to expand the debtor's business. Jason asked his parents to invest in the debtor, but they declined. However, they did agree to make the "Factoring Loan" so that the debtor could timely pay its drivers and fill the gap created by the delay the debtor experienced in receiving payment from its customers. The Duncans agreed to make the Factoring Loan because they were attracted by the 25% interest rate. For Jason, it allowed him to replace a higher interest factoring loan. Payments were made on the Factoring Loan until June 2012. All three loans had originally been oral agreements. They were formalized in September 2012 through the execution by the debtor of promissory notes. Because the debtor was obtaining financing from GE Capital, GE required that DLP subordinate its interest to the GE Capital financing. The debtor filed for a chapter 11 petition in 2015 and it was later converted to chapter 7. When DLP filed a proof of claim of approximately $2.4 million under the three loans, the chapter 7 trustee objected. Ultimately, the trustee sought to recharacterize the Factoring Loan from debt to equity or, in the alternative, to subordinate it under §510(b). Finally, the trustee sought to disallow pre-petition interest on all three loans. The bankruptcy court ruled against the trustee.

The court recognized that under *In re Fitness Holdings Int'l, Inc.,* 714 F.3d 1141 (9th Cir. 2013), a court was authorized to recharacterize a debtor's obligation under state law principles if the obligation owed by the debtor was not a "claim" for purposes of bankruptcy. Under Idaho state law, courts could recharacterize "loans" as capital contributions based on the intent of the parties regardless of the label assigned to their transactions. However, the court found that the Factoring Loan was clearly a loan and not an equity investment. Indeed, the Duncans had declined the chance to invest in the debtor. Instead, they were persuaded to extend a loan by its attractive terms, and the money advanced was used by the debtor in its corporate operations. Although the Factoring Loan was originally an oral agreement, the subsequent promissory note described a credit transaction in no uncertain terms. Moreover, if the advances were an equity advancement, there would have been no need for a subordination agreement. As to subordination, the trustee argued that the oral agreement constituted an investment contract under *S.E.C. v. W.J.Howey Co.,* 328 U.S. 293 (1946) and *United Hous. Found., Inc. v. Forman,* 421 U.S. 837 (1975). But the court determined that the oral agreement failed the third prong of the test for subordination because there was no reasonable expectation of profit. DLP merely expected to recover the funds advanced, plus interest, regardless of the debtor's financial success. The court also rejected any disallowance of pre-petition interest because the notes explicitly provided that interest was to accrue on the loan balances beginning on the effective date of the notes, regardless of when the payments were to commence.

[*Author's comment*: Trustees and others seek to recharacterize debt to equity not only to deny the validity of the claim, but also to turn loan repayments outside of the preference recovery period into avoidable fraudulent transfers. But these cases always turn on their specific facts and on the subject documents.]

§362(a) and O.C.G.A. §44-14-161

Foreclosing creditor retains deficiency claim

In re LaPrade's Marina, LLC 566 B.R. 84 (Bankr. N.D.Ga. 2017) (Sacca, J.)

Secured creditor Multi-Bank filed a $6.2 million secured proof of claim in the debtor's chapter 11 case. After the debtor was unable to confirm a plan, the court granted Multi-Bank's stay relief motion to permit and authorize it to pursue its rights and remedies under the terms of its loan documents and state law, including non-judicial foreclosure proceedings. The debtor and Multi-Bank had stipulated the value of the collateral at $3.3 million. Multi-Bank conducted the non-judicial foreclosure sale, with an affiliated entity of Multi-Bank winning the bid at $4.5 million. Multi-Bank then asserted an unsecured deficiency claim for $1.39 million. Various parties in interest objected to the claim, arguing that it was entitled to no deficiency because it had neither sought nor obtained a judicial confirmation of the foreclosure sale within 30 days after the sale was conducted, as required by Georgia law. O.C.G.A. §44-14-161. Multi-Bank re-

sponded that the automatic stay had not been modified to pursue confirmation and that the bankruptcy court had jurisdiction to determine the deficiency from the sale rendering a state court proceeding unnecessary. The bankruptcy court agreed with Multi-Bank and denied the objection to its claim.

The court agreed that Multi-Bank had never sought nor obtained relief from the automatic stay to file an action in state court to confirm the foreclosure sale and, thus, the automatic stay effectively tolled the 30-day requirement. The court agreed with the holding in a similar case, *In re Virginia Hill Partners 1,* 110 B.R. 84 (Bankr. N.D.Ga. 1989) where the stay relief order's language was determined not to be broad enough to lift the stay with respect to confirmation of the foreclosure sale. In that case, it was noted that the foreclosure relief was an action against the property, but the deficiency claim was an action against the debtor. The stay relief order in that case was determined not to be broad enough to lift the stay with respect to confirmation of the sale because the allowance of claims, including deficiency claims, was within the bankruptcy court's exclusive jurisdiction. Further, Multi-Bank's failure to report the sale within 30 days, regardless of whether or not the stay relief order had allowed it to do so, was not fatal to its ability to maintain a deficiency claim under Georgia law because the 30-day period would not begin to run until either the bankruptcy case was dismissed or the court lifted the automatic stay, under controlling Georgia state law. *Breeze v. Columbus Bank & Trust Co.,* 448 S.E. 2d 276 (Ga. App. 1994). Finally, the court determined that it had the authority to determine the issues in the foreclosure confirmation proceeding within the context of the claims allowance process in the bankruptcy case in reliance on *FDIC v. Windland Co.,* 245 Ga. 194 (1980), which held that O.C.G.A. §44-14-161 could not operate to deprive federal courts of jurisdiction to confirm a foreclosure sale in a case which was otherwise subject to federal jurisdiction.

[*Author's comment:* In many non-judicial foreclosure states, there is a similar requirement that the foreclosure sale be confirmed by the state courts in order to preserve the right to a deficiency. Stay relief motions are granted daily in these jurisdictions, but it is rare for the foreclosing lender to seek confirmation of the sale to preserve a deficiency claim in a chapter 7 case. However, it does happen in large asset cases. Historically, the fair market value of an underlying residential property would have exceeded the loan amount anyway. However, when the meltdown occurred, property values throughout the country fell below the outstanding mortgages, resulting in a massive number of sale confirmation actions. That economic anomaly has largely been corrected with home prices returning to former levels or higher in many parts of the country. This should lead to a reduction of sale confirmation proceedings.]

§501(a)

Unobjected to claim in no asset case not a final adjudication

Kipp Flores Architects, LLC v. Mid-Continent Casualty Co. 852 F.3d 405 (5th Cir. 2017)

Kipp Flores Architects, LLC ("KFA") was to be paid by Hallmark Designs for the homes it designed under certain licenses. When they failed to pay, KFA sued for copyright violations. The Hallmark entities both filed chapter 7 bankruptcy cases that were initially indicated as "no asset" cases. Two months later, the trustee in the Hallmark collection case caused notice to issue that it appeared that assets might be available and that claims were to be filed within 90 days. KFA timely filed a proof of claim. The bankruptcy court had set no deadline for objecting to claims, and no party in interest did object nor did the bankruptcy court ever enter an order allowing or disallowing the claim. Ultimately, the trustee determined that it was a no asset case and submitted a no asset report and the case was closed. Meanwhile, KFA proceeded with its copyright lawsuit against Hallmark Design and other defendants that ultimately resulted in a $3.2 million damage award. It asserted an unsecured claim in that amount in the Hallmark Design case. After further litigation, the insurer of Hallmark Design and Hallmark Collection, Mid-Continent Casualty, paid KFA $3 million on the claim allowed in the Hallmark Design case. KFA then made demand for Mid-Continent to pay KFA's "final judgment" in the Hallmark Collection case, contending that because no party had objected to its claim, it was "deemed allowed under §502(a)," and became a final judgment sufficient to trigger Mid-Continent's duty to indemnify its insured. The 5th Circuit Court of Appeals agreed with Mid-Continent that no final judgment resulted in the no asset case. The Bankruptcy Code read as a whole provides that proofs of claims may be filed and become subject to bankruptcy court adjudication in the claims process only when assets are available or thought to be forthcoming for distribution. After learning that the Hallmark Collection bankruptcy was a no asset case, Mid-Continent had no reason to ascertain that KFA had even filed a proof of claim much less object to it.

§707(b)

Debtor's counsel ordered to pay trustee's fees and costs in successfully prosecuting a §707(b) motion

In re Beinhauer, 2017 WL 1373254 (Bankr. E.D.N.Y. 2017) (Scarcella, J.)

The debtor's schedules showed monthly gross income of $6,053 and payroll deductions of $2,358, including mandatory contributions for retirement plans of $363.22 and "required repayment of retirement fund loans" of $258.31. The debtor listed $0 for "voluntary contributions for retirement plans." The debtor also scheduled monthly expenses of $3,934, which left her with a monthly deficit of $239. She had also scheduled two bank accounts with balances totaling $4,800. The trustee requested, and the debtor provided, copies of her financial records, including, bank statements and canceled checks. The trustee reviewed these documents and thereafter moved to dismiss the case pursuant to §§707(b)(1) and (3), asserting that the debtor had monthly net income of $1,636. The trustee made this determination after concluding that the retirement plan contributions and retirement loan repayments were voluntary and should have been included in her disposable income along with financial contributions from her husband. The trustee also sought an award of fees and costs pursuant to §707(b)(4). The debtor did not oppose the dismissal motion, so the only issue before the court was whether the debtor's attorney was liable for payment of the trustee's fees and costs based on a failure to make a reasonable independent investigation into the debtor's income and expenses in violation of

§707(b)(4)(C). The trustee asserted that the debtor's pay stubs and bank statements revealed that the debtor's retirement fund contributions and retirement loan payments were not mandatory and that debtor was receiving financial assistance from her husband. The attorney essentially blamed the debtor for the errors, asserting that he had asked the debtor for more information, but she failed to provide it to him and also did not tell him that she was engaged (and married a few weeks after the petition date). The trustee contended that the attorney never asked for the information from the debtor until after the trustee had requested it. Regardless, the court determined that by scheduling the payments as being mandatory, counsel made a representation that they should be excluded from the debtor's disposable income. This apparently had no factual support. Moreover, an engagement ring valued at $1,000 was scheduled, which should have led counsel to inquire further about the debtor's marital status, household size, and possible contributions from the fiancé or spouse. Additionally, the debtor's primary bank account statements showed that it was a joint account in the name of the debtor and her fiancé (later spouse) and showed direct deposits from both the debtor's employer and a second employer.

Section 707(b)(4)(C) states: "The signature of an attorney on a petition … shall constitute a certification that the attorney has … performed a reasonable investigation into the circumstances that gave rise to the petition … and determined that the petition … is well-grounded in fact and is warranted by existing law or a good faith argument for the extension, modification or reversal of existing law …." The court observed that a reasonable investigation is determined on a case-by-case basis. "The attorney must independently verify publicly available facts to determine whether the client's representations are objectively reasonable and investigate further, if any inconsistencies are raised, by asking questions, obtaining additional documents, or by some other means." Here, the court found that the attorney failed to conduct a reasonable investigation. An attorney "cannot absolve himself of the duty to conduct a reasonable investigation under Section 707(b)(4)(C) by affirmatively allowing clients to bring in only the bare minimum of information and then claiming that it is not his fault that he did not have sufficient information to review." Accordingly, the court ordered the attorney to reimburse the chapter 7 trustee for the fees and costs incurred in prosecuting the motion for dismissal against the debtor.

[*Author's comment:* The minimal investigation shown here is standard operating procedure for many debtor attorneys throughout the country. However, most trustees refer these matters to the UST for further action. Such referrals often lead to dismissals with prejudice (but sometimes for only six months) and disgorgement of counsel fees under §329. BAPCPA introduced the ability of the case trustee to bring the action and be repaid fees and costs by the debtor counsel when successful. It would seem that bringing such action would immediately place the debtor's counsel into a conflict situation in terms of representing the debtor on the dismissal issue itself. Because many trustees are operating with shrunken case dockets, they may now have the time to bring these actions where justified rather than simply refer them to the UST. On balance, it is believed that most trustees will continue to refer them to the UST.]

§503(b)(3)(D)

Court allows chapter 7 administrative expense claim for "substantial contribution"

In re Maqsoudi, 566 B.R. 40 (Bankr. C.D.Cal. 2017) (Houle, J.)

The chapter 7 trustee successfully avoided the debtor's undisclosed transfer of real property to defendant within one year of the petition date. Thereafter, trustee obtained court approval and sold the property. The trustee remitted from the sale proceeds $210,000 to creditor Mayar. Mayar then filed a motion for payment of administrative expenses. The focus was on whether Mayar could qualify for an administrative expense claim based on having made a "substantial contribution" to the case. The pertinent statute is §503(b)(3)(D) which provides in pertinent part: (b) After notice and a hearing, there shall be allowed administrative expenses …, including - - (3) the actual, necessary expenses, … incurred by - - (D) a creditor, … in making a substantial contribution in a case under Chapter 9 or 11 of this title." The court relied on *In re Connolly N. Am. LLC,* 802 F. 3d 810 (6th Cir. 2015) which was a split panel decision that allowed recovery of an administrative expense for a substantial contribution in chapter 7. That split decision had created a conflict in the circuits which had previously not permitted such a recovery given the limiting language of the statute to cases under chapters 9 or 11 only. In that decision, the dissent had noted that 86% of bankruptcy courts or district courts had denied an administrative expense for substantial contributions in a chapter 7 case, while only 14% had reached the conclusion of the 6th Circuit. Like the 6th Circuit, this court believed that the word "including" gave it the discretion to award an administrative expense claim for substantial contribution even in a chapter 7 case. The court found that the applicant had substantially assisted the trustee in successfully maintaining the adversary proceeding that resulted in the recovery and sale of the property which had produced a surplus estate. The court, nevertheless, reduced the amount of the administrative claim sought to only those services which were performed for the estate's benefit as opposed to the benefit of the applicant, Mayar. Thus, the court allowed an administrative claim of $8,491.02.

[*Author's comment:* We reported on the 6th Circuit opinion when it was first issued and predicted that it would create problems like this. Prior thereto, almost every court had determined that the limiting language to allowance as an administrative claim only in chapters 9 or 11 for a substantial contribution would result in trustees being barraged with such claims that would deplete estate resources in defending against them. Of course, one has to wonder whether this was driven primarily by the fact that it was a surplus estate, and the court was not anxious to see the debtor receive additional funds after having fraudulently transferred the property and failing to disclose the transfer in the SOFA.]

Barton Doctrine

Barton Doctrine extended to trustee's counsel

Lankford v. Wagner, et al., 853 F.3d 1119 (10th Cir. 2017).

The Lankfords had profited from their investment in the Vaughn Company's

interest-bearing promissory notes, which were actually issued as part of a Ponzi scheme. After the Ponzi scheme collapsed, Vaughn Company filed for chapter 11 relief in New Mexico. The appointed trustee commenced adversary proceedings to claw back the fictitious profits from investors like the Lankfords who received net gains from the Ponzi scheme. The Lankfords accused the trustee of extortion, incompetence and fraud. The bankruptcy court twice denied their formal requests under the *Barton* doctrine to file counterclaims on those grounds and ultimately granted the trustee summary judgment, accepting her calculations that the Lankfords owed the estate $45,939, and that David Lankford individually owed $21,465. The Lankfords moved to vacate the summary judgment, which was denied. They then appealed the order denying their motion to vacate but did not appeal the summary judgment order itself or the two denials of their requests to file counterclaims. The district court affirmed. Instead of appealing further, the Lankfords commenced a civil lawsuit in district court against the trustee and her counsel, accusing them of committing fraud and violating criminal statutes during the prosecution of the adversary proceeding. The magistrate judge concluded that the *Barton* doctrine precluded their claims and recommended dismissal for lack of subject matter jurisdiction. The district court adopted those proposed findings and recommended disposition, and dismissed the lawsuit. The circuit court affirmed, holding that the *Barton* doctrine applied because the actions underlying the Lankford's claims were related to the trustee's and her counsel's duties in the administration of the estate, to which no applicable exception was established. The circuit court determined that the Lankfords could not circumvent appellate procedural rules by filing a separate lawsuit to collaterally attack the bankruptcy court's summary judgment ruling nor were the alleged criminal violations proper areas of inquiry in a civil lawsuit by private citizens against the trustee and her counsel. In *Satterfield v. Malloy*, 700 F.3d 1231 (10th Cir. 2012), the 10th Circuit followed other circuits and extended the *Barton* doctrine beyond receivers to encompass bankruptcy trustees. Now the 10th Circuit followed the three other circuits in extending the doctrine to trustee's counsel or counsel when acting under the direction of, or as the functional equivalent of, the trustee. Otherwise, the protection afforded by the leave requirement would be meaningless if it could be avoided simply by suing the trustee's counsel, thereby following *McDaniel v. Blust*, 668 F.3d 153 (4th Cir. 2012); *Lawrence v. Goldberg*, 573 F.3d 1265 (11th Cir. 2009); and *Allard v. Weitzman (In re Delorean Motor Co.),* 991 F.2d 1236 (6th Cir. 1993).

[Author's comment: As more debtors, particularly *pro se* debtors, aggressively seek to pursue the trustee and trustee's professionals, the expansion of the *Barton* doctrine is a welcome development.]

LLC's

Virginia Code Ann. §13.1-1023 (V.)(1) and 13.1-1050.2(c)

Trustee for individual members of LLC could void sale of interest in LLC that violated the LLC's operating agreement

In re Kang, 664 Fed. Appx. 336 (4th Cir. 2016)

Debtors were the sole members of two LLCs that were the sole members of a third LLC that was created for the sole purpose of acquiring, developing, and managing a retail shopping center in Centreville, Virginia. The operating agreement for that LLC provided that its owners could not transfer more than a 49% interest therein, could not incur debts outside the ordinary course of business, and could not encumber the property with additional security interests. Nevertheless, in a 2009 transaction, the debtors agreed to effectively sell 60% of their interest in the subject LLCs to two other individuals, in direct violation of the terms of the operating agreement. When the chapter 11 case was filed the following year, the official committee of unsecured creditors, and later the appointed trustee, sought to reverse several transactions as being void and in violation of the operating agreement. The bankruptcy court entered a declaratory judgment invalidating the transfer of the ownership interest. The district court affirmed. On further appeal, the circuit court likewise affirmed.

The defendants argued that the trustee did not have standing to challenge the transactions, because the trustee's interest was only in the debtors' two LLCs which were the members of the subject LLC, rather than the debtor being the member of the subject LLC itself. The court rejected that argument because under Virginia law, the property of cancelled LLCs passed automatically to the managers, members, or holders of interest who would then act as trustees in liquidation to distribute the company's assets after the LLC was wound up and all liabilities and obligations were satisfied. Here, the LLCs in which the debtors were members had been cancelled as of December 31, 2008, for non-payment of annual registration fees. Thus, the trustee, stepping into the debtors' shoes, had standing to pursue the claim that the 2009 sale was null and void. Defendants next argued that one of the members of the subject LLC had never agreed to the operating agreement. However, the court observed that membership in an LLC was a matter of assent and a person could not become a member without agreeing to do so. Here, that individual had never agreed to be a member and knew nothing about the LLC according to his testimony. Most importantly, the court held that under Virginia law, an operating agreement bound the parties to the agreement, and actions that violated it were null and void because they exceeded the scope of authority conferred by the operating agreement. The court observed that companies that engaged in transactions with an LLC appropriately looked to these agreements during the due diligence process to determine such authority. Actions taken outside the authority conferred by the operating agreement were thus *ultra vires* and without legal effect.

[*Author's comment:* Although this opinion was not published, it contains important discussions about the standing of the trustee to challenge more remote interests in an LLC whose members were other LLCs that had as their members the debtors.]

§105

Pre-filing injunction against vexatious *pro se* litigants approved

In re Carroll, 850 F.3d 811 (5th Cir. 2017)

In a case converted from chapter 13 to chapter 11 and then to chapter 7, the chapter 7 trustee sought (a) a declaration that the debtors and their adult daughters

were vexatious litigants and (b) the imposition of sanctions. The bankruptcy court had entered a 22-page thorough opinion that detailed a series and pattern of harassment, attempts to frustrate property sales, two attempts to remove the trustee that were wholly unsupported by any evidence, and failures to pay prior ordered sanctions. The bankruptcy court determined that the true motive of the debtors and their daughters was to "harass the trustee and thereby delay the proper administration of the estate in the hope that they would be able to retain their assets, or make pursuit of the assets so unappealing that the trustee would be compelled to settle on terms favorable to [them]." The bankruptcy court found that they were bad-faith filers and that the failure to pay previous contempt sanctions ordered against them demonstrated "that monetary sanctions alone will not deter them." The bankruptcy court then enjoined them and anyone acting on their behalf from filing any pleading or document in this case or its associated cases or adversary proceedings and from filing any future cases in the bankruptcy court for the middle district of Louisiana, without first obtaining bankruptcy court permission. The bankruptcy court further assessed monetary sanctions under §105 in the amount of $49,432 representing the attorneys' fees incurred in defending against the actions of the debtors and their daughters. The district court issued a similarly detailed 25-page opinion affirming the bankruptcy court. The Circuit Court likewise affirmed.

The circuit court began its review by noting that federal courts have inherent powers, including authority to sanction a party or attorney when necessary to achieve the orderly and expeditious disposition of their dockets. They further have the authority to enjoin vexatious litigants under the All Writs Act, 28 U.S.C. §1651. Moreover, under §105, "a bankruptcy court can issue any order, including a civil contempt order, necessary or appropriate to carry out the provisions of the bankruptcy code." To enjoin future filings, the court was required to consider four factors: (1) the parties' history of litigation and whether vexatious, harassing, or duplicative lawsuits were filed; (2) whether the party had a good faith basis for pursuing the litigation, or simply intended to harass; (3) the extent of the burden on the courts and other parties resulting from the parties' filing; and (4) the adequacy of alternative sanctions. The circuit court rejected the appellant's argument that sanctions could not be imposed against them because they were *pro se* litigants. That was simply incorrect. Next, they rejected the appellants' challenge to the bankruptcy court's findings that they acted in bad faith, as the circuit court determined that the finding of bad faith was well supported by their engagement in conduct intended to harass and delay by repeatedly attempting to litigate issues that had been conclusively resolved against them or that they had no standing to assert and by their further unsupported and multiple attempts to remove the trustee. The sanctions of $49,432 represented the amount of attorneys' fees incurred by the trustee in responding to the bad faith conduct of the debtors and their daughters. Finding all of these rulings to be well supported, the circuit court affirmed the lower courts.

[*Author's comment:* Trustees are encountering with more frequency vexatious *pro se* litigants. They pay no attorney fees and are not deterred for economic reasons. It is not even certain that this trustee will be able to collect these sanctions ordered (twice). For that reason, the pre-filing injunction is sometimes more helpful than the award of sanctions. In other instances, trustees do indeed "throw in the towel" and just determine that it will not be cost effective to continue on with actions that would be pursued in a normal case.]

§554(c)

Trustee could not unilaterally prevent abandonment of scheduled asset upon case closing

In re Wright, 566 B.R. 457
(6th Cir. BAP 2017)

Debtor had listed his PI claim against Simms in Schedule B, reflecting injuries sustained from a fall while under Simms' employ. He listed the value as "unknown" and no exemption was claimed. The debtor later amended Schedule B to value the claim at $21,625, but still claimed "0.00" as the exemption. A related workers comp claim was never scheduled. Trustee obtained a court order to employ the debtor's PI attorney as special counsel. A year after the PI lawsuit was filed, the trustee filed an NDR certifying that the estate had been fully administered "with the exception of a possible settlement in connection with a personal injury claim" against Simms. The NDR further stated: "the above-referenced settlement shall remain property of the bankruptcy estate upon the entry of a final decree; if money becomes available to creditors from this asset, the case will be reopened and a trustee will be appointed to administer the asset." The bankruptcy court entered the final decree closing the case and discharging the trustee without setting forth any reservations regarding the PI claim. Almost two years later, the trustee filed a motion to reopen the case, asserting that special counsel had notified her of a substantial settlement of the PI action. The debtor objected on the basis that the estate's interest in the PI litigation had been abandoned by the trustee. An agreed order was entered reopening the case but reserving the debtor's argument concerning abandonment. The trustee then withdrew the NDR, had special counsel reinstated over the debtor's objection, and presented a motion to compromise the PI claim for $180,000. The motion set forth that the debtor would be paid the maximum PI exemption of $21,625, even though the debtor had never filed a claim of exemption. The debtor again objected on the basis of abandonment and also asserted that the settlement was a global settlement encompassing the workers comp claim. The bankruptcy court found the claims were not abandoned and approved the settlement. On appeal, the bankruptcy appellate panel reversed (a) the finding that the PI claim was not abandoned and (b) the approval of the settlement.

Section 554(c) provides:

> Unless the court orders otherwise, any property scheduled [and] not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title." (Emphasis added.)

The court observed that this form of abandonment was referred to commonly as "technical" abandonment but stated that the more precise legal description was that it was an abandonment "by operation of

law." The court noted that cases were divided over whether a technical abandonment could be revoked, with many courts providing flexibility and relief in limited circumstances under a Rule 60(b) analysis. However, here, the issue was even narrower: whether an abandonment had occurred at all upon entry of the final decree. Finding that the language of the statute was plain, the absence of a court "ordering otherwise" was dispositive. The trustee could have proceeded under §554(c) to ask the court to "order otherwise" but did not do so in this case. Therefore, the "bankruptcy court erred as a matter of law by holding that the trustee did not abandon the personal injury claim pursuant to 11 U.S.C. §554(c)." (*Id.* at 463) Finally, the appellate court agreed with the bankruptcy court that the unscheduled workers comp claim was not abandoned even though the trustee had knowledge of it. The court would not imply any form of judicial estoppel against the trustee recognizing that some courts had done so. Accordingly, the bankruptcy court was affirmed on finding that the workers comp claim was not abandoned but reversed on its finding that the PI claim was not abandoned and its approval of the settlement motion.

[Author's comment: It is hard to find fault with any of the court's analysis. §554(c) is clear and the procedure to close the case while preserving a scheduled asset is straight forward. However, it is troubling that there have been courts that treat unscheduled assets as abandoned if the trustee knew about them. This is contrary to the same statute. Appellate courts have gone so far as to hold that lawsuits listed in the SOFA do not qualify as being "scheduled," and are not abandoned upon the closing of a case. The most prudent course is to reserve the asset whether listed in either the schedules or the SOFA.]

§326(a) and (c) and §330(a)

Court orders proration of commission between original and successor trustees

In re Turner Grain Merchandising, Inc., 568 B.R. 96 (Bankr. E.D.Ark. 2017) (Jones, J.)

Following the conversion of the debtor's case from chapter 11 to chapter 7, the DIP bank account in the amount of $619,251.39 was turned over to the original trustee (Cox). Additionally, $240,059.30 was received by Cox from an accounts receivable action originally filed as an interpleader in the district court, and a further recovery was made by adversary proceeding against a bank in the amount of $314,688.38. Cox made two disbursements to a secured creditor in the total amount of $840,051.79, plus paid $4,869.52 for bank and technology service fees, for total disbursements of $844,921.31. Approximately a year after his appointment as trustee, Cox resigned (for reasons unstated) and transferred the remaining funds in the amount of $329,077.76 to the successor trustee (Rice). Cox applied for reimbursement of expenses (which were not contested) and a trustee commission of $45,496.07 based on the compensation percentages set forth in §326(a). Cox asserted that he should be entitled to the higher percentages under the sliding fee scale of §326(a) based on the theory of "first in, first out," ("FIFO"). By applying the higher percentages at the front end, he would be entitled to the commission amount sought. Rice objected, noting that Cox had prosecuted only a single adversary proceeding while he had already filed forty-six adversary proceedings and would be incurring the cost associated with a multi-year administration of the case. Rice sought to have the commission calculated on a prorated basis as being fairer under the circumstances. The court agreed.

First, the court noted that under §326(c) where "more than one person serves as trustee in a case, the aggregate compensation of such persons for such service may not exceed the maximum compensation prescribed for a single trustee." However, neither that Code section nor any other addressed the question of how to apply the sliding fee scale. The court recognized that if Cox received the maximum commission sought, he could receive a higher fee than Rice who would probably serve several times longer and shoulder a much greater administrative burden. Indeed, Rice would have to recover an additional $1,084,071.91 and disburse $1,413,149.67 to creditors in order to be entitled to receive the same amount of fee that Cox was requesting. The court found that extraordinary circumstances were present to rebut a presumption of reasonableness of the trustee fee being requested by Cox. The court noted the potential for distorting the statute's purpose by overcompensating the first trustee and under compensating the second trustee, leaving neither reasonably compensated under the requirements of §§326 and 330. Ultimately, the court agreed with Rice that under the circumstances of this case, the proper methodology was that set forth in *In re Calhoun*, 30 B.R. 536 (Bankr. W.D.Wis. 2010). In that case, Judge Martin had determined the aggregate trustee fee under §326(a) and then prorated between the two trustees by dividing each trustee's distributions by the total amount distributed in the case and not using the FIFO approach. The court here found this to be "the most equitable way to apportion the aggregate trustee fees between Cox and Rice, given the facts and circumstances of this case." However, as the *Calhoun* decision had recognized, the court agreed that this method would typically require waiting until the end of the case when all of the disbursements had been made for the compensation amounts to be determined. Accordingly, the total trustee commission was to be prorated between the two trustees at the end of the case by dividing each trustee's distributions by the total amount distributed in the case.

[*Author's comment:* We commented on the *Calhoun* opinion when it was issued in 2010 as often providing the most equitable way to divide the commission where trustees could not otherwise reach agreement. Both this case and *Calhoun* had fact patterns that would have prejudiced the successor trustee under a FIFO approach. Another potential approach is to prorate based on time rather than disbursements. However, the trustees in this case preferred a disbursements-based methodology because time records apparently had not been maintained (nor are time records kept by most trustees throughout the country).]

§544(b) and 28 U.S.C. §3304(a)(2) and §3306(b)(3)

Trustee seeks to apply two-year reach-back on insider preferences under F.D.C.P.A.

In re Alpha Protective Services, Inc.: (1) *Gordon v. Rogich* 2017 WL1487621; (2) *Gordon v. Security Essentials, Inc., et al.* 2017 WL 1487620; and (3) *Gordon v. Hackenberry* 2017 WL 1458858 (Bankr. M.D.Ga. 2017) (Laney, J.)

In three separate lawsuits, the trustee sued Rogich, Hackenberry, and Hacken-

berry's wholly-owned business, Security Essentials, Inc. to avoid transfers to the individuals in repayment of antecedent debts more than a year but less than two years before the chapter 11 petition date, and against the business for both pre-petition payments within and outside of the 90-day reach back under §547 and for unauthorized post-petition transfers under §549. Because the transfers to the individuals were in satisfaction of an antecedent debt, there could be no fraudulent transfer. Also, the transfers were 14 and 15 months, respectively, before the petition date. Therefore, the normal reach back under §547 was not helpful to the trustee. Hence, the trustee sought recovery under the 2-year reach back under the Federal Debt Collection Procedures Act ("FDCPA") based on the IRS being a substantial creditor of the debtor both at the time of the transfers and on the petition date. In an earlier lawsuit in the same case, the court had determined that the FDCPA was applicable to reach back six years for avoidance of a fraudulent transfer. *Gordon v. Harrison (In re Alpha Protective Services, Inc.)* 531 B.R. 889 (Bankr. M.D.Ga. 2015).

The court first noted that in order to prevail, the trustee had to satisfy the three elements set forth in 28 U.S.C. §3304(a)(2) as follows: (1) "the transfer was made to an insider for an antecedent debt;" (2) "the debtor was insolvent at the time of the transfer;" and (3) "the insider had reasonable cause to believe that the debtor was insolvent." Both individuals were held to be insiders because they were directors of the debtor corporation at the time of the transfers. The trustee was granted partial summary judgment as to that element. With respect to the other two elements, the trustee demonstrated that Bank of America had frozen the debtor's operating account immediately prior to the petition date due to a garnishment from a creditor based on a federal court judgment in the amount of over $1.8 million, obtained prior to the transfers. The trustee also established that the IRS had been owed at the time of the transfers approximately $170,000 for withholding taxes and within two months of the transfers approximately $420,000 more in additional taxes. Hackenberry advanced $110,000 to the debtor to help cover a payroll for February, 2011. He was repaid in full less than three weeks after the advance. Rogich advanced $100,000 to help cover a payroll for March, 2011 and was repaid in full approximately six weeks after the advance. The court observed that the FDCPA defined "Insolvency" in the same manner as the Bankruptcy Code, but that the debtor was presumed insolvent if it "is generally not paying debts as they become due." §3302(b). The court applied a "flexible-totality-of-the-circumstances test". The court considered the affidavit of a CPA presented by the trustee that the debtor was insolvent based on unaudited financial statements for 2010, an audited financial statement for 2009, the proof of claim of the IRS in the amount of over $2.8 million, testimony from the debtor's CPA, the pleadings related to the judgment of over $1.8 million on behalf of a creditor, the testimony of the debtor's principal, the petition and schedules, and the testimony of the defendants. The trustee's witness concluded that the debtor was not generally paying its debts as they became due prior to and at the time of the transfers which would lead to a presumption of insolvency. This was buttressed by the fact that the debtor had to borrow from the insiders to cover two payrolls. The defendants presented their own affidavits. The court did not believe that absent a complete balance sheet test that it could make the finding of actual insolvency.

Although the trustee had made a compelling case for reasonable cause to believe the debtor was insolvent, the court held otherwise for summary judgment purposes. The insiders maintained that they had no knowledge of the financial condition of the business and had not participated in any board meetings for at least two years (thus, apparently relying on the "ostrich" approach). Therefore, the court would not grant summary judgment as to either insolvency or reasonable cause to believe the debtor was insolvent.

As to the business, the court did grant summary judgment as to the 90-day preferences and unauthorized post-petition transfers, and awarded the trustee judgment for $62,000 but denied it as to a further $67,500, representing the transfers more than 90 days and less than a year before the petition date. This required a trial to establish whether the business was a non-statutory insider. The trustee had argued that as the sole owner of the business, Hackenberry's knowledge was imputed to the business. The court was not willing to go that far on summary judgment.

[*Author's comment:* The FDCPA is an important tool in the trustee's arsenal. It can only be used selectively, such as when a federal creditor is present, but can lead to substantial recoveries. In the predecessor case of *Gordon v. Harrison*, when the court denied the defendant's motion to dismiss and ruled that the trustee could take advantage of the extended reachback of the FDCPA, the case reached a mediated settlement of $950,000. There is an additional $272,500 represented in the FDCPA claims in these three cases. More often than not, once the trustee clears the hurdle of the motion to dismiss, the cases can be favorably settled.]

§544(b)(1) and 28 U.S.C. §3306

Trustee's fraudulent transfer lawsuits utilizing extended reach-back under F.D.C.P.A. survives dismissal motions

In re CVAH, Inc., 2017 WL 1684119 (Bankr. D.Id. May 2, 2017) (Pappas, J.)

Exactly one week after three opinions described in the preceding case summary, an Idaho bankruptcy court denied motions to dismiss in four consolidated adversary proceedings to enable the trustee to proceed with the extended reach-backs to avoid fraudulent transfers provided in the Federal Debt Collection Procedures Act ("FDCPA") and Internal Revenue Code that totaled about $357,000. The debtor had been organized and operated to provide veterinary services to its customers. It failed to pay corporate income taxes owed both to the IRS and Idaho State Tax Commission ("ISTC") for calendar years 2009-2013. It later failed and filed the chapter 7 petition on May 27, 2014, owing the IRS and ISTC approximately $1.5 million. The transfers sought to be avoided were payments made to satisfy debts incurred by other individuals or entities, including the only licensed veterinarian ever employed by the debtor and his family members. The debtor is alleged to have had a history of failing to file tax returns and avoiding tax payments until depletion of its assets. The trustee sought to "step into the shoes" of the IRS and thereby utilize its long reachback found in the FDCPA, 28 U.S.C. §3306, and the IRC, 26 U.S.C. §6502, to recapture any transfers

made by the debtor to the defendants within six years prior to the petition date. The motions to dismiss were based on the argument that the debtor could not utilize the extended reachback to avoid any of the subject transfers. The defendants did not challenge the adequacy of the trustee's factual allegations, but only his stated legal basis for relief. The court denied the dismissal motions in a lengthy opinion.

The court first observed that §544(b)(1) did not restrict which of the debtor's actual creditors a trustee may choose as a vehicle to avoid a transfer so long as that creditor held an unsecured claim allowable under §502, or not allowable only under §502(e). The court found this to be the plain language of the statute. It disagreed with the defendants that the FDCPA precluded its use by a bankruptcy trustee, noting that a significant majority of the courts that had considered the issue agreed that a bankruptcy trustee could utilize the FDCPA under §544(b)(1). While there were certain minority views on this issue, the court found that the majority view was the better reasoned view. The court rejected defendants' argument that the statute was ambiguous. Defendants had argued that allowing use of the FDCPA look-back period would result in the discontinued use of §548 and state fraudulent transfer law. The court found this to be unpersuasive because a slightly decreased use of the state fraudulent transfer law "is much different than the FDCPA preempting [it]." Next, defendants brought out the statements of one of the authors of the final version of the FDCPA who had stated that "provisions of the bankruptcy code making reference to non-bankruptcy law are to be read as if this act did not exist." 136 Cong. Rec. H13288 (Daily ed. Oct. 27, 1990) (Statement of Rep. Jack Brooks). However, the court agreed with the reasoning of the court in *In re Tronox, Inc.,* 503 B.R. 239 that relying on statements to contradict the plain meaning of the FDCPA would assign it too much weight. The court here states: a court must be cautious in relying on a single comment made by an individual congressman in the process of enacting legislation in Congress. *N.L.R.B. v. SW General, Inc.,* __ S.Ct. __ 2017 WL 1050977 (2017) instructing that 'floor statements by individual legislators rank among the least illuminating forms of legislative history'; *Garcia v. United States,* 469 U.S. 70, 76 (1984) 'We have eschewed reliance on the passing comments of one Member [of Congress] …. ') (citing *Weinberger v. Rossi,* 456 U.S. 25, 35 (1982) and at n.15 'The contemporaneous remarks of a sponsor of legislation are certainly not controlling in analyzing legislative history.')" Next, the defendants argued that the civil collection procedures were exclusive to the United States and could not be utilized by bankruptcy trustees. The court disagreed, finding that the power Congress gave the IRS as a federal creditor to avoid fraudulent transfers was not inconsistent with that same Congress decreeing that if an unsecured creditor in a bankruptcy case could sue to avoid a transfer, the bankruptcy trustee, "with the same rights as a creditor, could also seek avoidance. These statutory grants are not inconsistent." Indeed, the court noted that under the facts of this case, the IRS would be the primary beneficiary of any recovery made by the trustee as it was owed about 80% of the unsecured debt in the case. Next, the defendants argued that prior to an assessment, the IRS could not collect and neither could the trustee. The court disagreed. "An action by IRS against a transferee from the taxpayer is a 'collection suit,' and is subject to the ten-year limitation in IRC §502." The court found that there was no requirement of a prior assessment.

The defendants also argued that a trustee's exercise of avoiding powers did not implicate public rights or interests such that the trustee should be able to step into the shoes of the IRS. However, the court observed that because of the debtor's bankruptcy filing, the IRS would be prevented by the Code from exercising its right to pursue transferees of avoidable transfers, which only the bankruptcy trustee could pursue. However, the IRS would benefit from the operation of the bankruptcy laws because the trustee, as its statutory representative, could pursue recovery of the transfers standing in its shoes, unconstrained by state-law extinguishment statutes. Under the defendants' arguments, the IRS would be deprived of its statutory right to recover the transfers, and the trustee would be unable to do so also. "The Court declines to conclude that the Supreme Court would intend that a doctrine designed to enhance the ability of the United States to enforce its claims against others … should not be available to IRS's statutory representative simply because the taxpayer/debtor filed a bankruptcy case." The court determined that since "outside of bankruptcy, IRS could have commenced a court proceeding to avoid the transfers in question without making an assessment against the defendants,

Trustee may do the same." The court further rejected defendants' argument that the IRS could not pursue recovery from a transferee until it had exhausted its collection remedies against the transferor-taxpayer. In the context of a bankruptcy case, particularly chapter 7, such efforts would be futile as the debtor is a defunct corporation in a chapter 7 case. Plus, the IRS would be prohibited by the automatic stay. Next, defendants argued that allowing the expanded limitations period would lead to an absurd result. The court disagreed and also disagreed with its policy arguments, primarily determining that when the law is clear, the court was not permitted to resort to policy. It also observed that the policy argument was likely indefensible in a case like this where the tax obligations went unpaid because the funds were diverted away from satisfaction of them. It is only the trustee who seeks to recover those funds and pay the tax obligations to the extent possible. The next argument was that the FDCPA and tax code require that the IRS be a creditor at the time of the targeted transfers in order for them to be avoided. The court disagreed. Both Idaho State Law and IRC §3304(b) did not require the IRS to be a creditor at the time of transfer. The court noted that the state law and the FDCPA also applied certain avoidance to both existing and future creditors. The trustee had alleged that the transfers were with the actual intent to hinder, delay, or defraud its creditors, that the debtor was insolvent, that the debtor's assets were unreasonably small in relation to its business, and that is principals reasonably believed or should have believed it would incur debts beyond its ability to pay as they became due. Under all of those allegations, the IRS need not have been a creditor at the time of the transfers. Accordingly, the motions to dismiss were denied.

[*Author's comment:* It is encouraging to see the increased momentum by which trustees are bringing actions under ex-

tended reach-back provisions and that the great majority of the courts are agreeing with the trustees. Trustees should still expect aggressive dismissal motions to be filed in virtually every case where extended reach-backs are attempted.]

§541

Product liability claim not estate property

Mendelsohn v. Ross, 2017 WL 1900288 (E.D.N.Y. 2017)

The debtor had filed her chapter 7 petition in 2004. The trustee made a distribution to creditors and closed the case in 2006. In 2015, the trustee moved for an order re-opening the case to administer an undisclosed product liability claim resulting from a pre-petition medical procedure involving the implantation of a defective mesh pelvic sling. The device had been implanted in the debtor in a 1999 surgery, but it was not until 2011 that the FDA issued an advisory opinion regarding possible defects with the device. The debtor became aware of the possible defects and contacted product liability counsel in 2012. Thereafter, the debtor received a settlement award in the amount of $105,172 in exchange for a pre-injury release. The bankruptcy court denied the trustee's motion to re-open, ruling that no cause of action had accrued as of the petition date. On appeal, the district court affirmed. It observed that the bankruptcy court had failed to specifically analyze whether, despite the fact that a claim had not accrued under state law as of the petition date, the settlement proceeds were nonetheless sufficiently rooted in the debtor's pre-bankruptcy past to constitute estate property. The district court conducted that analysis and determined that the debtor's pre-bankruptcy past did not create an interest that manifested itself in the settlement agreement. Instead, it was the combination of events that occurred in the debtor's pre-bankruptcy past (the implantation of the medical device and certain post-bankruptcy events (the FDA advisory opinion regarding possible defects with the medical device) that created the interest that resulted in the settlement proceeds. Without the post-bankruptcy events, the district court held that the pre-bankruptcy event would be rendered meaningless insofar as trustee's ability to obtain settlement proceeds is concerned.

[*Author's comment:* Trustees reopen bankruptcy cases routinely to administer product liability claims not originally scheduled. However, trustee sought to reopen this case 16 years after the device was implanted and 9 years after the case was closed. Given that the FDA did not issue its advisory opinion until five years after the bankruptcy case was closed, it is not surprising that the court ruled as it did.]

§506(c)

Court allows surcharge for bulk of legal fees and payroll expenses

In re Kent Manor Inn, LLC, 2017 WL 2267241 (Bankr. D.Md. 2017) (Catliota, J.)

The chapter 11 debtor had operated a hotel. The debtor was indebted to the bank under two loans with an outstanding balance of $3.1 million secured by deeds of trust against the real property and a security interest in the debtor's other assets. Although the automatic stay had been lifted, the bank agreed to forebear from exercising its foreclosure rights so long as the debtor retained a broker and sold the real and personal property on or before January 31, 2017. The auction was held on December 1, 2016 and closed on January 31, 2017 for a sale price on all of the property of $4.1 million. The debtor had been required to maintain its business operations through the closing date but had insufficient cash flow to do so. Therefore, the debtor obtained court authorization to obtain a DIP loan of $58,099. The DIP lender was given a super priority claim but not priming lien over the bank's deeds of trust or security interest. At the closing, the bank was paid its loan payoff with the balance of the sale proceeds being escrowed by the debtor. The debtor then moved to surcharge the bank's collateral under §506(c), seeking a total surcharge of $169,126, consisting of $106,029 of legal fees, the DIP loan of $58,099 and a $5,000 reserve to cover certain other administrative expenses. The court noted that the debtor bore the burden of establishing that an expense (1) was incurred primarily to protect or preserve the collateral, (2) provided a direct and quantifiable benefit to the secured creditor, and (3) was reasonable and necessary. The debtor's expert witness testified that the bankruptcy sale as a going concern generated $500,000 more than a foreclosure sale would have generated. Further, the only two parties submitting bids both intended to operate the debtor's business, again highlighting the importance of the going concern value. The court determined that the total direct and quantifiable benefit to the bank was $114,959. The court allowed a total of $79,842 in legal fees as reasonable and necessary in order to allow the business to be sold as a going concern, but found that $26,187 of legal fees was incurred for general case administration and certain other categories of services that were not necessary to preserve and protect the collateral. That left $35,117 of payroll expenses that could also be surcharged.

[*Author's comment:* Surcharge issues can be very challenging for trustees. Absent a consensual resolution, both the trustee and lender are often both dissatisfied with the outcome.]

§726(a)(5)

Interest awarded in surplus case at federal rate

In re Robinson, 567 BR 644 (Bankr. N.D.Ga. 2017) (Sacca, J.)

The issue before the Court was what does "interest at the legal rate" mean under 726(a)(5) for purposes of a distribution on unsecured claims in a surplus chapter 7 case. The court had to determine whether the phrase meant interest at the federal judgment rate or the applicable non-bankruptcy rate on the unsecured claim that existed pre-petition. The court recognized a split of authority but determined the better reasoned cases held that the federal judgment rate was the applicable rate. The leading case was *In re Cardelucci,* 285 F.3d 1231, 1234-36 (9th Cir. 2002). The 9th Circuit considered the issue in the context of chapter 11 plan confirmation and listed four reasons why the federal judgment rate was the applicable rate: (1) Congress chose the more specific language of "interest at the legal rate" instead of the more general originally proposed language of "interest on claims allowed", and the chosen language used the more definite "the" instead of an indefinite "a" or "an", thereby indicating Congressional intent for an interest rate

derived from a common, single source, being the federal statute awarding interest on judgments; (2) post-petition interest is procedural in nature and, therefore, dictated by federal law; (3) a single, uniform rate is equitable to all unsecured creditors and insures that no single creditor receives a disproportionate share of assets; and (4) trustees should not be burdened by having to determine and calculate the appropriate rate for each individual unsecured creditor. Here, the bankruptcy court found that the first two reasons were compelling based on the language of §726(a)(5) and agreed with the last two reasons based on policy considerations.

The court noted that when the Bankruptcy Code was passed in 1978, the federal judgment interest rate was "the rate allowed by State law." This was interpreted to mean the state law in which the federal court sat. "State laws were then and still are all over the board on how to calculate interest on judgments." The court observed that some states have a set interest rate on judgments, some fix the amount unless the claim is based on a contract, in which event the contract rate would be applicable (or at least up to a certain percentage), others were based on the lesser of the contract rate or fixed percentage, and in some states it was based on a federal index or a prime rate plus a certain percentage. The court noted that in its own state of Georgia, the interest rate on judgments had been 12%, but the current law based the judgment rate on a rate published by the Board of Governors of the Federal Reserve System. O.C.G.A. §7-4-12. The court observed that from a policy standpoint that this would present real problems for the trustee. Stating that one could "imagine the expense, particularly in a large case, that a trustee would incur if (s)he had to contact each creditor to supplement their claims to provide the pre-petition interest rate and how the trustee in court would solve the problem of what to do in the event creditors did not respond to such a request." FN2 The court rejected the reasoning *In re Dvorkin Holdings, LLC* 547 B.R. 880 (N.D.Ill. 2016) that applied a "balance of the equities" test. Among the reasons the court noted that in *Law v. Siegel*, 134 S.Ct. 1188 (2014), bankruptcy courts were prohibited from using their equitable powers to create a remedy contrary to the existing statutory scheme. Accordingly, the court concluded that the interest rate to be applied under §726(b)(5) was the rate set forth in the federal judgment interest rate statute, 28 U.S.C. §61.

[Author's comment: This opinion certainly serves the interest of trustees well, obviating the need to contact each creditor in a surplus case to have each claim supplemented to provide the pre-petition interest rate, particularly when many claimants are unresponsive.]

§522; Equitable Estoppel

Split panel finds trustee did not satisfy all of the necessary elements for equitable estoppel of an exemption claim

In re Lua, 2017 WL 2799989 (9th Cir. 2017)

The debtor had deleted her homestead exemption, indicating she had no interest in that property. She instead exempted other assets using her "wild-card" exemption. Consequently, the trustee did not seek to pursue the newly exempted items of property and instead pursued the real estate originally covered by the homestead exemption. Only 3 years later, after much work by the trustee, did the debtor amend to claim the property under the homestead exemption. During that 3-year period, trustee had litigated successfully to establish the estate's interest in that property and reached a settlement with the debtor's spouse to sell it and pay all of her creditors in full. The bankruptcy court sustained the trustee's objection to the homestead exemption, pointing out that in *Law v. Siegel* 134 S.Ct. 1188 (2014), where state opt-out exemptions are used, they can be challenged under state law. "It is of course true that when a debtor claims a state-created exemption, the exemption's scope is determined by state law which may provide that certain types of debtor misconduct warrant denial of the exemption." *Id.* at 1196-97. The bankruptcy court had found that the doctrine of equitable estoppel, well-recognized under California law, would apply to bar the debtor's amended homestead exemption. The bankruptcy court found that all 5 factors for application of the doctrine were present. (1) *Representation or concealment of material fact* was satisfied by the debtor's written statement under penalty of perjury that she was not claiming nor was she entitled to any homestead exemption in the property; (2) *Made with knowledge of the facts* was satisfied by the debtor's knowledge that she could claim a homestead exemption and did so in her original schedules and was aware during the following 3 years of all of the actions that the trustee took to monetize her interest in the homestead; (3) *To a party ignorant of the truth* was satisfied by the fact that the trustee had no knowledge or indication that the debtor was going to amend her schedules 3 years later, particularly given that there had been no objections or other responses to all of the actions taken by the trustee; (4) *With the intention that the ignorant party act on it,* was satisfied by the debtor's failure to object or oppose any of the actions being taken by the trustee over this 3-year period; and (5) *That said party was induced to act on it* was satisfied by the trustee's justifiable reliance over a nearly 3-year period while incurring substantial administrative expense in a case that would otherwise pay nothing to unsecured creditors, instead of payment in full. Accordingly, the bankruptcy court sustained the objection. The district court affirmed. *In re Lua*, 529 B.R. 766 (Bankr. C.D.Cal. 2015) (Saltzman, J.), *aff'd* 551 B.R. 448 (C.D. Cal. 2015).

On further appeal to the circuit court, a split panel reversed. The majority found that the trustee had not satisfied all 5 elements for application of equitable estoppel. The circuit court stated that the party urging equitable estoppel must demonstrate "(a) a representation or concealment of material facts, (b) made with knowledge, actual or virtual, of the facts, (c) to a party ignorant, actually and permissibly, of the truth, (d) with the intention, actual or virtual, that the ignorant party act on it and (e) that party was induced to act on it." Here, the court found that the amended exemption could not form the basis of an equitable estoppel. The court disagreed with the bankruptcy court's finding that the trustee had no knowledge or indication that the debtor was going to file her second amended schedules. The debtor had never made a representation that she would not further amend her schedules. "In fact, circumstances changed almost three years later when, at the request of the Trustee, the bankruptcy court entered an order finding that the Property was 100% community property providing Lua a new factual basis to claim a homestead exemp-

tion." The circuit court also concluded that the trustee was aware of all of the existing facts known to the the debtor. Thus, there could not have been justifiable reliance. In an opinion "not for publication", the circuit court reversed and remanded the case.

In dissent, Judge Callahan did not believe that an abuse of discretion had occurred by the bankruptcy court.

> "By amending her initial schedules to remove her claim for a homestead exemption, Lua represented that she would not be seeking such an exemption during her bankruptcy. Based on this representation, the Trustee spent the next roughly three years attempting to maximize the value of the bankruptcy estate by monetizing Lua's interest in her home. While it is true that Lua did not know her exact interest in the home at the time she filed her first amended schedules and that Lua never affirmatively stated she would not change her amended exemption election at a later time, Lua stood idly by as the Trustee toiled away, failing to give the Trustee even so much as an indication that she was contemplating claiming the homestead exemption. In light of these particular facts, I cannot say that the bankruptcy court abused its discretion in finding that this case's equities favored not allowing Lua to amend her first amended schedules. As a result, I would affirm the bankruptcy court's application of equitable estoppel."

[Author's comment: This is not an opinion that states that equitable estoppel is not available to trustees and other parties objecting to exemptions. It simply finds that the trustee did not satisfy all five elements of the test for application of the doctrine. A better use of the doctrine would be one where the debtor is engaged in a fraudulent scheme in which the asset later claimed exempt has been concealed. Also, different states have different standards for application of the doctrine, so it is important to know the applicable law in whichever opt-out state your trustee practice is located. (Even though this was a split decision, it is not known at this point in time whether an application for rehearing *en banc* will be filed.)]

§707(b)

Cases initially filed under chapter 13 and converted to chapter 7 are subject to dismissal under Section 707(b)

Pollitzer v. Gebhardt (*In re Pollitzer),* 2017 WL 2766088 (11th Cir. 2017)

The issue in this case was whether §707(b) applies to a petition initially filed under chapter 13. Section 707(b)(1) provides that:

"After notice and a hearing, the court on its own motion or a motion by the United States Trustee, trustee . . . or any party in interested, may dismiss a case filed by an individual debtor under this chapter . . . if it finds that the granting of relief would be an abuse of the provisions of this chapter." (emphasis added)

In this case, the debtor filed a chapter 13 petition and made the required plan payments for over two years before converting his case to chapter 7. The UST moved to dismiss the case as abusive under §707(b) contending that the debtor's disposable income would allow for a significant dividend to unsecured creditors under chapter 13. The debtor opposed the motion on the sole ground that §707(b) did not apply to petitions initially filed under chapter 13." The bankruptcy court concluded that §707(b) applied to converted cases and dismissed the petition. The district court affirmed. The circuit court likewise affirmed.

The circuit court traced the history of the Code section. It noted that in 1984, "Congress added this provision because it believed that the bankruptcy courts were insufficiently invoking the 'for cause' provision to dismiss petitions filed by a growing number of Chapter 7 debtors that had income sufficient to pay their creditors." Nevertheless, the circuit court observed that two decades later, Congress was not satisfied that the "substantial abuse" provision went far enough in limiting the number of Chapter 7 petitions filed by debtors with repayment ability. Therefore, Congress significantly strengthened the Code section in BAPCPA in 2005, making it even easier for bankruptcy courts to dismiss abusive petitions by (a) eliminating the presumption in favor of granting the requested relief by adding a means test that created a presumption of abuse, and (b) lowering the standard from "substantial abuse" to "abuse". Based on this history, the circuit court determined that the goal of §707(b) "would be eviscerated" if the debtor's interpretation were adopted, to allow a debtor to file a Chapter 13 petition and convert it to chapter 7 the next day, thereby enabling the debtor to avoid an abuse review under §707(b). "We find it unlikely - - indeed inconceivable - - that Congress contemplated, much less authorized such a result." The court further stated that "we reject interpretations of the Code that would produce such absurd results." *Id.* Finally, the court determined that in interpreting statutory provisions, the language at issue could not be reviewed in isolation, but only in the broader context of the statute as a whole. "Given that Congress took care to craft specific exclusions for certain debtors from §707(b)'s means testing, we are loathe to infer the wholesale exclusion of converted petitions." It also noted in conclusion that Rule 1019(2)(A) was not revised upon adoption of BAPCPA or thereafter. That rule sets a new time period for filing a motion under §707(b) in a case that has been converted from Chapter 13. The circuit court viewed the Rule as unintelligible if §707(b) did not apply to converted cases. "Congress has presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change."

[*Author's comment:* Courts have been greatly divided on this issue, and this holding applies only within the 11th circuit's jurisdiction. However, it is hard to argue with the reasoning and analysis of the court with respect to this poorly written code provision.]

Supreme Court rules that proofs of claim based on stale debts do not violate the FDCPA

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

In a highly anticipated ruling, the Supreme Court, in *Midland Funding, LLC v. Johnson* held that the filing of a proof of claim that is time barred—even if obviously so—is not a violation of the Fair Debt Collection Practices Act. In so ruling, the Court noted that the Bankruptcy Code defines a "claim" as a "right to payment" and under the laws of 48 states, the running of the statute of limitations does not extinguish the right to payment only

certain avenues a creditor may take to obtain payment. Moreover, the Court held that the underlying purpose of the FDCPA—to protect consumers—is not implicated nearly as much in bankruptcy as there is a bankruptcy trustee tasked with ensuring that claims that should be objected to, are objected to. In sum, the Supreme Court's decision reaffirms the principle that what the Bankruptcy Code allows other federal statutory schemes cannot prohibit.

First Circuit clarifies what is "materially false" under section 523(a)(2)(B)(i)

Curran v. Privitera, 855 F.3d 19 (1st Cir. 2017)

In *Curran v. Privitera*, the First Circuit addressed whether a debt was non-dischargeable for being incurred in connection with a written statement "that is materially false" under §523(a)(2)(B). In doing so, the First Circuit affirmed the dismissal of the complaint holding that the plaintiff did not plausibly allege the misstatement was material. The Court held that "[t]o make out a claim that a statement is materially false within the purview of section 523(a)(2)(B), a plaintiff must plausibly allege that the statement misrepresented the kind of information that would normally affect the decision to grant credit…." The Court went on to note that the misrepresentation can be direct or one of omission but that "[t]o sink to the level of a misstatement by omission, the party privy to the omitted information must have been obligated to furnish it."

The Court held that while the plaintiff attempted to rely on misstatements by omission it had failed to plausibly allege wrongful omission because while the plaintiff may have wanted to know the information the debtor did not disclose, the plaintiff's request to the debtor did not actually require the disclosure of that information. Having failed to allege facts that showed the debtor was otherwise obligated to provide the information (that the debtor's property was encumbered by liens), the plaintiff had failed to allege the existence of a materially false statement.

Tenth Circuit BAP reaffirms broad turnover powers

Rupp v. Auld, 561 B.R. 512 (10th Cir. BAP. 2017)

In *Rupp v. Auld*, the trustee ran into difficulty having the debtor turnover certain information such as loan applications and vehicle titles. The trustee asked the bankruptcy court to order turnover of these documents. The debtor did not oppose the trustee's motion yet the bankruptcy court denied the motion on the basis that the trustee should use Rule 2004 to obtain the information he sought.

On appeal, the BAP reversed. Specifically, the court held that the debtor has a duty to "cooperate with the trustee" under §521(a)(3) and that duty requires that the debtor "shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate." Importantly, the court noted that these duties are "self-executing" and that the trustee need not demand that the debtor comply, but that when a debtor does not comply, "[a] trustee's remedy for non-performance is to obtain a court order requiring the debtor to run over or account for estate property and recorded information," which is what the trustee did. In reversing, the BAP also reaffirmed that in order to compel turnover, the trustee need not show that the debtor has present possession of the property, just that the debtor had "possession, custody, or control" during the bankruptcy case.

Inaccurate notice not necessarily fatal

In re Guzman, 567 B.R. 854 (1st Cir. BAP 2017)

In *Guzman,* the debtors' case was converted from chapter 11 to chapter 7. After the conversion, the debtors amended their claimed exemptions to include funds that had been held in the debtor-in-possession account. The Trustee objected to the debtors exempting their DIP account; however the notice provision incorrectly advised parties that they had a 30-day period to object, rather than a 14-day period under the local bankruptcy rules. The bankruptcy court first sustained the trustee's objection and then vacated that order when the debtors' filed a motion for reconsideration based on the error in the notice.

Later, the debtors filed another amendment to their exemption to claim an apartment they owned. The trustee filed another objection that, in part, re-raised the DIP account argument. Yet again, however, the notice provision was incorrect. The court sustained the trustee's objection and this time denied the debtors' motion to reconsider. On appeal, the BAP affirmed. The BAP agreed that the notice error was not misleading because the debtors had prior knowledge of the correct response period by virtue of the earlier proceedings relating to the Trustee's first objection.

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