Recent Developments: Leading Bankruptcy Opinions: January to March 2015

This webinar is the second in a series of monthly presentations designed to keep you up-to-date on changes in bankruptcy and restructuring; track recent filings, motions, and decisions; and implement revisions to bankruptcy rules and forms. From detailed intelligence on federal and bankruptcy court dockets and opinions, to step-by-step guidance through all levels of the bankruptcy process from American Bankruptcy Institute (ABI) treatises, these ABI and Bloomberg BNA co-sponsored webinars will help bankruptcy attorneys and practitioners gain a deeper understanding of bankruptcy law issues.

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Supreme Court

Commentary:

The Supreme Court ostensibly granted certiorari in Wellness International immediately after breakaway day last term because the justices couldn't decide the consent issue in Executive Benefits.

As it turns out, they had even bigger fish to fry.

There is faction on the Court believing that bankruptcy judges cannot adjudicate any issues based even in part on state law. Justices Breyer and Sotomayor seem to believe there is final Article I adjudicatory power whenever the debtor has possession of or title to property.

Justice Breyer was visibly angry that anyone would believe bankruptcy courts have been violating the Constitution for 100 years by resolving disputes involving state law. It's at the core of what they do.

Breyer in substance said that taking the narrow view would shift most issues in bankruptcy to district court, which would be at odds with Stern which said the decision would little affect the distribution of work between bankruptcy and district courts.

If the Court adopts the possession or title theory, the case will represent a significant narrowing of Stern v. Marshall.

I do not know if the Court will even reach the issue of consent, actual or implied, because the case can be disposed of entirely on the broader question of power over state-law issues.

Also, Wellness is not a good case for a broad consent ruling because the appellee was the debtor who voluntarily filed bankruptcy. Thus, the Court at best could hold that filing a petition represents consent. Anything else would be dicta.

Justices May Duck Big Issue to Decide a Bigger Issue

The U.S. Supreme Court heard arguments in a case that could either ensure business as usual in bankruptcy courts or further gut the powers of bankruptcy judges and force federal district judges to take over the bulk of work now routinely handled in the lower courts.

The case heard yesterday stems from the high court's 2011 decision in Stern v. Marshall declaring that powers of life-tenured U.S. district judges were being delegated to bankruptcy judges in violation of the U.S. Constitution.

More narrowly, Stern took away the power of bankruptcy courts to make final decisions in lawsuits against third parties based on state law.

In doing so, the case raised more questions than it answered. The 2011 opinion left open the issue of whether someone can consent to a final ruling in bankruptcy court. More important, Stern raised the possibility that the system of federal magistrate judges also violates the Constitution.

In the case before the court yesterday, Wellness International Network Ltd. v. Sharif, the justices are being asked to decide whether the powers of district judges can be given to bankruptcy judges if all parties consent. Wellness International was also seen as a case to decide whether the magistrate judge system is unconstitutional.

The questioning by the justices suggested they may not tackle the major issues after all. Bankruptcy courts nevertheless could lose many or most of the powers they have

exercised for the past century, depending on how the decision comes down.

Wellness International involved a man who filed for bankruptcy claiming that his home, his bank account and most other property he had been using for years was actually in a trust for his mother and thus shielded from creditors' claims.

The bankruptcy judge ruled against the man, bringing the alleged trust assets into the estate for distribution to creditors, because he failed to produce documents.

On appeal, the bankrupt argued that Stern deprived the bankruptcy judge of the power to decide issues of state law regarding the validity of the trust. The Chicago-based U.S. Court of Appeals for the Seventh Circuit agreed, saying the decision was beyond the power of the bankruptcy judge.

The circuit court also ruled that it's not possible to give power to a bankruptcy court with consent. To read about that opinion, click here for the Aug. 23, 2013, Bloomberg bankruptcy report.

The Supreme Court agreed to hear the case because the federal circuit courts are split on whether consent can give bankruptcy judges power over lawsuits based on state law.

Although the lawyers for both sides tried to focus the court on the consent issue, the justices spent most of their time on the even broader question of whether bankruptcy judges can make any decisions turning on or even involving state law.

Consequently, how the court rules will either limit the effect of Stern or dramatically curtail the power of bankruptcy judges such that there might be little left for them to do aside from handing out property everyone concedes belongs to the bankrupt.

Justices Stephen Breyer and Sonia Sotomayor seemed to believe that bankruptcy courts have power where the bankrupt is either in possession of property or has title to property. Breyer said the ability to decide whether property belongs to a bankrupt is the ``most fundamental'' issue in bankruptcy. He said it's ``not hard'' to show that Wellness International is different from Stern and see how the bankruptcy court has power.

Breyer said property ownership is almost always a question of state law. He implied that the constitutional right of Congress to make uniform bankruptcy laws brings with it the ability to decide questions of property ownership.

Justice Antonin Scalia made a comment that could have been understood to mean the new case is the same as Stern. He also asked whether the bankruptcy court lacks power anytime there's contested ownership of property.

Breyer said federal agencies every day affect or limit state-law property rights. That's permissible, he said, as long as the owners are given due process in agency procedures.

The justices also talked about arbitration, in which the parties endow outsiders with the power of the courts and require federal courts to enforce arbitration awards almost always.

Scalia said arbitration involves nothing more than enforcement of contract.

Justice Elena Kagan observed that arbitration is more threatening to the power of federal courts than bankruptcy.

A decision that the bankruptcy judge had the power to say trust property actually belonged to the bankrupt would be enough to reverse the lower court and never reach the question of whether the debtor properly consented to a ruling in bankruptcy court.

The justices asked whether they could decide both issues, even though either would be sufficient to determine the case.

Seeing the new case as different from Stern, the solicitor general, who argues for the U.S. government before the Supreme Court, said the bankruptcy judge had the power to rule on ownership of trust property.

It was the solicitor general who recommended adopting a rule that the bankruptcy court has power when the bankrupt either owns or has title to property.

For more on Wellness International, click here for the July 2 Bloomberg bankruptcy report.

The case in the high court is Wellness International Network Ltd. v. Sharif, 13-935, U.S. Supreme Court (Washington). The case in the appeals court was Wellness International Network Ltd. v. Sharif, 12-1349, U.S. Court of Appeals for the Seventh Circuit (Chicago).

Published January 15, 2015

Commentary:

Except for Justice Sotomayor, the Supreme Court seemed divided along the usual lines on the question of whether fee defense costs are allowable.

At oral argument in the Ascarco case from the Fifth Circuit, Sotomayor twice asked whether defense of fees benefitted only the professional. If she votes with Justice Scalia, there may not be enough votes to make defense costs compensable.

If Justice Ginsburg writes the majority opinion, it will be a victory for the debtor bar. She took the simple approach that defense costs are merely a subset of a "reasonable fee."

The justices as a whole were uncharacteristically quiet. I could not decide whether it was from a lack of interest or having made their minds up already. I suspect it was a lack of interest.

Justices Split on Paying Lawyers to Defend Fees

The U.S. Supreme Court heard arguments Wednesday on whether professionals in bankruptcy cases can be paid for defending their fee requests.

The justices seemed split into two camps. It wasn't clear which side commands a majority. The case in substance will decide whether the so-called American rule -- that the winner bears its own costs -- prevails in bankruptcy fee disputes.

The U.S. Court of Appeals in New Orleans ruled categorically in April that bankruptcy lawyers can never be paid for defending their fee requests unless opposition was mounted in bad faith. The Supreme Court agreed to hear an appeal by law firms Baker Botts LLP and Jordan Hayden Womble Culbreth & Holzer PC, which were denied recovery of $5 million spent successfully defending their fees.

The dispute arose in the Chapter 11 reorganization of Asarco LLC. The two Texas firms represented the company in successfully prosecuting a fraudulent-transfer suit against the metal producer's Mexican owner, Grupo Mexico SAB.

Evaluating the victory as worth $7 billion to $10 billion, the bankruptcy judge awarded $113 million in fees to Houston-based Baker Botts and $7 million to Corpus Christi-based Jordan Hayden as base compensation.

The bankruptcy court also granted bonuses of $4.1 million and $125,000 to the firms. The court allowed bonuses only for work on the fraudulent-transfer suit, not other aspects of the case.

The bankruptcy court also gave the firms $5 million and $15,000 in reimbursement for successfully defending their fee requests from attack by Grupo Mexico. That money, like their other fees, would come from the Asarco bankruptcy estate.

When control reverted to the Mexican parent after emergence from Chapter 11, Asarco unsuccessfully appealed the fee awards in U.S. District Court. The Fifth Circuit in New Orleans upheld the bonuses but set aside the $5 million award for defending fees, saying defense costs neither benefited the estate nor were ``necessary for case administration."

The justices seemed divided into two factions. On one side, Justice Elena Kagan said defense costs are merely one aspect of what's a ``reasonable'' fee that Section 330 of the Bankruptcy Code permits. Along the same lines, Justice Ruth Bader Ginsburg

saw no difference between seeking fees in the first place and defending fees later.

On the other side, Justice Antonin Scalia said a law firm that must sue for its fees outside of bankruptcy pays its own costs of collection under the American rule, which holds that a winner in a lawsuit doesn't collect fees from the loser. He questioned why the same rule doesn't apply in bankruptcy.

On two occasions, Justice Sonia Sotomayor seemed on Scalia's side, when she observed that defending fees benefits only the lawyer, not the bankrupt estate.

Chief Justice John Roberts, like Scalia, said collection costs are borne by the lawyer outside bankruptcy.

The U.S. solicitor general, representing the government, argued on the side of the law firms, contending that defense costs must be allowed so professionals get the fees to which they are entitled.

With the exception of Justice Clarence Thomas, all the justices asked questions. Justice Samuel Alito asked why sanctions for frivolous objections aren't enough to compensate lawyers who defend fees.

The justices allowed an appeal because there is a split among the circuit courts. The Ninth Circuit in San Francisco gives bankruptcy judges discretion to pay fees for defending fee requests.

For details on the Asarco decision in the Fifth Circuit, click here for the May 2 Bloomberg bankruptcy report.

The case in the Supreme Court is Baker Botts LLP v. Asarco LLC, 14-103, U.S. Supreme Court (Washington).

The case in the appeals Court is Asarco LLC v. Jordan Hayden Womble Culbreth & Holzer PC (In re Asarco LLC), 12-40997, U.S. Court of Appeals for the Fifth Circuit (New Orleans).

Published February 26, 2015

Commentary:

The Chapter 7 strip-off case, argued March 24 in the Supreme Court, is important for lenders and the country as a whole, not merely consumer bankrupts.

Depending on whom you believe, the result will either decrease the availability of subordinate lending or allow homeowners to keep their houses.

Supreme Court to Side With Homeowners or Banks: Bankruptcy (1)

The U.S. Supreme Court will hand down a decision by June critical to the lives of millions of Americans who bought homes at the peak of the housing boom, only to find the properties now worth less than their mortgage debt.

While a company in bankruptcy can cut down a mortgage to the value of the property, people in Chapter 7 don't have the same right because most courts leave every mortgage on a home even when the property is worth a fraction of secured debt.

In Chapter 7, an individual's non-exempt property is sold for the benefit of creditors and unsecured debt is immediately extinguished. In most Chapter 7s, there's nothing left for unsecured creditors.

Among the 11 U.S. Circuit Courts of Appeal, only Atlanta's allows a person in Chapter 7 to eradicate a second mortgage when the property is worth less than the first-mortgage debt.

Following a 1992 Supreme Court decision, called Dewsnup, every other appeals court to consider the issue has concluded that subordinate mortgages survive in full in Chapter 7, regardless of the value of the property.

In Dewsnup, the high court ruled that a person in Chapter 7 can't ``strip down'' a second mortgage to the value of the property when the property is worth more than the first mortgage but less than the two mortgages together.

The Atlanta court ruled that Dewsnup didn't explicitly overrule one of that circuit's cases which permitted stripping off a subordinate mortgage when the property is worth less that the first-mortgage debt.

The two cases before the Supreme Court this year, Bank of America v. Toledo-Cardona and Bank of America v. Caulkett, will determine whether bankruptcy law permits ``stripping off'' a subordinate mortgage when the first mortgage sops up all the value in the property.

The lender, supported by several banking associations, filed its brief this month, contending that allowing a so-called strip off in Chapter 7 has a ``destabilizing effect'' on the $40 billion market for subordinate loans.

For bankrupt individuals, a high court decision in their favor would give them a better shot at keeping their homes and avoiding foreclosure.

For society at large, the benefit question is knottier.

If an individual can't strip off a mortgage that has no value by filing in Chapter 7, bankruptcy alone won't enable that person to keep the home because the second-mortgage holder could foreclose later.

That same person could file a Chapter 13 petition and wipe the same second mortgage off the record.

Chapter 13, however, doesn't work for everyone because it usually requires a debtor

to pay a portion of future income to creditors for the ensuing five years.

For that and other reasons, some people are functionally ineligible for Chapter 13.

Adding to the irony, most courts would allow that same person to wipe out the second mortgage by filing in Chapter 7, followed a few months later by a Chapter 13 filing.

At first blush, a Supreme Court decision on behalf of lenders would seem to have societal benefit by strengthening the market for subordinate loans.

In practical terms, allowing the second mortgage to survive may not be so important because the holder of the first mortgage can still foreclose and wipe out the subordinate mortgage. Consequently, it's unclear how much economic benefit there is for lenders if their underwater mortgages survive Chapter 7.

Indeed, an argument can be made that permitting survival of underwater subordinate mortgages actually harms society because it raises the chance of foreclosure. In foreclosure, property tends to lose even more value.

The Supreme Court, however, typically bases its opinions on meticulous interpretation of the statute, not conjectural economic theory.

The banks said in their high-court briefs that a bedrock principle of bankruptcy law for more than 100 years has been the ability of mortgages to survive, or ``ride through,'' bankruptcy.

Although that principle was largely true under the Bankruptcy Act of 1898, the rule has been successively weakened with the development of corporate and individual reorganization statutes and provisions in the Bankruptcy Code dealing with secured claims.

The bankrupts are to file their briefs on Feb. 17. Oral arguments may be held in late March or early April, with a decision before the court adjourns at the end of June.

The circuit courts in Richmond, Virginia; Cincinnati, and Chicago don't permit stripping off in Chapter 7, although strip-offs are uniformly allowed in Chapter 13, whose statutory language is different.

Atlanta's is the only circuit court to allow eradication of completely underwater subordinate mortgages.

For more on the subject, click here for the Nov. 18 Bloomberg bankruptcy report.

For other a discussion of the circuit split, click here for the April 1 report.

The cases are Bank of America v. Toledo-Cardona, 14-163, and Bank of America v. Caulkett, 13-1421, U.S. Supreme Court (Washington).

Published January 20, 2015

Commentary:

In Bullard, where the Supreme Court will decide what is a final order in the bankruptcy context, the respondent makes a persuasive argument that finality is the same in the bankruptcy context as in general federal litigation, because Congress created a safety valve allowing interlocutory appeals with permission.

The case is the first time the high court will visit the notion of more flexibility in bankruptcy appeals.

The Solicitor General came down on the side of a broad notion of finality, even broader than the appellant had temerity to advocate.

Bank Asks Justices to Permit Fewer Appeals in Bankruptcy Cases

A bank that defeated a man's Chapter 13 debt-adjustment plan will ask the U.S. Supreme Court April 1 to reject the notion that there's more flexibility in permitting bankruptcy appeals.

If the bank wins, and depending on how the high court writes its opinion, fewer rulings by bankruptcy judges may be automatically appealable.

The decision will probably also establish when appeals can be taken in business reorganizations under Chapter 11. Fewer permissible appeals would enhance the power of bankruptcy judges at a time when the Supreme Court generally has been restricting the clout of those courts.

In Bullard v. Blue Hills Bank, a bankruptcy judge refused to approve an individual's Chapter 13 plan, which would have required paying a portion of claims over five years before receiving a discharge wiping out the remaining liabilities. Having lost on the first appeal to a Bankruptcy Appellate Panel, the bankrupt turned to the U.S. Court of Appeals for the First Circuit in Boston.

Although the bankrupt contended no other plan was feasible, the First Circuit dismissed the appeal, concluding that denial of confirmation wasn't a final order required by Section 158 of the Judiciary Code. The Supreme Court took the case because five circuit courts refuse to hear appeals from denials of confirmation in Chapter 13, while three permit them.

Supported by the U.S. solicitor general, the bankrupt filed his brief in January, arguing that denial of confirmation was appealable as of right because it finally determined a discrete dispute within the larger bankruptcy.

In a brief filed last week, the bank argued that the finality rule in bankruptcy is no different from other appeals in federal court. Adopting a more ``flexible finality'' would undermine the statutory structure by ``rendering largely superfluous the specific statutory scheme governing interlocutory appeals in bankruptcy,'' the bank said.

When an important ruling that's not final deserves immediate appeal, Section 158 has a safety valve allowing so-called interlocutory appeals with permission from the court, the bank said. That mechanism should be used, rather than altering the overall notion of finality, according to the bank. An interlocutory appeal is one from an order that's not otherwise considered ``final.''

The case will turn on Section 158(a)(1), which says there's a right of appeal from a ``final'' order in bankruptcy ``cases and proceedings.'' The solicitor general, the

government's representative in the Supreme Court, said that statute is broader than those governing non-bankruptcy appeals because it allows appeals from ``proceedings.''

The bank countered that a proceeding regarding a plan is ``final'' only when the plan is confirmed or the entire bankruptcy is dismissed.

Not all banks agree with Blue Hills, which won in the lower courts. Bank of America NA filed a friend-of-the-court brief advocating automatic appeals.

To read about the First Circuit's decision, click here for the May 16 Bloomberg bankruptcy report. To read about arguments by the bankrupt and the solicitor general, click here for the Feb. 17 Bloomberg bankruptcy report.

The case is Bullard v. Blue Hills Bank, 14-116, U.S. Supreme Court (Washington).

Published March 3, 2015

Commentary:

Hats off to Columbia Law Prof. Ronald Mann who filed a petition for certiorari on the question of whether taxes on a late filed tax return can ever be discharged. He adroitly points out the disarray among the circuits, although they reach the same results since the 2005 amendments.

Also working pro bono, Prof. Mann won the New York rent control case where the Second Circuit held that a lease is not property that a trustee can sell.

Columbia Professor Wants High Court to Hear Tax Case

A professor at Columbia Law School is urging the U.S. Supreme Court to hear a case involving the ability of people to shed tax debt in bankruptcy that put the courts at odds with the IRS.

The justices should take the case because three courts of appeal to address the issue ``ruled against the taxpayers on a ground that the Internal Revenue Service won't defend,'' the professor, Ronald J. Mann said in papers submitted to the high court last week.

The appeals courts all agreed that taxes owed on late-filed returns can never be discharged in bankruptcy, but they don't apply the same logic.

Significantly, the courts used rationales that the IRS won't defend, Mann said on behalf of taxpayers in cases from the Denver-based U.S. Court of Appeals for the 10th Circuit.

The cases center on a so-called hanging paragraph inserted in Section 523(a) of the Bankruptcy Code by amendment in 2005. The Denver case involved people who didn't file tax returns in 2000 and 2001. The IRS assessed taxes in 2006. The taxpayers filed returns in 2007 and sought bankruptcy protection 2010. By that time, the tax debt would have been old enough for discharge had the returns been filed on time.

Reaching the same result as the New Orleans-based Fifth Circuit in early 2012, the Tenth Circuit concluded that the tax debt wasn't discharged, or wiped out, in bankruptcy. In February, the Boston-based First Circuit reached the same result, over one judge's lengthy dissent.

The dispute among the circuit courts was even worse with regard to cases before the 2005 amendment to Section 523. Mann said there was a ``multifaceted conflict in the courts of appeal'' on a theory the IRS would defend.

While conceding there's no ``conflict in the courts of appeal'' as to the result, the Supreme Court in recent years ``routinely has summarily reversed decisions that relied on reasoning that the government would not defend,'' Mann said.

Mann didn't side with the IRS, however. The government will permit discharge of debt on a late-filed tax return depending on whether the return was filed before ``assessment.'' Mann said the date of assessment is ``so random that it sheds no light at all on the probity of the taxpayer's conduct.''

The IRS, through the U.S. solicitor general, will have an opportunity to file papers saying whether the Supreme Court should accept the case or not. Although the IRS won in the three most recent cases, the appeals courts rejected its theory.

"If the IRS really wants to stick to its guns, then they will want the court to take the

case," Mann said in a phone interview.

To read about the most recent decision, from the First Circuit, click here for the Feb. 20 Bloomberg bankruptcy report. For the Denver case, click here for the Dec. 31 report. For the Fifth Circuit opinion, click here for the Jan. 6, 2012, report.

The case is Mallo v. U.S., 14-1072, U.S. Supreme Court (Washington).

Published March 10, 2015

Circuit Splits

Commentary:

There is an entrenched split of circuits on third party releases in Chapter 11, an issue begging for a grant of certiorari from the Supreme Court.

If the Supreme Court adopts Section 524(e) as the authority for banning non-debtor releases, big company reorganization practice will change dramatically. There will need to be companion class actions for management to have immunity from post-confirmation suits.

Circuit Split Widens on Director Releases in Chapter 11 Plans

The U.S. Court of Appeals in Atlanta used a small case to publish a major opinion and join a majority of circuits allowing Chapter 11 plans to provide so-called third-party releases to non-bankrupts such as officers and directors.

U.S. Circuit Judge R. Lanier Anderson wrote in a March 12 opinion for a three-judge panel of Atlanta's 11th Circuit that the courts of appeal for the Second, Third, Fourth, Sixth and Seventh Circuits permit third-party releases.

According to the Collier bankruptcy treatise, Anderson said, the courts of appeal for the Ninth and 10th Circuits don't allow a corporate bankruptcy plan to shield someone who wasn't in bankruptcy from a lawsuit.

Anderson also used the case, which involved a company worth $200,000, to say that the New Orleans-based Fifth Circuit, in its 2012 Vitro decision, misinterpreted a 1989 11th Circuit decision, Jet Florida. The Fifth Circuit read Jet Florida to mean that the 11th Circuit wouldn't permit third-party releases.

Anderson said Jet Florida didn't involve those facts and stands for a different principle. A 1996 11th Circuit case called Munford, Anderson said, approved third-party releases in proper cases. He devoted his new opinion to providing ``guidance'' to bankruptcy courts that are called on to decide whether a third-party release is proper.

Anderson ``respectfully'' disagreed with the minority view, which interprets Section 524(e) of the Bankruptcy Code to bar third-party releases. That section says a bankruptcy discharge doesn't affect the liability of anyone else on the debt.

Quoting the Chicago-based Seventh Circuit, Anderson said that section ``says nothing about the authority of the bankruptcy court to release a non-debtor.'' If Congress had wanted the section to serve that purpose, lawmakers ``would have done so clearly,'' Anderson said.

The power to issue third-party releases is found in Section 105(a) of the Bankruptcy Code, known as the All Writs Act, according to the opinion. Anderson warned, as do other courts, that the power should be used only in ``unusual cases.''

Anderson told bankruptcy courts in Alabama, Georgia and Florida to employ the non-exclusive seven-part test formulated in 2002 in the Dow Corning case by the Cincinnati-based Sixth Circuit. The lower courts have discretion to decide which elements to apply in a particular case, the judge said.

We are reviewing the decision, ``its impact and our next course of action,'' Richard Gaal of McDowell Knight Roedder & Sledge LLC in Mobile, Alabama, said in a phone interview.

Gaal represented the creditor in the case. His options include seeking rehearing

before all active judges on the circuit court or asking the U.S. Supreme Court to hear the case and resolve the split among the circuit courts.

The case is SE Property Holding LLC v. Seaside Engineering & Surveying Inc., 14-11590, 2015 BL 66279, U.S. Eleventh Circuit Court of Appeals (Atlanta).

Published March 18, 2015

Commentary:

The split continues on the question of whether filing a time-barred claim is a violation of the Fair Debt Collection Practices Act.

Stale Claim Doesn't Violate Fair Debt Collection Practices Act

Courts are split over whether filing a proof claim based on a time-barred debt is a violation of the federal Fair Debt Collection Practices Act.

U.S. District Judge Manish S. Shah in Chicago ruled Feb. 3 that a proof of claim which complies in form and substance with the Bankruptcy Code and rules doesn't violate Section 1692e of the FDCPA.

But in a footnote, the judge insinuated it's possible that a claim based on a stale debt might violate Section 1692f.

The case before Shah involved a credit-card debt of about $600 that was time-barred because the last activity in the account was more than five years before bankruptcy. The proof of claim was formally proper because, among other things, it accurately stated the date of last activity.

Shah noted a split among courts over whether filing a stale claim violates the FDCPA. He held that a proof of claim, proper on its face, is not ``false, deceptive or misleading'' and thus does not violate Section 1692e, because it does ``not falsely assert that it was timely.''

The judge said that a claim based on a stale debt ``does not purport to be anything other than a claim subject to dispute in the bankruptcy case.''

In the footnote, however, Shah said the plaintiff hadn't alleged violation of Section 1692f, which bars using ``unfair or unconscionable means'' to collect a debt. In dismissing the complaint, the judge gave the plaintiff a chance to file an amended version.

For discussion of the court split, click here and here for the Oct. 6 and July 14 Bloomberg bankruptcy reports.

The case is Robinson v. Ecast Settlement Corp., 14-cv-8277, U.S. District Court, Northern District of Illinois (Chicago).

Published February 10, 2015

Commentary:

Creating a split of circuits, the Eleventh Circuit politely told the Fifth Circuit that its cases making collateral estoppel more difficult to apply to confirmation were overruled by the Supreme Court in 2009 in Travelers v. Bailey.

11th Circuit Splits from 5th on Confirmation Res Judicata

The U.S. Eleventh Circuit Court of Appeals in Atlanta split from its sister Fifth Circuit in New Orleans by saying there is no tougher res judicata test for confirmation orders.

The Eleventh Circuit also politely said the three earlier Fifth Circuit cases were overruled by a 2009 decision from the U.S. Supreme Court, named Travelers Indemnity Co. v. Bailey, which says that the same res judicata rules apply to confirmation orders and Chapter 11 plans they implement.

Res judicata is a legal principal which says that the same parties can't litigate the same dispute a second time.

The Eleventh Circuit case involved a company in Chapter 11 where the principal guaranteed one of the corporation's debts. The principal contributed very substantial new cash value as part of the plan. In return, the plan gave the principal a release from all claims by creditors related to the company.

After bankruptcy, a creditor sued the principal on his guarantee of a company debt. The bankruptcy judge held that liability on the guarantee was released by the plan, to which the creditor had neither objected nor taken an appeal.

The Eleventh Circuit, in a 19-page opinion by Circuit Judge Jill Pryor, easily found that the release in the plan plainly covered the company's principal. She then went on to deal with the creditor's argument based on Fifth Circuit cases requiring that a release in favor of a third party must be ``sufficiently specific'' for res judicata to apply.

Pryor said the Eleventh Circuit would ``decline to apply'' the Fifth Circuit's additional requirement because it came from cases that predated the Supreme Court's Travelers v. Baily which says that the same res judicata tests apply to plans and confirmation orders.

Even iaf the Fifth Circuit standard applied, Pryor said it was met, entitling the principal to a release from the creditor's suit on the guarantee.

The case is Iberiabank v. Geisen (In re FFS Data Inc.), 14-11473, U.S. Eleventh Circuit Court of Appeals (Atlanta).

Published January 26, 2015

Commentary:

A district court in California followed the Second Circuit and differed from the Eleventh by holding that only the bankruptcy court has jurisdiction to impose damages for stay violation.

Courts Split on Jurisdiction for Stay-Violation Suit

The U.S. Court of Appeals in San Francisco may be called on to address an issue dividing its sister courts and decide whether bankruptcy courts have exclusive jurisdiction over complaints seeking damages for violation of the automatic stay.

An individual filed a Chapter 13 petition. The next day, a lender conducted a non-judicial foreclosure of the bankrupt's home.

After the Chapter 13 petition was dismissed, the former bankrupt sued in district court seeking damages for violation of the automatic stay. In the meantime, the bank had rescinded the foreclosure.

U.S. District Judge Beverly Reid O'Connell in Los Angeles granted the lender's motion to dismiss the complaint in an opinion on Feb. 26.

O'Connell noted that the courts of appeal are divided on whether claims for violation of the stay can be brought only in bankruptcy court. Where the Second Circuit Court of Appeals in New York has held that the Bankruptcy Code preempts state-law claims, the Eleventh Circuit in Atlanta concluded that district courts have jurisdiction over violations of the automatic stay.

The judge also showed how lower courts in the Ninth Circuit are similarly divided on the question.

O'Connell decided to dismiss the suit, based in part on local rules that refer bankruptcy-related cases to the bankruptcy courts.

The case is Swartz v. Nationstar Mortgage LLC, 14-08649, U.S. District Court, Central District California (Los Angeles).

Published March 2, 2015

Commentary:

Parting from the Ninth, the Eleventh Circuit holds that the bankruptcy court has power to grant fees for appellate defense of dismissal of an involuntary and for fees in pursuit of bad-faith damages.

Circuits Split on Attorneys' Fees in Bad-Faith Filing

The federal courts of appeal are now split on the question of whether bankruptcy courts have power to award attorneys' fees incurred on appeal in upholding dismissal of an involuntary bankruptcy petition filed against an individual.

Although not directly on point, how the split is finally resolved may be influenced by the forthcoming U.S. Supreme Court decision in Baker Botts LLP v. Asarco LLC, where the high court will decide whether lawyers are entitled to recover fees for defending their fee requests.

The U.S. Court of Appeals in Atlanta handed down an opinion on Feb. 27 broadly on the side of people seeking attorneys' fees and awards of damages for having an involuntary petition dismissed.

A lender filed an involuntary Chapter 7 petition based on a personal guarantee. The alleged bankrupt prevailed on the bankruptcy court to dismiss the petition because the guarantee didn't run in favor of the lender who filed the petition.

The borrower then sued for attorneys' fees along with compensatory and punitive damages. Eventually, the bankruptcy judge awarded more than $1 million under Section 303(i)(1) of the Bankruptcy Code, which allows a person to recover attorneys' fees when an involuntary petition is dismissed.

The $1 million award included attorneys' fees incurred in upholding dismissal when the lender appealed unsuccessfully all the way to the court of appeals.

After a separate jury trial in district court, the borrower got a judgment for $360,000 on claims under Section 303(i)(2) for emotional distress arising from a bad-faith involuntary filing.

The lender argued on appeal that only the appellate court could award fees incurred during appeal.

Writing for the three-judge panel, U.S. Circuit Judge Frank M. Hull disagreed with the U.S. Court of Appeals in San Francisco and ruled that Section 303(i)(1) entitles a bankruptcy court to award appellate attorneys' fees for upholding dismissal on appeal. He said that section in its language doesn't limit the award to fees incurred in bankruptcy court before dismissal.

Hull also rejected the argument that only the appellate court may award fees. He noted that Rule 38 of the Federal Rules of Appellate Procedure grants fees only for a frivolous appeal, while Section 303(i)(1) has no frivolity requirement.

The Supreme Court's 1990 decision in Cooter & Gell v. Hartmark held that appellate fees couldn't be awarded for a Rule 11 violation. In that case, the Supreme Court said that Rule 11 isn't a fee-shifting statute.

By contrast, Hull said, Section 303 is a fee-shifting statute, thus making the Supreme Court decision inapplicable.

Hull observed that the Eleventh Circuit in Atlanta hadn't yet decided whether a

person can recover attorneys' fees for seeking actual and punitive damages for a bad-faith filing under Section 303(i)(2).

Hull came down on the side of awarding attorneys' fees under subsection (2) because the power to award fees under subsection (1) ``applies to all phases of the Section 303 action.'' He cited the ruling by the Ninth Circuit in San Francisco, which gives a bankruptcy court discretion to award fees in pursuit of bad-faith damages under Section 303(i)(2).

The case is DVI Receivables XIV LLC v. Rosenberg (In re Rosenberg), 13-14781, U.S. Eleventh Circuit Court of Appeals (Atlanta).

Published March 2, 2015

Stern Progeny

Commentary:

The Eleventh Circuit opinion held that a trial deciding which group owned the debtor is within the bankruptcy court's final adjudicatory power. It is not clear that all courts would agree before we have a Supreme Court decision in Wellness International, even though the ownership decision would be decided in the course of passing on the validity of a claim.

Bankruptcy Judge Can Decide a Company's Ownership

When ownership of a company is in dispute, the outcome of resulting litigation is within the power of a bankruptcy judge to decide, according to a Feb. 20 ruling by the U.S. Court of Appeals in Atlanta.

After one group of alleged owners put a company in Chapter 11, another group claiming control consented to having the bankruptcy judge determine ownership.

After the judge ruled, the U.S. Supreme Court decided Stern v. Marshall, finding that bankruptcy judges can't issue final decisions in some disputes based on state law.

The loser then argued that ownership was a state-law question exceeding the ability of a bankruptcy judge to make a final ruling. The loser also contended that Stern rights can't be waived.

U.S. Circuit Judge Frank M. Hull said that ruling on ownership ``was critical to the administration of the alleged debtors' estates and directly affected the debtor-creditor relationship.'' Writing for a three-judge panel, he said the ``bankruptcy court necessarily had to determine who actually owned the alleged debtor to adjudicate the validity of the alleged $32 million debt.''

Even if the issue were non-core, the loser consented and waived any objection to the power of the bankruptcy court, Hull said. In a footnote, he said the district court held a so-called de novo review, thus obviating any issues regarding the ability of the bankruptcy court to make a final judgment.

Hull upheld denial of a withdrawal-of-the-reference motion that would have taken the dispute out of bankruptcy court.

The case is In re Fisher Island Investments Inc., 12-15595, U.S. Court of Appeals for the 11th Circuit (Atlanta).

Published February 27, 2015

Chapter 11

Commentary:

A Delaware district judge held that a tender offer is Ok in Chapter 11, despite lack of oversight from the SEC.

Energy Future Make-Whole Offer Survives Appeal

Tender offers that might not be possible outside of bankruptcy court got a blessing from a federal district judge in an appeal involving the reorganization of Energy Future Holdings Corp.

Energy Future, the Dallas-based power generator and distributor, filed for Chapter 11 reorganization in April and got bankruptcy court approval in June to settle with holders of two issues of first-lien notes issued by the unit that owns 80 percent of the company's regulated Oncor power-line business.

The settlement allowed Energy Future to pay off first-lien debt with 5 percent extra for holders who gave up claims for a so-called make-whole, a premium investors can collect when their bonds are paid off early. The settlement was financed with a $5.4 billion loan approved at the same time.

The indenture trustee for one of the noteholder groups appealed and contended that the settlement was a coercive tender offer that wouldn't pass muster outside bankruptcy and shouldn't have been allowed in bankruptcy either.

Delaware Trust Co., as indenture trustee for holders of 10 percent first-lien notes, argued on appeal that the decision established a precedent which would ``open a Pandora's Box of coercive tender offers in Chapter 11.''

The trust company said the offer was unfair because one set of noteholders got a 62 percent recovery on the make-whole while the return was only 25 percent for the other ``identically situated'' group.

U.S. District Judge Richard G. Andrews in Wilmington, Delaware, explained in his 17-page opinion that the differing recoveries resulted from maturity dates and interest rates on the two issues that weren't identical.

The judge rejected the argument that tender offers can't be used in Chapter 11 reorganizations before plan approval because the Securities and Exchange Commission isn't involved in the process of approving solicitation materials as it would be outside of bankruptcy.

The judge also rejected the contention that differing recoveries for similarly situated creditors are permissible only through Chapter 11 plans. As for unequal treatment, Andrews said bondholders not accepting the settlement kept the right to sue for the full amount of the make-whole.

Andrews rejected the argument that Section 1123(a)(4) of the Bankruptcy Code was violated because it proscribes unequal treatment of similar claims. Even assuming that section applied to pre-plan settlements, it permits creditors to accept different treatment voluntarily, the judge said.

Energy Future worked out a reorganization plan with some senior lenders before its Chapter 11 filing. That plan would have used a tax-free spinoff structure. Facing opposition from some creditor groups and reluctance by the bankruptcy judge to approve a $1.9 billion refinancing, the company said in July that it was abandoning the

initial plan. The settlement regarding the make-whole wasn't affected.

To move the reorganization forward, the bankruptcy judge last month approved procedures for an auction of Oncor that doesn't necessarily require a tax-free structure.

Formerly TXU Corp., Energy Future was taken private seven years ago by KKR & Co., Goldman Sachs Group Inc. and TPG Capital in a record $48 billion leveraged buyout. The company filed for Chapter 11 on April 29 with about 70 affiliates. Its petition listed assets of $36.5 billion and debt totaling $49.7 billion.

The company has 14 power plants with a combined capacity of 15,400 megawatts, making it the largest unregulated electricity provider in Texas.

The appeal is Delaware Trust Co. v. Energy Future Holdings Corp. (In re Energy Future Holdings Corp.), 14-cv-00723, U.S. District Court, District of Delaware (Wilmington).

The Chapter 11 case is Energy Future Holdings Corp., 14-bk-10979, U.S. Bankruptcy Court, District of Delaware (Wilmington).

Published February 20, 2015

Commentary:

Delaware effectively banned bonuses absent 100% creditor recovery. In addition, lawyers who charge high rates are presumed to provide the highest levels of services and can't expect bonuses.

Delaware Judge Bars Bonus for Highly Paid Lawyers

Because professionals for the Fisker Automotive Inc. creditors' committee were ``paid handsome market-rate hourly fees'' -- in some cases more than $1,000 an hour -- they aren't entitled to $2.5 million in bonuses, U.S. Bankruptcy Judge Kevin Gross in Delaware ruled.

Law firms Brown Rudnick LLP and Saul Ewing LLP and financial adviser Emerald Capital Advisors Corp., working for Fisker creditors, sought bonuses of 53.7 percent for opposing a quick sale and ultimately arranging a recovery of as much as 100 times the initial offer of $500,000. They said unsecured creditors had little prospect of any meaningful recovery at the beginning of the bankruptcy in November 2013.

Gross's opinion is important because it seems to say that professionals aren't eligible for bonuses when ``creditor recovery is less than 100 percent,'' Nancy Rapoport, a professor at the University of Nevada's William S. Boyd School of Law in Las Vegas, said in an e-mailed statement.

Rapoport, an expert on legal fees in bankruptcy, interpreted the opinion to mean that ``very high billing rates carry with them the built-in expectation of ability not justifying fee enhancement.''

Creditors received about $40 million to $50 million for their claims when Wanxiang Group Corp. -- a buyer the committee brought forward -- agreed to pay about $150 million in cash and stock for Fisker's luxury hybrid car business at the conclusion of a highly competitive, 72-hour auction, the professionals said.

Fisker originally intended to sell its assets to another buyer at a lower price without an auction. The committee professionals successfully opened up the sale to a competitive bid from Wanxiang.

Gross said bonuses would amount to ``excessive compensation.'' He cited two federal courts of appeal in saying there's a ``high hurdle'' for bonuses and a third that limited bonuses to rare and exceptional cases.

In his Jan. 21 opinion, Gross said the professionals can't plead risk of nonpayment because there were several firms vying for the work. He also said the successful sale ``was hardly the result of an arduous undertaking.'' Even though the result was ``better than expected, it is a far cry from full recovery.''

According to the judge, the professionals ``did their job and were paid for it on the terms they requested.'' The bonuses would have come on top of about $4.6 million in regular fees that were paid.

Fisker filed for Chapter 11 protection listing liabilities of as much as $1 billion and assets less than $500 million. The company changed its name to FAH Liquidating Corp. on completion of the sale to Wanxiang in March.

The case is In re FAH Liquidating Corp., 13-bk-13087, U.S. Bankruptcy Court, District of Delaware (Wilmington).

Published January 23, 2015

Commentary:

Bankruptcy Judge Kevin Gross filed his opinion explaining why he changed venue to Chicago on the involuntary petition filed in Delaware against the Caesars casino operating company. Gross said he would have sent the case to Las Vegas had anyone asked.

He ducked the question of which party has the burden of proof when an involuntary in one district is followed by a voluntary in another. He said the burden is on the court, a curious concept.

Gross made law by saying that retaining the case would set a bad precedent by rewarding creditors who peremptorily file an involuntary to strip the debtor of the option of selecting venue.

Judge Says He Would Have Sent Caesars to Vegas

Even though Caesars Entertainment Operating Co. engaged in pre-bankruptcy conduct the Delaware bankruptcy judge called ``suspect'' on its face, he nevertheless decided the Chapter 11 reorganization should be in Chicago because the casino owner's choice of Illinois is ``entitled to just enough deference.''

The Caesars bankruptcy began on Jan. 12 when second-lien bondholders filed an involuntary Chapter 11 petition in Wilmington, Delaware. The company filed a voluntary petition for itself and dozens of affiliates three days later in Chicago. Caesars then asked U.S. Bankruptcy Judge Kevin Gross in Delaware to move the involuntary case to Chicago.

Gross announced his decision in court on Jan. 28 and filed a 23-page opinion Monday explaining his reasons for picking Chicago.

With Caesars' largest casinos in Las Vegas, Gross said he ``may very well'' have sent the case to Nevada, except neither the company nor the creditors wanted it there.

Cutting against Chicago, Caesars has ``far more significant concentrations of assets'' elsewhere, Gross said. Looking at the convenience of the parties, a relevant consideration under the governing statute, he found neither Chicago nor Delaware was more convenient for the company and creditors.

Similarly, the court in either city can conduct the case efficiently, Gross said.

Gross said he ``narrowly'' picked Chicago because Caesars' choice ``is entitled to just enough deference'' to favor Illinois.

The judge made important law regarding a pre-emptive filing, saying that rewarding the creditors by keeping the case in Delaware ``would set a bad precedent for future bankruptcy cases and limit the ability of future debtors to openly negotiate with creditors prior to filing.''

As before, Gross was careful to say he wasn't deciding whether U.S. Bankruptcy Judge A. Benjamin Goldgar in Chicago should select Jan. 12 or Jan. 15 as the start date. The earlier date will make it easier for junior creditors to void liens on so-called cage cash given to senior lenders about three months before bankruptcy.

Caesars Entertainment Corp., the non-bankrupt parent, filed papers Monday saying it won't oppose an initiative by junior lenders to have an examiner conduct an investigation. The Caesars parent said the lenders mounted ``baseless and false

attacks" on pre-bankruptcy transactions that brought Caesars Operating $2.75 billion, including $2 billion in cash.

The parent said it's in favor of a ``focused, expeditious investigation by an independent and fair-minded examiner."

Before bankruptcy, Caesars negotiated the outline of a proposed reorganization plan under which secured bank lenders with $4.35 billion of debt would be paid in full and first-lien lenders, owed $6.35 billion, would have a 92 percent recovery.

Junior noteholders said the plan would be worth 10 percent to 12 percent for lower-ranked creditors that include holders of $5.24 billion of second-lien bonds and about $1 billion of unsecured bonds.

Caesars Operating has 38 of the combined companies' 50 casinos in five countries and 14 states. It listed assets of $12.4 billion and debt totaling $19.9 billion. The operating unit generates 64 percent, or $5.4 billion, of the combined companies' $8.4 billion of annual revenue.

Caesars was named Harrah's Entertainment Inc. before a $27.2 billion leveraged buyout in January 2008 by Apollo Management LP and TPG Inc. There was a public offering in February 2012, while Apollo and TPG retained control.

The voluntary filing in Chicago is In re Caesars Entertainment Operating Co. Inc., 15-01145, U.S. Bankruptcy Court, Northern District of Illinois (Chicago).

The involuntary case in Chicago is In re Caesars Entertainment Operating Co. Inc., 15-03193, U.S. Bankruptcy Court, Northern District of Illinois (Chicago).

The involuntary case in Delaware was In re Caesars Entertainment Operating Co. Inc., 15-10047, U.S. Bankruptcy Court, District of Delaware (Wilmington).

Published February 3, 2015

Commentary:

The Third Circuit took a strict view and held that a settlement in reality was a post-confirmation plan amendment. The opinion favors creditor democracy even when the purported settlement ostensibly would benefit creditors. I am not certain all circuits would agree.

Stretching Plan Is Amendment, Not Settlement, Court Says

A settlement that stretches a confirmed Chapter 11 plan from five years to eight years is a plan modification, not a settlement, even though it has economic benefits for creditors, the U.S. Court of Appeals for the Third Circuit ruled Feb. 24.

A company emerged from Chapter 11 in 2009 with a plan giving creditors payments over the ensuing five years from the buyer, who had the right to offset the payments against expenses from defending lawsuits.

As it turned out, the buyer claimed enough offsets so nothing was paid to creditors. Eventually, the trustee for the creditors' trust negotiated a settlement under which the buyer agreed to stretch out the payments three more years, although subject to the same right of setoff.

After the bankruptcy court approved the settlement, the creditors appealed and lost in Delaware district court. They appealed again and won in the Philadelphia-based Third Circuit.

Saying that decisions from other circuits weren't binding, U.S. Circuit Judge Robert E. Cowen, writing for the court, ruled that ``turning a five-year plan into an eight-year plan constitutes a modification of the plan itself'' under Section 1127 of the Bankruptcy Code.

It was a modification even if it provided ``greater economic benefits for the estate and its creditors,'' Cowen said. It didn't appear to matter that there was no increase in the maximum that creditors theoretically could receive.

Cowen sent the case back to the bankruptcy court to determine whether the settlement would pass muster as a post-confirmation plan modification.

The case is CFI Class Action Claimants v. SCH Corp. (In re SCH Corp.), 14-2888, U.S. Court of Appeals for the Third Circuit (Philadelphia).

Published February 25, 2015

Commentary:

Chicago Bankruptcy Judge Goldgar held that he has no statutory power to disband a committee. His decision could be seen as differing with Judge Rhodes' opinion in the Detroit municipal bankruptcy.

Detroit, Caesars Judges Differ on Power to Disband a Committee

U.S. Bankruptcy Judge A. Benjamin Goldgar in Chicago explained in the case of Caesars Entertainment Operating Co. why a bankruptcy court simply doesn't have the statutory power to disband an official creditors' committee.

After filing for Chapter 11 reorganization in January, the casino operator argued to the U.S. Trustee that second-lien bondholders were unsuitable for service on an unsecured creditors' committee. The U.S. Trustee, the Justice Department's bankruptcy watchdog, responded by appointing two committees, one for general unsecured creditors and one composed entirely of second-lien bondholders and their indenture trustees.

Caesars asked Goldgar to disband the second-lien committee, for a variety of reasons.

Although Goldgar said some of Caesars' concerns were ``well taken,'' that was ``beside the point.'' There's nothing in Section 1102(a) of the Bankruptcy Code that empowers a court to disband a committee formed by the U.S. Trustee, the judge ruled.

Goldgar relied on the doctrine of ``expressio unius est exclusion alerius,'' meaning ``the expression of one thing is the exclusion of another.''

Section 105(a) of the code, the so-called All Writs Act, similarly provides no power to disband a committee. That section, Goldgar said, gives ``power only to implement existing Code sections.'' It ``does not allow bankruptcy courts to contradict the Code.''

In that respect, Goldgar parted company with now-retired U.S. Bankruptcy Judge Steven Rhodes, who ruled in February 2014 in Detroit's municipal bankruptcy that Section 105 confers power to tinker with a committee because the code doesn't expressly prohibit it. For details on Rhodes' decision, click here for the March 3, 2014, Bloomberg bankruptcy report.

The Detroit and Caesars cases are different because Rhodes said the code doesn't authorize committees in municipal bankruptcies.

Goldgar said he lacked the power to limit the junior-lien committee's activities. He said Section 1103 lays out the duties of a committee but doesn't permit the court to limit its activities.

Goldgar recognized that some of the company's concerns about excessive cost were legitimate. The judge said he can keep expenses in check because he has the power to control the hiring and compensation of committee professionals and limit the scope of an examiner's investigation.

The case is In re Caesars Entertainment Operating Co. Inc., 15-01145, U.S. Bankruptcy Court, Northern District of Illinois (Chicago).

CZR US

NV, CNO, LEI, TRAVEL, ENT

Published March 18, 2015

Commentary:

A Delaware district court decision told bankruptcy judges to make sure there is a sufficient record about notice when approving settlements in situations where there was no hearing, just submission of an order under certificate.

No Notice to Committee Makes Settlement Defective

The practice in Delaware bankruptcy court and elsewhere of approving last-minute settlements with little notice was drawn into question in a Jan. 16 opinion by U.S. District Judge Leonard P. Stark in Wilmington.

In Chapter 11, a secured creditor objected to a sale of property. The objection was resolved with a first settlement where the lender's collateral was to be segregated and not sold. When it appeared the collateral had been sold anyway, the lender filed a motion to enforce the prior settlement.

Just before the hearing on the enforcement motion, there was a second settlement where the company and the buyer agreed to pay the lender about $1 million. The amended agenda for the hearing, which was served on the creditors' committee, said the court would consider a settlement, although details weren't given.

The bankruptcy judge approved the settlement. Later, the reorganization was converted to Chapter 7 where a trustee was appointed. The trustee wanted to sue the lender for preferences.

The lender persuaded the bankruptcy judge to dismiss the preference suit because the second settlement gave releases of all claims that might be made against the lender.

On appeal, Stark reversed and sent the dispute back to the bankruptcy court. The trustee argued successfully there might not have been sufficient notice of the second settlement.

Stark noted how Bankruptcy Rule 9019 ordinarily requires 20 days' notice of settlement. Although the bankruptcy judge has discretion to shorten or eliminate notice, Stark said ``there are limits.''

Stark focused on part of the bankruptcy court's opinion saying it was not clear the committee had ``advance notice'' of the second settlement. He also said the ``record fails to demonstrate there was any notice.''

Stark sent the case back to the bankruptcy court with instructions to decide whether rules and case law on notice regarding settlements had been followed.

The case means that even routine, non-controversial settlements require either explicit consent or proven notice at least to the creditors' committee. Settlement approval orders also should lay out what notice was given and why it was sufficient.

The case is Burtch v. Avnet Inc., 13-060, U.S. District Court, District of Delaware (Wilmington).

Published January 20, 2015

Commentary:

The Third Circuit upheld Bankruptcy Judge Sontchi in Delaware by ruling that a tax-sharing agreement gives a refund to the bankrupt parent, not to the FDIC as receiver for the failed bank. Although other circuits reached different conclusions, the difference might be explained by differently-worded agreements, not a split of circuits.

Downey Creditors Beat FDIC for $370 Million Tax Refund

Creditors of Downey Financial Corp., whose bank subsidiary Downey Saving & Loan Association was taken over by regulators in November 2008, got a $370 million victory at the expense of the Federal Deposit Insurance Corp. on an issue dividing the federal courts of appeal.

In an unsigned opinion handed down on Monday, the U.S. Court of Appeals for the Third Circuit in Philadelphia upheld U.S. Bankruptcy Judge Christopher Sontchi, who decided that a tax refund goes to the parent Downey Financial even though the refund was generated by losses incurred by the bank subsidiary taken over by the FDIC.

The FDIC unsuccessfully argued to Sontchi that the parent held the tax refund in trust. Writing for the three-judge appellate panel, U.S. Circuit Judge Joseph A. Greenaway Jr. sided with Sontchi.

Not all courts have reached the same result. The FDIC won some of the cases, though they tend to turn on the precise language in the companies' tax-sharing agreements more than on federal or state laws.

Greenaway said the parent wasn't agent for the bank subsidiary because the bank had no control over Downey Financial under the tax-sharing agreement. For example, the parent could decide whether to have the refund paid or applied against taxes in later years.

The agreement didn't create a trust under California law either, Greenaway said.

Greenaway also rejected an argument for a resulting-trust, a theory intended to prevent unjust enrichment. The judge said there's nothing unjust about enforcing parties' contracts.

The appeals court allowed a direct appeal from Sontchi's ruling, bypassing the district court.

In November, the U.S. Supreme Court declined to allow an appeal in a case involving liquidated NetBank Inc., where the U.S. Court of Appeals in Atlanta had awarded the refund to the FDIC as receiver, not to the holding company. Previously, the high court declined to hear a similar case involving BankUnited Financial Corp.

To lay the foundation for the Jan. 26 circuit opinion, the suit was brought by the trustee for Downey Financial, which filed for Chapter 7 liquidation in November 2008, not even trying to reorganize in Chapter 11.

As soon as the bank was taken over, the assets of the thrift subsidiary were bought by U.S. Bank NA in a transaction assisted by the FDIC. The Downey bank failure cost the FDIC insurance fund $1.4 billion, the agency said at the time.

Fox Rothschild LLP represented the Downey trustee, while Blank Rome LLP was counsel for an indenture trustee.

The appeal is Cantor v. FDIC, 14-1586. U.S. Court of Appeals for the Third Circuit

(Philadelphia).

The bankruptcy case is In re Downey Financial Corp., 08-13041, U.S. Bankruptcy Court, District of Wilmington (Delaware).

Published January 27, 2015

Commentary:

Bankruptcy lawyers in Texas should know that Bankruptcy Judge Jeff Bohm in Houston is no fan of mediation. He wrote an opinion warning that he will not routinely approve mediation. The judge said he is no "mediation romantic."

Bohm may be correct on one point. A mediator may be a "professional" for whom retention should be approved in advance. I recommend reading the opinion in full text as it is gaining wide renown.

Houston Judge Bars Using Mediation as First Resort

Mediation, as a means for concluding a contentious bankruptcy, is usually seen as an unqualified good, but apparently not in the courtroom of U.S. Bankruptcy Judge Jeff Bohm in Houston.

Saying he's not a ``mediation romantic,'' Bohm wrote a 24-page opinion this week announcing 10 standards he will apply before approving mediation. Bohm has been a bankruptcy judge for 10 years in Houston, where he is the chief judge.

In the case before him, Bohm said he wouldn't approve mediation because the contending lawyers were on amiable terms and capable of reaching settlement without the cost of mediation.

Before he approves the expense of hiring a mediator, Bohm said, there must be some document exchange and initial attempts at reaching a settlement ``without third-party intervention.''

Even if discussions fail, ``mediation is not necessarily appropriate'' because it's ``not free,'' the judge said.

Bohm also said he won't necessarily approve mediation ``merely because the monetary costs of litigation outweigh the costs of mediation.''

He said there can be beneficial effects from litigation not possible in mediation. He cited the example of someone beaten in court and embarrassed on cross-examination. That person might modify future behavior, which wouldn't be the case were the resolution the result of arm-twisting in mediation.

The parties may have made a mistake by hiring a recently retired bankruptcy judge to be mediator without first filing papers to authorize the retention.

Noting that commentators don't agree, Bohm said that a mediator is a ``professional person'' whose retention must be approved in advance by the court.

He also said there would be an ``appearance of cronyism'' were a sitting judge to approve the hiring of a retired judge without holding a thorough hearing. Bohm said he wants to avoid the ``incestuous referee-trustee relationship rampant under the old Bankruptcy Act,'' which was repealed in 1978.

The case is In re Smith, 12-32096, U.S. Bankruptcy Court, Southern District Texas (Houston).

Published January 30, 2015

Consumer

Commentary:

The Ninth Circuit BAP tells us that making all required monthly payments for five years is not enough to win a Chapter 13 discharge. Creditors must also receive the promised percentage recovery.

This was a case in which the bankrupts' counsel may have committed malpractice, causing the debtors to waste $48,000 due to their lawyer's inattention to details.

Chapter 13 Debtors Must Pay Promised Percentages

Even though a couple in Chapter 13 made five years of monthly payments in the required dollar amount, their case was properly dismissed because they didn't pay unsecured creditors the promised percentage, the U.S. Bankruptcy Appellate Panel for the Ninth Circuit in Pasadena, California, ruled on Feb. 25.

The plan required paying $812 a month for 60 months and promised a 48 percent recovery for unsecured creditors.

When the plan was confirmed, the bankrupts evidently assumed that a holder of a junior mortgage on their home would not file an unsecured claim. The property was worth less than the first mortgage, meaning that the subordinate mortgage could only be an unsecured claim.

As it turned out, the junior mortgage holder eventually filed a timely claim before confirmation. The bankrupts never objected to the claim.

Over five years after confirmation, the bankrupts paid a total of $48,000 to unsecured creditors, or about 15 percent of those claims. They were nonetheless $78,000 short of paying creditors 48 percent promised in the plan, because they hadn't figured in the junior mortgage holder's $150,000 unsecured claim.

Finally noticing the shortfall, the bankrupts sought a hardship discharge and didn't attempt to modify the plan.

The bankruptcy court denied the bankrupt's motion for a discharge and granted the Chapter 13 trustee's motion to dismiss the case, even though the bankrupts had faithfully and fully made their monthly payments.

Writing for the three-judge appellate panel, Bankruptcy Judge Ralph Kirscher said his court had not before decided whether it's sufficient to make required monthly payments in dollar amount, even though creditors don't receive the promised percentage recovery.

Kirscher upheld the bankruptcy court and said it was a proper exercise of discretion to dismiss the Chapter 13 case. He said the bankrupts knew or should have known for four years that their payments would be insufficient to pay the required 48 percent under the plan.

The result was the worst possible for the bankrupts. They were out of pocket $48,000, yet their creditors became entitled to sue for the remainder of the debt because they never got a discharge. The case may be another instance where bankrupts suffered due to their lawyer's inattention to detail.

The case is Schlegel v. Billingslea (In re Schlegel), 14-1132, U.S. Ninth Circuit Bankruptcy Appellate Panel (Pasadena, California).

Published March 2, 2015
Commentary:

Bankruptcy Judge Michael Lynn in Fort Worth applied a Supreme Court Chapter 11 case in Chapter 13, concluding that the debtor can direct how the IRS applies payments toward tax claims.

Bankrupts Can Cram Home-Sale Proceeds Down on IRS

A 1990 decision by the U.S. Supreme Court involving Chapter 11 is applicable in Chapter 13 and allows the court to direct that the Internal Revenue Service must apply sale proceeds as the bankrupts elect, U.S. Bankruptcy Judge Michael Lynn from Fort Worth, Texas ruled in an opinion on Dec. 31.

Lynn's case involved a couple in Chapter 13 who chose to sell their exempt home and use the proceeds to pay down secured portions of the tax claims. The IRS objected, claiming the right to decide how the proceeds are applied among secured, priority, and unsecured tax claims.

Lynn disagreed with the IRS and said, like some other courts, that the Supreme Court's U.S. v. Energy Resources Co. applies equally to Chapter 13 cases.

For Lynn, compelling the IRS to apply home-sale proceeds to secured tax claims was essential to insure that the bankrupts could comply with their plan. If the IRS could apply the payment to unsecured or priority claims, interest owing to the IRS on secured claims would continue to grow, perhaps disabling the bankrupts from making payments required by their plan.

The case is In re Fielding, 13-43212, U.S. Bankruptcy Court, Northern District Texas (Fort Worth).

Published January 8, 2015

Commentary:

A district judge in New Orleans holds that exhaustion of administrative remedies does not apply to adversary proceedings for discharge of student loan debt. The failure to seek administrative relief nonetheless goes to the good faith issue under Section 523(a)(8).

'Exhaustion' Rule Inapplicable to Student Loan Debt

A bankruptcy court can't require a bankrupt to seek an administrative deferral or discharge of student loans before seeking an ``undue hardship discharge'' under Section 523(a)(8) of the Bankruptcy Code, U.S. District Judge Susie Morgan in New Orleans wrote in a Feb. 26 opinion.

A bankrupt in Chapter 7 claimed he was disabled and filed suit seeking a discharge of student-loan debt. Without being urged to do so by the lender, the bankruptcy judge instructed the bankrupt first to seek an administrative discharge of the debt under the Federal Family Education Loan Program.

When the bankrupt insisted he was entitled to seek a discharge under Section 523(a)(8), the bankruptcy judge dismissed the discharge complaint for lack of prosecution. The bankrupt appealed and won.

Morgan said that the ``overwhelming consensus of the courts'' shows that bankrupts are not required to exhaust administrative options before pursuing an undue hardship discharge. She explained how administrative procedures may take years to effect and may not wipe out student loans entirely.

The case is Dorsey v. U.S. Department of Education, 14-1402, U.S. District Court, Eastern District Louisiana (New Orleans).

Published March 2, 2015

Commentary:

A Milwaukee district judge sides with the Fourth Circuit and the Ninth Circuit BAP by holding in substance that statutory commissions are mandatory for a Chapter 7 trustee.

Milwaukee Judge Pays Trustee Full Statutory Commissions

A federal district judge in Milwaukee came down firmly on the side of paying statutory commissions to Chapter 7 trustees regardless of how much or little time was spent on the case.

A Chapter 7 trustee sought a commission of about $28,000 calculated under Section 326 of the Bankruptcy Code. A creditor objected, saying little work was required and wanting the fee reduced.

The bankruptcy judge granted the full amount, and the creditors appealed, to no avail.

U.S. District Judge Lynn Adelman explained how the appeal stemmed from a lack of clarity resulting from 2005 amendments to the code. She cited cases from the U.S. Court of Appeals in Richmond, Virginia, and the Bankruptcy Appellate Panel in San Francisco, as standing for the proposition that statutory commissions must be paid absent ``extraordinary circumstances.''

Adelman concluded the elimination of a reference to a Chapter 7 trustee in Section 330(a)(3) means that a Chapter 7 trustee is presumptively entitled to statutory commissions. Adelman didn't reach the question of whether there can be deductions only in extraordinary circumstances.

The judge said ``reasonable compensation'' under Section 330(a) means statutory commissions. Reductions should be ``sparing,'' the judge said, and there should be no adjustments based on the amount of time spent.

The fact that a trustee spent little time on a particular asset is ``not grounds for excluding the proceeds'' from the calculation.

To read about the Richmond and San Francisco cases, click here for the April 30 Bloomberg bankruptcy report and here for the Aug. 10, 2012 report.

The case is Mohns v. Lasner, 14-1280, 2015 BL 6596, U.S. District Court, Eastern District Wisconsin (Milwaukee).

Published January 14, 2015

Commentary:

A decision from an Illinois district judge is a warning about the binding nature of valuations in schedules. An individual bankrupt who had a fire loss was stuck with the personal property valuation shown in his schedules when it came an insurance claim, although the values were based on advice of counsel.

Bankruptcy Schedules Control Over Later Insurance Claim

Someone who lists personal property as worth $950 in a personal bankruptcy is stuck with that amount in filing an insurance claim if the goods are later destroyed in a fire.

The bankruptcy trustee isn't stuck with it, according to a Feb. 19 opinion by U.S. District Judge J. Phil Gilbert from East St. Louis, Illinois.

In his Chapter 7 schedules, a man listed items of personal property as worth $950. After he got his discharge, the home he rented, along with contents, was destroyed by fire. He lodged a claim of $125,000 with the insurance company. The adjuster gave the property a cash value of about $50,000.

The insurance company didn't pay, claiming a violation of the ``concealment and fraud'' provision in the policy. The individual and his trustee both sued.

Using the doctrine of judicial estoppel, Gilbert said the man was ``stuck'' with the $950 value he placed on personal property because that was his ``sworn representation in his bankruptcy proceeding.'' It didn't matter that the value was listed on advice of bankruptcy counsel, Gilbert said.

The trustee came out better. Because the trustee made no false representations, Gilbert is allowing the trustee to claim at trial that the value is in line with the adjuster's estimate.

The case is Bruegge v. Metropolitan Property & Casualty Insurance Co., 13-cv-1256, U.S. District Court, Southern District of Illinois (East St. Louis).

Published February 24, 2015

Commentary:

A Florida district court holds that the court loses jurisdiction over a homestead abandoned in Chapter 7. Some may disagree.

Jurisdiction Lost When Chapter 7 Trustee Abandons Homestead

A district judge in Miami ruled that the bankruptcy court loses jurisdiction over a bankrupt's home if a Chapter 7 trustee abandons the property.

The case involved a person whose condominium was worth less than the first mortgage. The trustee abandoned the property.

Despite abandonment, the bankruptcy judge concluded that he retained jurisdiction because the home was covered by the Florida homestead exemption and the bankrupt would retain the property after bankruptcy.

The bankruptcy judge proceeded to strip off a subordinate lien on the home, saying it wouldn't be enforceable after the bankrupt received her discharge.

U.S. District Judge Robin L. Rosenberg reversed on Dec. 5, holding that jurisdiction ceases when a property is abandoned, even if it's a homestead.

Lacking jurisdiction, it was error for the bankruptcy court to strip off the under-water lien, Rosenberg said, even though authority from the governing U.S. Court of Appeals in Atlanta gives power to strip off a valueless subordinate mortgage.

The district judge seems to assume there's jurisdiction only with regard to property of the estate. There's no discussion of ``related to'' jurisdiction.

In November, the U.S. Supreme Court agreed to hear an appeal in two cases involving Bank of America NA to resolve a split among federal courts and decide whether underwater mortgages can be stripped off in Chapter 7, the same as in Chapter 13. For more, click here for the Nov. 18 Bloomberg bankruptcy report.

If the Supreme Court sides with lenders in the Bank of America cases and prohibits lien stripping in Chapter 7, Rosenberg's case won't matter because lien stripping will be impossible in Florida and other states covered by the Atlanta appeals court.

If the Supreme Court permits lien stripping in Chapter 7, Rosenberg's case will be important because, unless overruled by the Atlanta court, a Chapter 7 trustee could eradicate a bankrupt's right to lien strip by abandoning the property.

The Supreme Court has held that mortgages can't be stripped down in Chapter 7, by lowering the amount of the secured debt to the value of the lenders' interest in the collateral.

The case is La Paz at Boca Pointe Phase II Condominium Association Inc. v. Bandy, 14-80783, BL 343839, U.S. District Court, Southern District Florida (Miami).

Published January 2, 2015

Commentary:

Declining to part with the Fifth and Third Circuits, the Ninth held that a Chapter 7 trustee's fees don't include percentages of a credit bid. Judge Kozinski said the result may be "harsh," but it is not "absurd." Some might disagree.

It's another example of how a secured creditor can enjoy the advantages of bankruptcy compared with foreclosure without paying the price.

Bankruptcy Trustee Fees Not Based on Credit Bidding

When a Chapter 7 trustee sells property to a secured creditor making a so-called credit bid, the trustee's fee isn't calculated based on the debt used to purchase the property, according to a decision on Monday by the U.S. Ninth Circuit Court of Appeals in San Francisco.

A Chapter 7 trustee sold property to secured lenders in exchange for $1.5 million in debt, a process known as credit bidding. The bankruptcy judge awarded the trustee a fee of about $100,000, calculated using the credit bid. On appeal, the Bankruptcy Appellate Panel reversed. The reversal lowered the trustee's fee to about $40,000.

Writing for the three-judge Ninth Circuit, Circuit Judge Alex Kozinski focused on the language of the governing statute, Section 326(a) of the Bankruptcy Code. That section says a trustee's fees are measured by a percentage of ``all moneys disbursed or turned over.''

Kozinski said the words retain their ordinary meaning. The only thing turned over was real property. He said ``moneys'' can't be ``expansive enough to encompass real estate.''

The judge wasn't inclined to create a split with two circuit courts, in New Orleans and Philadelphia, which don't calculate a trustee's fees using credit bids.

The trustee argued it would be absurd to award a larger fee if property is bought by a cash buyer when there was an auction pitting a credit bidder against the cash purchaser. In that case, the fee would depend on who won the auction.

Kozinski said the result ``may be harsh and misguided, but it is not absurd.''

The case is Tamm v. UST v. United States Trustee (In re Hokulni Square Inc.), 10-1468, U.S. Ninth Circuit Court of Appeals (San Francisco).

Published January 27, 2015

Commentary:

A Milwaukee district judge decided that Chief Cecelia Morris in New York had the best analysis of how to dispose of cash when a Chapter 13 is dismissed before confirmation.

Lawyers Properly Stiffed for Fees When Chapter 13 Case Dismissed

When a Chapter 13 case was dismissed before plan confirmation, the bankruptcy court didn't commit error in declining to exercise jurisdiction after dismissal to grant fee awards to the bankrupts' attorneys.

The individual Chapter 13 bankrupts' attorneys filed motions for dismissal for failure to make required pre-confirmation payments. Before dismissal, the lawyers filed applications for fees.

The bankruptcy judge dismissed the cases without reserving jurisdiction to grant fees later. At a hearing after dismissal, the bankruptcy judge said he lacked jurisdiction to pay the lawyers.

The lawyers appealed and lost in a Dec. 29 opinion by U.S. District Judge Joseph P. Stadtmueller in Milwaukee.

Several provisions in the Bankruptcy Code ``cannot be read in harmony with one another,'' Stadtmueller said. He also said courts considering the same issue are ``all over the map in attempting to construe these phrases.''

Favoring the lawyers, Section 1326 requires returning money to the bankrupts after deducting any ``unpaid allowed'' claims for expenses of the bankruptcy. Weighing ``heavily against'' the lawyers, Section 349(b)(3) provides that property goes back to the prior owner on dismissal, Stadtmueller said.

Stadtmueller said he was most swayed by a 2013 decision by Chief U.S. Bankruptcy Judge Cecelia Morris of the Southern District of New York, in a case called Garris.

Because the bankruptcy judge hadn't approved fees before dismissal, the judge should have turned remaining cash over to the bankrupts without holdbacks for fees, Stadtmueller said. The question remained whether the bankruptcy judge could or should have retained jurisdiction over fee allowances, according to Stadtmueller.

Although the bankruptcy judge could have kept ancillary jurisdiction after dismissal, Stadtmueller said it was no abuse of discretion to dismiss without retaining jurisdiction.

Dismissal accompanied by returning all cash to the bankrupts was ``the best outcome in terms of serving the goals of the statutes and swift administration of bankruptcy cases,'' Stadtmueller said.

The case is In re Ward, 14-882, U.S. District Court, Eastern District of Wisconsin (Milwaukee).

Published January 2, 2015

Commentary:

A district judge in Reno overruled a bankruptcy judge who held that a Chapter 7 trustee lacked power to sell the assets of an LLC that was owned by the debtor.

Trustee Succeeds to Power of Sale over Bankrupt's LLC

When an individual bankruptcy owns a limited-liability corporation, the trustee automatically has the right to take control and sell the LLC's assets, Chief U.S. District Judge Gloria M. Navarro in Reno, Nevada, said in a September opinion.

The bankruptcy judge had ruled that, even though ownership of the LLC became property of the bankrupt estate, the trustee had no right to sell or take ownership of the assets of the company. Navarro disagreed.

Navarro sided with courts holding that the trustee succeeds to all the owner's rights and need take no further action to exercise control. The trustee isn't limited to a charging order under Nevada law, the judge said.

The trustee has the right to take ownership and sell the company's assets, Navarro ruled.

The case is Schwartzer v. Cleveland (In re Cleveland), 14-00068, U.S. District Court, District of Nevada (Reno).

Published January 14, 2015

Commentary:

The Second Circuit and the First Circuit BAP chided bankruptcy judges for not reopening cases.

Appellate Courts Reverse for Failure to Reopen Cases

Two appellate courts handed down decisions within days of each other chastening bankruptcy judges for refusing to reopen closed cases.

Both cases recite how a decision to reopen a case is committed to the sound discretion of the bankruptcy court and can't be set aside on appeal absent abuse of discretion, a high standard of review.

The U.S. Second Circuit Court of Appeals in Manhattan reversed a bankruptcy court for failing to consider whether there would be prejudice from reopening a case. It wasn't sufficient, the circuit court said in its unsigned summary opinion, to consider only if there would be prejudice from denial of the motion to reopen.

The second case, from the First Circuit Bankruptcy Appellate Panel in Boston, involved seven judicial liens totaling more than $700,000 on an individual in Chapter 7 whose home was worth about $270,000. His lawyer claimed a homestead exemption on the home in the amount of ``$0.00.''

The bankruptcy judge refused to void the judicial liens, saying they weren't impairing a claimed exemption given the value of zero. The judge then granted the discharge and closed the case.

Nine months later, the bankrupt filed a motion to reopen the case. The judge denied the motion. The bankrupt appealed to the appellate panel which reversed with instruction to reopen.

The bankrupt had argued to the bankruptcy judge that he shouldn't be saddled with consequences of his lawyer's delay and failure to claim a dollar amount on the homestead exemption.

The bankruptcy judge said, ``The client has to suffer if the attorneys don't play by the rules.''

Writing for the three-judge appellate panel, Bankruptcy Judge J. Michael Deasy said the bankruptcy judge failed to consider a line of cases saying that a bankrupt can amend exemptions. Deasy also said there is no time limit for amending exemptions to claim a dollar amount.

In addition, Deasy said a holder of one of the judicial liens showed no prejudice were the case reopened.

Deasy didn't say the bankruptcy would win in knocking out judicial liens. He only said it was error not to reopen the case, allow the bankrupt to amend his exemptions, and try to set aside judicial liens that impaired his homestead exemption.

The New York case is Harbor Trust Co. Ltd. v. Aaron (In re Plusfunds Group Inc.), 14-817, 2015 BL 13700, U.S. Second Circuit Court of Appeals (Manhattan).

The Boston case is Ludvigsen v. Osborne (In re Ludvigsen), 14-309, 2015 BL 16225, U.S. First Circuit Bankruptcy Appellate Panel (Boston).

Published January 26, 2015

Commentary:

An individual debtor couldn't revoke a homestead waiver granted before the Supreme Court decided Law v. Siegel.

Debtor Can't Revoke Homestead Waiver Even After Change of Law

A man who waived his homestead exemption relying on case law that was later reversed by the U.S. Supreme Court couldn't use the change of law to revoke his waiver.

U.S. District Judge Brian Morris in Missoula, Montana, had a case in which an individual bankrupt claimed a homestead exemption. It turned out that he lied on his schedules by failing to disclose ownership of gold and coins.

Under case law at the time from the governing U.S. Court of Appeals in San Francisco, the trustee could disallow the otherwise proper homestead exemption to satisfy liability for fraud. Facing the further possibility of criminal prosecution, the bankrupt settled with his trustee.

With advice from counsel, the bankrupt waived his homestead exemption, among other things. But once the trustee began trying to sell the home, the bankrupt filed papers to revoke the waiver.

Before that motion was decided, the Supreme Court handed down Law v. Siegel, holding that a court can't use equitable powers to override a statutory homestead exemption. The bankruptcy judge nonetheless allowed the waiver to be revoked.

On appeal, Morris reversed, citing Rule 60(b)(6) of the Federal Rules of Civil Procedure, which permits relief from a final judgment for ``any other reason that justifies relief.''

Observing that the bankrupt made an ``informed, strategic choice,'' Morris said a ``mere change in decisional law'' after a settlement is no ``exceptional circumstance'' justifying relief from a judgment.

The case is Brandon v. Bodeker (In re Bodeker), 14-cv-195, U.S. District Court, District of Montana (Missoula).

Published February 11, 2105

Commentary:

An individual with a confirmed Chapter 11 plan should not close the case before receiving a discharge. Trying to save money on U.S. Trustee fees could backfire horribly.

Trying to Save Money Accidentally Terminates Automatic Stay

Trying to save a few bucks on fees owed to the U.S. Trustee, a couple who had been in Chapter 11 found themselves unprotected when a secured lender foreclosed.

The couple got a confirmation order approving their Chapter 11 plan. To avoid paying quarterly U.S. Trustee fees, they prevailed on the judge to close the case even though payments under the plan weren't completed and they hadn't been granted a discharge.

When they failed to pay a lender, the bank successfully sued in state court to enforce the plan and assert rights in some of the bankrupt's property. Later, the bankrupts reopened their Chapter 11 case and sued the bank for violating the so-called automatic stay and intruding on the bankruptcy court's exclusive jurisdiction over the plan.

The bankruptcy judge ruled against them, as did the Bankruptcy Appellate Panel in Denver.

U.S. Bankruptcy Judge Janice Miller Karlin said the result flowed from a ``simple reading'' of two provisions in the Bankruptcy Code, Sections 362(c)(1) and 1141(b).

The former dissolves the stay when property no longer belongs to the estate. Section 1141(b) provides that property on confirmation re-vests in the debtors. Consequently, the property was no longer protected by the stay after confirmation because it had been taken out of the estate and vested in the individual bankrupts.

Karlin also ruled that the bankruptcy court didn't have exclusive jurisdiction over disputes arising from the plan.

The case is Rael v. Wells Fargo Bank NA (In re Rael), 14-035, U.S. Tenth Circuit Bankruptcy Appellate Panel (Denver).

Published March 3, 2015

UCC & Sales

Commentary:

We can rest easy, knowing there is no shadow UCC letting major firms and financial institutions off the hook for their mistakes.

The Second Circuit reached the same result as the Delaware Supreme Court by holding that JPMorgan is stuck with its lawyers' mistake in terminating a $1.5 billion security interest that should have remained on the books.

JPMorgan Loses Appeal Over $1.5 Billion GM Error

JPMorgan Chase Bank NA lost the second and decisive round of a $1.5 billion appeal when a federal appeals court in Manhattan ruled that creditors of General Motors Corp., the bankrupt automaker, are entitled to a billion-dollar payday thanks to mistakes by lawyers paying off a $300 million loan.

Unsecured creditors were told when the Detroit-based automaker was emerging from bankruptcy that their recovery depended chiefly on two factors. First was the value of the stock and warrants they got in the reorganized ``new'' GM. The second was the outcome of the lawsuit resulting from a mistake made during a loan refinancing.

The story begins in 2001 with a $300 million synthetic lease financing from New York-based JPMorgan. In 2006, with the same bank as agent, GM obtained a new $1.5 billion loan secured by most of the carmaker's assets.

GM paid off the smaller loan in October 2008, before its June 2009 Chapter 11 filing in Manhattan.

As it turned out, lawyers for JPMorgan and GM mistakenly filed documents that, on their face, also terminated the security interest for the $1.5 billion financing that was supposed to remain on the books.

Discovered when GM's Chapter 11 reorganization was in progress, the creditors' committee claimed the mistake meant JPMorgan didn't have a valid lien to secure the $1.5 billion loan.

U.S. Bankruptcy Judge Robert E. Gerber ruled in favor of the bank in March 2013 and said the loan's secured status survived the error because it wasn't what either GM or the bank intended.

Creditors went straight to the U.S. Court of Appeals for the Second Circuit in Manhattan. In June, the court asked Delaware's Supreme Court to resolve an undecided issue of state law under the Uniform Commercial Code, which governs the validity of the JPMorgan loan and security interest.

The Delaware court issued an opinion in October in favor of the creditors, saying ``unambiguous provisions'' in the statute ``dictate'' that the creditors must win on the question because it's ``enough that the secured party authorizes the filing.''

The Delaware court's decision alone didn't mean the creditors would win and GM would lose collateral for the loan. The Second Circuit said it still had to decide whether the law firm was authorized as agent to terminate the security interest.

In an unsigned 15-page opinion Wednesday, a three-judge circuit panel said the filing was authorized, although mistaken.

The opinion starts by explaining how the assignment was first given to an associate who subcontracted some of the labor to a paralegal. Documents were prepared that, as

it turned out, terminated not only a lien that was intended to end but also the $1.5 billion lien that wasn't.

The appeals court said bankers and lawyers for GM and JPMorgan all were sent documents multiple times asking for review and comment.

The circuit court said ``repeated manifestations'' by JPMorgan and its own lawyers showed they knew GM's lawyers would file the papers, even though it turned out the documents would terminate the wrong security interest.

``Nothing more is needed,'' the court concluded.

The appeals panel sent the case back to the bankruptcy court to make appropriate changes in the treatment of creditors under old GM's plan.

Before then, JPMorgan can attempt a final appeal to the U.S. Supreme Court. The high court, however, takes few cases concerning state commercial law, since the states are ordinarily the final authority on that subject.

``We're still reviewing the decision and looking at our options,'' Andrew Gray, a spokesman for JPMorgan, said in an interview Wednesday.

To read the opinion, click here. For the federal appeals court's interim ruling, click here for the June 18 Bloomberg bankruptcy report. For discussion of the Delaware opinion, click here for the Oct. 21 report.

GM filed for reorganization under Chapter 11 listing assets of $82.3 billion and debt of $172.8 billion. The business was sold the next month to a ``new'' company, General Motors Co.

Old GM, now formally Motors Liquidation Co., implemented a Chapter 11 plan in March 2011, distributing stock and warrants received from new GM.

The plan created four trusts. One distributes the new GM stock and warrants as consideration for the sale of the assets. Creditors of old GM split up 10 percent of the stock of new GM plus warrants for 15 percent. For details, click here for the Sept. 1, 2010, Bloomberg bankruptcy report.

The appeal in federal court is Official Committee of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank NA (In re Motors Liquidation Co.), 13-2187, U.S. Court of Appeals for the Second Circuit.

The question certified to the state court is in Official Committee of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank NA, 325 2014, Supreme Court, State of Delaware.

The GM Chapter 11 case is In re Motors Liquidation Co., 09-bk-50026, U.S. Bankruptcy Court, Southern District of New York (Manhattan).

Published January 22, 2015

Commentary:

Even though a business was sold free of claims, the buyer is stuck with the seller's antitrust liability if management, after the acquisition, participated in the ongoing price-fixing conspiracy, an Ohio district judge held. The opinion is an excellent survey of law on the issue of successor liability in the context of a bankruptcy sale.

Buyer in Bankruptcy Might Get Stuck With Antitrust Claims

Even after buying a company's assets free and clear of claims in a typical bankruptcy sale, a purchaser can still become liable for the seller's antitrust liability if it joins the conspiracy after the sale, U.S. District Judge Jack Zouhary in Cleveland ruled on Feb. 6.

Foamex, a foam-products maker, has been in bankruptcy twice. The first Chapter 11 in 2007 was a traditional reorganization, with the company restructuring debt and remaining in business. Unsecured claims were discharged.

Two years later, Foamex was back in Chapter 11. This time, the assets were sold in a competitive auction, where the price rose substantially, and a new set of owners took over. The buyers obtained multiple protections from claims that might exist against the ``old'' company.

Foamex was among several defendants sued for an alleged price-fixing conspiracy covering 1999 to 2010. Under new ownership after 2009, the company filed a motion to dismiss the complaint.

It seemed at first from Zouhary's opinion that new Foamex would get off scot-free, until the judge reached allegations that the company participated in the conspiracy after the second bankruptcy.

Zouhary recited law for the proposition that someone who joins an existing conspiracy is not only liable for damages going forward, but also for damages from the time the conspiracy began. He said there was enough evidence about joining the conspiracy to defeat a motion to dismiss.

He let the plaintiffs proceed with claims that Foamex joined the conspiracy after bankruptcy.

The plaintiffs pulled out all the stops trying to hold ``new'' Foamex liable for the two prior companies' antitrust violations.

Zouhary dismissed several successorship arguments based on a combination of bankruptcy- and state-law principles. In that regard, the opinion gives comfort to buyers of businesses accused of antitrust violations, as long as they don't join the conspiracy.

The judge rejected arguments that antitrust plaintiffs hadn't received constitutionally sufficient notice of the bankruptcies. Because there was no continuity of ownership after the second bankruptcy, there was no de facto merger. Absent a merger, the buyers were protected by the principle of New York law that they didn't succeed to the seller's liabilities.

The case is In re Polyurethane Foam Antitrust Litigation, 10-md-2196, U.S. District Court, Northern District of Ohio (Cleveland).

Published February 11, 2015

Municipal Bankruptcy

Commentary:

The district court in Puerto Rico invalided the commonwealth law that mimics Chapter 11 for governmental entities, saying the law is preempted by Section 903.

Even assuming the preemption argument is correct, the judge does not analyze whether the commonwealth' sovereignty was violated by the application of Section 903, especially since Puerto Rico and its instrumentalities are barred from filing in Chapter 9.

With respect to the lack of a sovereignty analysis, the Puerto Rico opinion suffers from the same shortcomings as last week's decision on Stockton, California.

Puerto Rico Muni Bankruptcy Law Held to Violate US Constitution

A federal district judge invalidated a 2014 Puerto Rico law that would have allowed entities owned by the island commonwealth to restructure debt outside federal bankruptcy court.

U.S. District Judge Francisco A. Besosa in San Juan handed down a 75-page opinion on Feb. 6 finding that the law violates the Supremacy Clause of the U.S. Constitution on its face because it's preempted by Section 903(b) of the Bankruptcy Code. That section of the code, as Besosa explained, expressly preempts laws by states and Puerto Rico that bind non-consenting creditors to alteration of contracts.

In June, Puerto Rico adopted the Public Corporation Debt Enforcement and Recovery Act, theoretically enabling the commonwealth's public corporations to restructure debt in a manner akin to Chapter 11 reorganization.

In late June, bond funds affiliated with Franklin Resources Inc. and Oppenheimer Rochester Funds sued the commonwealth and Puerto Rico Electric Power Authority, contending the law is unconstitutional and depressed the value of $1.6 billion in power utility debt they hold. Owning $400 million in utility bonds, BlueMountain Capital Management LLC filed a similar lawsuit in July, also in U.S. District Court in Puerto Rico.

The power authority, known as Prepa, responded with a motion to dismiss the complaints. The bondholders answered with a motion for summary judgment, claiming the commonwealth law is unconstitutional on its face. Briefing concluded in November, followed by Besosa's Feb. 6 opinion.

Underlying the controversy is an anomaly in the Bankruptcy Code where Congress allows states to permit their instrumentalities to go bankrupt while Puerto Rico is prohibited from allowing its units to do the same. Unless there is an ability to enact a law of its own, Puerto Rico is seemingly bereft of ability to restructure public debt.

Besosa's opinion could be criticized for a lack of sufficient analysis with regard to Puerto Rico's sovereignty. Assuming Besosa is correct in stating how Congress views its ability to limit a state's sovereignty, it arguably doesn't deal sufficiently with the question of whether Section 903 violates Puerto Rico's sovereignty since the commonwealth has no ability to utilize Chapter 9 municipal bankruptcy law.

The opinion could also be said to accept the notion that the U.S. Supreme Court would concur with Congress' view of its ability to limit the commonwealth's sovereign powers, to the extent they exist.

The judge rejected arguments by Puerto Rico and Prepa that the suit isn't ripe in

either the constitutional or prudential sense. He said the case is ripe for review because the question of federal preemption depends on no factual development but looks only at the statute on its face.

Besosa nonetheless dismissed the bondholders' claims attacking the Puerto Rico statute's grant of power to enjoin federal suits because the plaintiffs hadn't yet suffered injury. He also dismissed claims against Prepa, leaving the commonwealth as a defendant.

On the question of preemption, the parties agreed there were no disputed facts and presented purely legal issues.

It was ``clear and manifest,'' Besosa said, that Section 903 preempts the Puerto Rico law. He said the case wasn't even close. Because the law was preempted, it was therefore unconstitutional as a violation of the Supremacy Clause.

On that basis, the judge granted summary judgment and permanently enjoined the commonwealth from implementing the law.

On other issues, the bondholder didn't yet win and in some cases lost.

The bondholders argued that the law violates the Contract Clause of the federal Constitution, which bars states from impairing the obligation of contracts.

Besosa said the clause doesn't bar every limitation on contract rights given the ``sovereign power to safeguard the welfare of its citizens.'' Even if there is a substantial impairment, the question remains whether the impairment is ``reasonable and necessary to preserve an important public purpose.''

Since the U.S. Supreme Court has held that the Contract Clause prohibits states from discharging debts, Besosa ``easily concluded'' there is a substantial impairment.

Besosa denied the motion to dismiss the Contract Clause claim because the bondholders might be able to show that the law wasn't reasonable and necessary. In their complaint, the plaintiffs laid out what they said were other ``cost-cutting and revenue-increasing measures'' short of commonwealth's bankruptcy-like law.

The bondholders also attacked the law for violating the Takings Clause, which prohibits government from taking property without just compensation.

Besosa denied the motion to dismiss and ruled that the bondholders made a plausible argument under the Takings Clause with regard to Section 108(b) of the commonwealth law that takes away the ability of a creditor to have receiver appointed.

The judge ruled in favor of Puerto Rico by dismissing claims based on an inability to place liens on Prepa assets because there had been no actual taking yet. In that regard, he said the statute wasn't unconstitutional on its face, only if it were applied in violation of the Constitution.

For discussion of both sides' arguments on the motion to dismiss, click here for the Nov. 12 Bloomberg bankruptcy report. For more on the funds' theories, click here for the Aug. 13 Bloomberg bankruptcy report. For Puerto Rico's arguments, click here for the July 22 report.

To read the Feb. 6 opinion, click here.

The first lawsuit is Franklin California Tax-Fee Trust v. Commonwealth of Puerto Rico, 14-cv-01518, U.S. District Court, District of Puerto Rico (San Juan). The second is BlueMountain Capital Management LLC v. Padilla, 14-1569, U.S. District Court, District of Puerto Rico (San Juan).

Published February 9, 2015
Commentary:

Bankruptcy Judge Christopher Klein handed down his written opinion explaining why he will confirm Stockton, California's Chapter 9 plan. The big loser was not the Franklin bond funds. Rather, it was Calpers, because Klein explained in detail why the protections Calpers has under state law evaporate in face of federal bankruptcy power.

Klein explained why his holdings regarding Calpers are not dicta. Some may not be convinced. Calpers appealed weeks before an order was actually entered.

Stockton Bankruptcy Judge Calls Calpers Bully With `Glass Jaw'

Arguments raised by the California Public Employees' Retirement System and Franklin Resources Inc. in the municipal bankruptcy of Stockton were emphatically rejected by a federal judge, who accused the pension system of bullying its way through the case.

Calpers said it had a potential claim of $1.6 billion in Stockton's bankruptcy. Franklin's high-yield bond funds claimed the city's debt-adjustment plan violated basic principles of fairness because bondholders were bearing the brunt of the losses, while public worker pensions are being paid in full.

U.S. Bankruptcy Judge Christopher M. Klein shot down both arguments in a 54-page opinion Wednesday and said he will sign a confirmation order bringing an end to the city's municipal bankruptcy, which began in June 2012.

In the near term, Calpers came out a victor in the bankruptcy because Stockton decided to pay pensions in full and impose no loss on the state retirement system administrator. Klein's legal rulings, however, might have detrimental consequences for Calpers in the long run.

The judge said provisions of California law that purport to bar a city from terminating a pension plan or withdraw from the Calpers program are unenforceable. He also said a lien given by state law in favor of Calpers is invalid under bankruptcy law.

``Calpers has bullied its way about this case with an iron fist,'' Klein wrote. But the bully ``turns out to have a glass jaw,'' he said.

Klein rejected arguments by Calpers that a municipal bankruptcy can't affect public pensions in California. He also said a $1.6 billion lien that might have benefited Calpers can be set aside under federal bankruptcy law.

According to the judge, the section of the Bankruptcy Code that allows a state to control its cities doesn't bar the court from either voiding the Calpers lien or allowing a municipality to exit the pension system.

While Stockton isn't junking its deal with Calpers, the judge's rulings can be trotted out if another California city goes bankrupt and decides to terminate state pensions.

Klein shot down other claims raised by Franklin and Calpers. He said Calpers wouldn't have been Stockton's largest creditor because pensions would have been reduced. Workers, not the state pension system, would have suffered the losses.

Calpers didn't automatically have a $1.6 billion claim for underfunding, because that shortfall would arise only on termination of the pension plans, when assumptions about

returns on investments would be cut by more than half. As it now stands, Stockton is current on its pension contributions.

Klein initially announced his conclusions in open court on Oct. 30. He issued the written opinion because Franklin, a significant creditor, remains opposed to the city's debt-cutting plan. It filed an appeal in November.

Franklin had asked Klein to reject the city's plan unless it cut pensions. Klein said the company was wrong to claim that the capital markets creditors are recovering 1 percent on their claims while workers are unaffected by bankruptcy.

Explaining that workers took pay cuts and lost benefits, Klein said the ``value of what employees and retirees lose under the plan is greater than what capital markets creditors lose.''

Klein calculated worker losses at $550 million, more than 10 times Franklin's loss. He said the employees are recovering 1 percent on their claims, the same as Franklin on the $32 million unsecured portion of its $36 million in bonds.

Michael J. Gearin, a lawyer for Calpers, and James O. Johnston, an attorney for Franklin, didn't immediately return calls seeking comment on the judge's opinion.

Stockton filed a petition for Chapter 9 municipal bankruptcy in June 2012. With a population of 300,000, it was the largest U.S. city to do so before Detroit filed a year later.

The case is In re City of Stockton, California, 12-bk-32118, U.S. Bankruptcy Court, Eastern District of California (Sacramento).

Published February 6, 2015

First Circuit

Commentary:

There is no circuit split. Two circuits agree with the opinion by Fifth Circuit Judge Carolyn King in early 2012 that taxes on a late-filed return can never be discharged. In an opinion on Feb. 18, the First Circuit came down the same as the Tenth and Fifth Circuits. Lower courts in Massachusetts were split.

Three Circuits Agree: There's No Discharge for Late-Filed Taxes

The three federal courts of appeal to confront the issue all agree that taxes owing on late-filed returns can never be discharged in bankruptcy.

The latest decision came on Feb. 18 from the Boston-based U.S. Court of Appeals for the First Circuit, interpreting the so-called hanging paragraph inserted in Section 523(a) of the Bankruptcy Code by amendments in 2005.

The Denver-based 10th Circuit reached the same result in December, as did the Fifth Circuit in New Orleans in early 2012.

The Boston court, however, wasn't unanimous. The majority opinion by U.S. Circuit Judge William J. Kayatta Jr. was exceeded in length by a dissent from U.S. Circuit Judge O. Rogeriee Thompson.

The lower courts in the First Circuit were divided on the issue, involving Massachusetts state taxes. Some bankruptcy judges and the circuit's Bankruptcy Appellate Panel ruled that a late-filed return was no bar to dischargeability. A Boston district judge took the opposite position.

Kayatta said it was not unfathomable, draconian or absurd to believe Congress intended that a debt survive if the bankrupt never paid the tax and was also late in filing a claim. Disagreeing with Thompson, Kayatta said the statue is not ``materially ambiguous."

The outcome of the case turned on an unnumbered subparagraph providing that a ``return" must ``satisfy the requirements of applicable nonbankruptcy law (including applicable filings requirements)."

Kayatta said it's ``more plausible that Congress intended to settle the dispute over late-filed tax returns against the debtor (who both fails to pay taxes and fails to file a return as required by law)."

To read about the Denver case, click here for the Dec. 31 Bloomberg bankruptcy report. For the Fifth Circuit opinion, click here for the Jan. 6, 2012, report.

The case is Fahey v. Massachusetts Department of Revenue (In re Fahey), 14-1328, U.S. Court of Appeals for the First Circuit (Boston).

Published February 20, 2015

Second Circuit

Commentary:

The Second Circuit upheld late Bankruptcy Judge Burton Lifland by holding that customer claims are not increased to reflect the time value of money. The result was not surprising, in view of the circuit's decision in 2011 holding that the calculation of net equity claims must ignore fictitious profits on account statement.

Madoff Trustee's Win Gets Victims $1.45 Billion

Victims of Bernard Madoff's Ponzi scheme will soon be receiving an additional $1.45 billion distribution, the fruits of an appeals court victory by the trustee unwinding the convicted swindler's investment firm.

Several customers appealed directly to the Manhattan-based U.S. Court of Appeals for the Second Circuit from a decision by a bankruptcy judge that they weren't entitled to an adjustment of their claims reflecting how long they invested with Madoff. Had those customers prevailed, long-time investors would have larger claims, at the expense of short-term victims.

In an opinion Friday for the three-judge appellate panel, U.S. Circuit Judge Chester J. Straub said an ``inflation adjustment'' isn't permitted by the Securities Investor Protection Act, which governs the liquidation of investment firms. He said the provision in the statute that defines a customer claim ``makes no mention of inflation.''

Straub also said SIPA is designed for a ``proportional distribution'' and isn't intended ``to restore to customers the value of the property they originally invested.''

The circuit court refused to give any deference to the views of the Securities and Exchange Commission, which had argued in bankruptcy court that some inflation adjustment was required.

Straub called the SEC's views ``novel, inconsistent with its position in other cases, and ultimately unpersuasive.''

The Madoff trustee, Irving Picard, said he will immediately file an application allowing a distribution of $1.45 billion that was held back pending the outcome of the appeal. Only an attempted further appeal by the customers to the U.S. Supreme Court could delay the distribution, Picard's spokeswoman, Amanda Remus, said in the e-mailed statement.

Should the investors turn to the high court, Picard might not be able to make the distribution until October, which could be when the justices would rule whether to permit an appeal. Since there's no contrary circuit court opinion on the issue, the chances of an appeal are slim, because the Supreme Court is prone to taking cases over which lower courts are split.

The Friday opinion was based in part on a decision from the same appeals court in August 2011. In that case, the appeals court said fictitious account statements issued to Madoff customers must be disregarded in calculating claims, because the firm bought no securities on their behalf.

The appeals court ruled that claims are correctly calculated based on cash invested less cash taken out, disregarding fictitious profit listed on account statements.

Madoff victims' losses exceeded $17 billion, not counting profits they thought they had earned. Picard so far has taken in $10.55 billion and distributed $7.2 billion from his

recoveries. In addition, the Securities Investor Protection Corp. advanced $823.7 million, which also has been handed out.

Picard is holding back $3.8 billion for issues still on appeal and in litigation, including the $1.45 billion for the question decided this week.

The appeal is 2427 Parent Corp v. Picard, 14-97, U.S. Court of Appeals for the Second Circuit (Manhattan). The Madoff liquidation is Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities LLC, 08-01789, U.S. Bankruptcy Court, Southern District of New York (Manhattan).

Published February 24, 2015

Commentary:

The Second Circuit held that a bankruptcy court lacks jurisdiction to pay a Chapter 7 trustee's fees from 401(k) assets. The per curiam opinion has loose language to be cited in pernicious attempts at finding no arising in, arising under, or related to jurisdiction in other cases.

Trustee Can't Pay Fees from 401(k) Plan Assets

The bankruptcy court lacks jurisdiction to pay a Chapter 7 trustee's expenses in terminating a 401(k) plan from the plan's assets, the U.S. Second Circuit Court of Appeals ruled.

A company in Chapter 7 liquidation sponsored the workers' 401(k) plan. The trustee decided to terminate the plan and distribute funds to the participants.

Over objection from the U.S. Labor Department, the bankruptcy court allowed the trustee to recover his expenses from the plan. When the plan's assets were insufficient, the judge authorized paying the remainder from the bankrupt company's assets.

The district court reversed on appeal, saying there was no jurisdiction in the bankruptcy court.

In an unsigned opinion on Feb. 5, the Manhattan-based Second Circuit reached the same result. The appeals court didn't reach the issue of whether the Employee Retirement Income Security Act bars the use of the plan's assets.

The appeals court said there was no ``arising under'' jurisdiction because Section 704(a)(11) of the Bankruptcy Code only says that a bankrupt must continue as administrator of a plan after bankruptcy.

Similarly, there was no ``arising in'' jurisdiction because the payment of an administrator's fees is typically an issue that arises outside of bankruptcy.

Finally, there was no ``related to'' jurisdiction because Section 541(b)(7) explicitly says that plan assets are not part of the bankrupt estate. Therefore, the circuit court said, ``the outcome of the proceeding related to compensation could not conceivably have had any effect on the debtors' estates.''

Because the issue was not within the scope of the allowed appeal, the circuit court expressed no opinion on whether the trustee could pay fees from the bankrupt estate for his work regarding the plan.

The case is Kirschenbaum v. U.S. Labor Department (In re Robert Plan Corporation), 14-1144, U.S. Second Circuit Court of Appeals (Manhattan).

Published February 6, 2015

Third Circuit

Commentary:

Without citing or distinguishing Law v. Siegel, the Third Circuit held in an unreported opinion that inherent powers enable a court to disallow damages for intentional violation of the automatic stay when the debtor fabricated evidence about some elements of damages.

`Shall' Isn't `Shall' When Inherent Powers Come Into Play

The requirement in Section 362(k)(1) of the Bankruptcy Code that the court ``shall'' impose damages on someone who intentionally violates the automatic stay doesn't always mean ``shall,'' the U.S. Court of Appeals for the Third Circuit ruled Feb. 5.

In an individual's Chapter 7 case, a creditor sold horses belonging to the debtor despite knowledge of bankruptcy. Concluding that the bankrupt fabricated an expert's report on damages resulting from the stay violation, the bankruptcy judge refused to impose damages because the debtor attempted to commit a fraud on the court.

The bankrupt appealed, arguing that imposition of damages was mandatory under Section 362(k)(1) regardless of his wrongful conduct.

In an opinion that won't be officially reported, U.S. Circuit Judge Thomas Ignatius Vanaskie said the conduct was a ``direct and brazen affront to the judicial process.'' The ``egregious behavior'' justified the bankruptcy judge's exercise of discretion in disallowing recovery of damages, Vanaskie said.

Vanaskie said Section 362(k)(1) doesn't modify or limit ``the bankruptcy court's inherent powers.''

The opinion doesn't have an analysis of the U.S. Supreme Court decision last year in Law v. Siegel, in which the high court said, in the context of a homestead exemption, that a court's equitable powers can't overcome the mandates of the statute. Click here for the March 5 Bloomberg bankruptcy report regarding Siegel.

The case is Theokary v. Shay (In re Theokary), 14-1287, U.S. Court of Appeals for the Third Circuit (Philadelphia).

Published February 10, 2105

Commentary:

The Third Circuit warned lawyers they will be significantly sanctioned ($137,000) for making unfounded allegations of criminal activity.

Faulty Bribery Allegations Lead to Sanctions of $137,000

A lawyer was properly saddled with six-figure sanctions for taking a ``relatively unremarkable event'' and making allegations about a vast bribery scheme, the U.S. Court of Appeals for the Third Circuit ruled this week.

A Chapter 7 trustee sued to bar a bankrupt person's discharge. Lawyers for the bankrupt filed multiple papers and press releases saying there was a vast bribery scheme because the trustee was paying attorney fees for a witness in the discharge trial.

In an opinion of more than 100 pages, the bankruptcy judge explained that while it would have been better to obtain court approval to pay the lawyers for the witness, there was no misconduct. The bankruptcy judge also assessed $137,000 in sanctions against the bankrupt's lawyers for vexatiously multiplying litigation under Section 1927 of the Judiciary Code.

The district court set aside the sanctions, but U.S. Circuit Judge Patty Schwartz in Philadelphia reinstated them on Jan. 26, saying the district court ``substituted its view of the facts, rather than reviewing whether the bankruptcy court's factual findings were unsupported.''

If there were any question about impropriety in paying the witness's counsel, the bankrupt's lawyers should have made a simple inquiry rather that ``alleging a vast bribery scheme'' in multiple filings and a request for a referral to the U.S. Attorney.

Schwartz said the pleadings ``read nefarious motives into a relatively unremarkable event with no proof of the allegedly bribed witness.''

The appeals court reinstated the sanctions because the findings of bad faith by the bankruptcy judge weren't ``clearly erroneous.''

The case is Prosser v. Gerber (In re Prosser), 14-1633, U.S. Court of Appeals for the Third Circuit (Philadelphia).

Published January 28, 2015

Sixth Circuit

Commentary:

The ancient Dow Corning reorganization is still making law. Beyond the Sixth Circuit's decision's economic significance for the case itself, the opinion holds that a plan may not prescribe the standard of review.

Dow Corning Is Still Making Law 20 Years Later

Dow Corning Corp. ranks second only to Johns Manville Corp. in the list of major bankruptcy reorganizations that are still making law decades later. Both cases deal with present and future products-liability claims.

In Dow Corning's case, the company initiated a Chapter 11 reorganization in 1995 to deal with breast-implant personal-injury claims. Although confirmed in 1999, the plan didn't become effective until 2004.

The plan set aside $2.35 billion for present and future claimants. A unique feature of the plan is its ability to pay lower-ranking creditors ahead of creditors with higher rank.

Dow Chemical Co. and Corning Inc., the two owners of Dow Corning, appealed and won after the district court allowed payment to lower-ranked creditors.

In a Jan. 27 opinion for a three-judge panel of the U.S. Court of Appeals for the Sixth Circuit, U.S. Circuit Judge Danny J. Boggs first tackled the standard the Cincinnati-based court should use on appeal.

The Dow Corning plan provided that an appeal from district court for permission to pay a lower-ranked claim would be tested by the ``abuse of discretion standard.''

Boggs said the provision was unenforceable because parties ``cannot determine this court's standard of review by agreement.'' Since the district judge relied on nothing outside the plan in making the decision, Boggs said the standard of review was ``de novo,'' meaning the circuit court would give no deference to the district court's reading of the plan.

Boggs then turned to the question of whether the evidence sufficiently showed that higher-ranked creditors still would be paid despite payments on lower-class claims. He began by rejecting the ``adequate assurance'' standard often used bankruptcy. He also rejected the notion that there should be an absolute guarantee, ``because it is impossible to account for all possible future uncertainties.''

The circuit settled on the ``virtual guarantee'' standard espoused by the two owners.

Boggs also reversed the district court by interpreting the plan as giving the court no discretion to ``ignore otherwise competent reports and testimony.''

The case is Dow Corning Corp. v. Claimants' Advisory Committee (In re Settlement Facility Dow Corning Trust), 14-1090, U.S. Court of Appeals for the Sixth Circuit (Cincinnati).

Published January 30, 2015

Seventh Circuit

Commentary:

The Seventh Circuit, per Judge Williams, reversed Milwaukee District Judge Randa and held that the federal Religious Freedom Restoration Act of 1993 does not preclude a $55 million fraudulent transfer suit against the Milwaukee archdiocese. Williams also held that a creditors' committee is not a government actor, perhaps the more important issue in the case from a bankruptcy perspective.

Milwaukee Archdiocese Must Defend $55 Million Fraud Lawsuit

The Archdiocese of Milwaukee, already in bankruptcy more than four years, won't be exiting Chapter 11 anytime soon in view of a decision on Monday from the U.S. Seventh Circuit Court of Appeals in Chicago ruling that the church isn't immune from a $55 million fraudulent transfer lawsuit.

The Milwaukee church filed for reorganization in June 2011 to deal with claims of clergy sexual abuse. The largest-single potential asset for abuse victim is $55 million transferred by the church before bankruptcy to a trust for Catholic cemeteries.

The official creditors' committee, representing abuse victims, sued in bankruptcy court to recover the $55 million, saying it was a fraudulent transfer. Although the bankruptcy judge allowed the suit to proceed, U.S. District Judge Rudolph T. Randa in Milwaukee handed down a decision in July 2013 concluding that the cemetery trust is exempted from creditors' claims by the federal Religious Freedom Restoration Act of 1993, or RFRA.

The case reached the Seventh Circuit in early June. The three-judge panel handed down a 38-page opinion on Monday reversing Randa and reinstating the suit. The appeals court didn't reach the question of whether the transfer of the $55 million was in fact a fraudulent transfer. That's an issue still to be decided in bankruptcy court.

Had it won the appeal, the archdiocese intended to proceed with a Chapter 11 plan that only offered abuse victims some $4 million.

In Monday's opinion, Circuit Judge Ann Claire Williams disagreed with Randa on virtually every issue and even insinuated that the district judge should have stepped down from hearing the case because his parents and other close family members are buried in the cemeteries at issue in the suit.

Timothy Nixon, a lawyer for the Catholic cemeteries, said in an e-mailed statement that the decision "casts a shadow over religious freedom." Without saying whether he would attempt an appeal to the U.S. Supreme Court, Nixon said he would "discuss all options with our client."

Looking at the "plain language" of the statute and legislative history, Williams said that RFRA is only applicable when the government is a party. The judge said that three other circuit courts also concluded that FRFA doesn't apply when the government is not a party.

Williams said the committee isn't the government and doesn't act under "color of law." She said the panel has duties only to creditors and no one else.

Although some of the committee's actions are subject to government and court supervisions, she said the panel's "core function" is to "advance the undivided interest

of its clients."

Apart from the RFRA, Williams examined Free Exercise Clause of the Constitution which says the government shall make no law "prohibiting the free exercise" of religion. She ruled that the Constitution standing alone doesn't bar the suit because fraudulent transfer provisions in bankruptcy law are "neutrally applicable and represent a compelling government interest." She said those provisions apply equally to a church, synagogue, deli, or bank.

To the extent the lawsuit placed any burden on the church, Williams said it was overcome by a "compelling government interest." She said there can be no "religious exception that would allow a fraudulent conveyance in the name of free exercise" of religion.

Because Williams reinstated the suit, she didn't rule directly on whether Randa should have recused himself, that is, sent the case to another judge since his family are buried in the cemetery in question.

She nonetheless said that a "reasonable person might wonder whether the impartiality of a judge" could be affected if the graves of "nine close relatives" might be affected by the outcome of the suit.

To read a report on arguments in the circuit court in June, click here for the June 3 Bloomberg bankruptcy report. For details on Randa's decision taking the $55 million away from abuse victims, click here for the Aug. 1, 2013 Bloomberg bankruptcy report.

The bankruptcy judge had put the church's Chapter 11 plan on hold until the circuit court decided the FRPA appeal.

The Roman Catholic archdiocese filed bankruptcy, it was the eighth diocese to seek bankruptcy protection from sexual-abuse claims. The Milwaukee church listed assets of $98.4 million and total liabilities of $35.3 million.

The appeal is Official Committee of Unsecured Creditors v. Listecki, 13-02881, U.S. Court of Appeals for the Seventh Circuit (Chicago). The lawsuit is Listecki v. Official Committee of Unsecured Creditors (In re Archdiocese of Milwaukee), 11-02459, U.S. Bankruptcy Court, Eastern District of Wisconsin (Milwaukee). The Chapter 11 case is In re Archdiocese of Milwaukee, 11-20059, U.S. Bankruptcy Court, Eastern District of Wisconsin (Milwaukee).

Published March 10, 2015

Commentary:

Circuit Judge Richard A. Posner handed down another doozie, finding continuing jurisdiction after dismissal to grant although not compel payment of fees. Significantly, the opinion keeps the door open for ancillary jurisdiction on other issues that could arise after dismissal or confirmation.

Judge Posner Finds Fee Jurisdiction After Dismissal

If a Chapter 11 reorganization is dismissed, the bankruptcy judge doesn't lose power to award fees to a lawyer for the official creditors' committee, even in the absence of a so-called retention of jurisdiction provision, U.S. Circuit Judge Richard A. Posner ruled in an opinion handed down Jan. 9.

When a plan failed, a bankruptcy judge dismissed the Chapter 11 case at the request of creditors, so they could sue the company in state court after dismissal. So as not to delay the creditors in pursuing their claims outside bankruptcy, the lawyer for the committee didn't file a fee request before dismissal.

After dismissal, the bankruptcy judge ruled there was no jurisdiction to grant fees because the so-called bankrupt estate no longer existed when the debtor-in-possession terminated and the assets revested in the debtor company.

Writing for a three-judge panel on the Seventh Circuit in Chicago, Posner said the bankruptcy judge failed to distinguish between the ability to grant fees and the ability to compel payment from the estate.

Posner agreed the bankruptcy judge had no power to compel payment of fees because there was no longer a bankrupt estate after dismissal. Nonetheless, the bankruptcy judge could award fees, enabling the committee's lawyer to compel payment through state court if required.

The case wasn't inconsequential, because the lawyer was seeking about $1.2 million.

Even after dismissal, Posner said the bankruptcy court retained ``ancillary'' jurisdiction ``clean up'' or ``take care of minor loose ends.''

Posner's opinion is seemingly at odds with a decision handed down in late December by a U.S. district judge in Milwaukee, where the court said there was no power for the judge to award fees to a lawyer in a Chapter 13 case that was dismissed before a plan was confirmed.

In the Milwaukee case, the lawyer who lost may still have time to appeal and seek reversal, citing Posner's opinion. Milwaukee is in the Seventh Circuit, so Posner's opinion is controlling. To read about the Milwaukee case, called In re Ward, click here for the Advance Sheets section in the Jan. 2 Bloomberg bankruptcy report.

The case is In re Sweports Ltd., 14-2423, U.S. Seventh Circuit Court of Appeals (Chicago).

Published January 13, 2015

Eighth Circuit

Commentary:

A divided Eighth Circuit panel lent a helping hand to creditors accused of receiving preferences from consumer debtors. Circuit Judge Colloton penned an admirable dissent.

Divided Eighth Circuit Finds Loophole Protecting Garnishments

A divided U.S. Court of Appeals for the Eighth Circuit drew a roadmap to show creditors of consumer bankrupts how to avoid preference judgments.

The case before the St. Louis-based court involved a creditor with a judgment who garnished a man's wages. In the preference period, the employer sent about $850 in garnished wages to the state court.

The court had sent about $550 to the judgment creditor before bankruptcy. When the bankrupt notified the court that he had filed for bankruptcy, the court sent some $300 back to him.

The bankrupt sued for a preference, seeking to ``avoid'' the entire $850 garnishment. The complaint only sought return of $550.

Citing Section 547(c)(8) of the Bankruptcy Code, the bankruptcy court dismissed the suit. That section of the law provides a defense in a suit regarding a consumer bankrupt barring a preference judgment when the transfer is less than $600.

The decision was upheld by the Bankruptcy Appellate Panel. In a 2-1 decision, the Eighth Circuit reached the same conclusion.

Writing for the majority, U.S. Circuit Judge Bobby E. Shepherd upheld the dismissal. Although he acknowledged that garnished wages are transferred to the creditor ``when earned,'' the judge said he couldn't overlook the fact that the suit only sought return of $550.

U.S. Circuit Judge Steven M. Colloton dissented. He said Nebraska law provides that wages are earned when services are performed, not when paid. The creditor gained ownership of the wages when earned, he said.

Colloton focused on how the complaint sought to avoid the entire $850. He said the complaint ``merely reflects the fact'' that $300 was already returned.

The bankrupt was represented in the circuit court by the Clinical Law Program at the University of Nebraska College of Law. Professor Kevin Ruser, who was the supervising faculty on the brief, said in a phone interview that they are ``evaluating'' whether to request rehearing before all active judges on the Eighth Circuit.

Where courts follow the Eighth Circuit majority, a creditor of a consumer bankrupt could return enough money after bankruptcy to reduce the net to less than $600, thereby avoiding a preference judgment for what it kept.

The case is Pierce v. Collection Associates Inc. (In re Pierce), 14-1365, 2015 BL 61830, U.S. Eighth Circuit Court of Appeals (St. Louis).

Published March 12, 2015

Tenth Circuit

Commentary:

Perjury evidently is not fraud on the court, at least when the judge had other evidence as the basis for the decision, so says the Tenth Circuit BAP.

Fabricated Evidence Falls Short of Fraud on Court

A lazy trustee couldn't cry ``fraud on the court'' to win a new trial when he hadn't bothered to look for pivotal evidence.

A woman in bankruptcy said she paid $8,100 just before bankruptcy to her former husband to reimburse him for rent he paid on her behalf. The trustee sued the former husband, claiming the $8,100 was a preference.

At trial, the husband testified that he never received the check. The trustee hadn't sought the canceled check during discovery, nor did he introduce other evidence to show where the money went.

The bankruptcy judge ruled in favor of the husband, denying the preference claim because the trustee hadn't proven the husband received the check, instead relying entirely on the bankrupt's testimony.

After trial, the trustee located the check, which showed the former husband's endorsement. At an ensuing hearing, the husband produced an expert who deemed the endorsement a forgery.

The bankruptcy judge found the expert's testimony wasn't credible, granted the trustee's motion under Rule 60(b)(3) to set aside the former judgment as resulting from fraud on the court, and gave the trustee a judgment for an $8,100 preference.

The U.S. Bankruptcy Appellate Panel for the 10th Circuit in Denver reversed. U.S. Bankruptcy Judge William T. Thurman, writing for the panel, said ``deceptive trial testimony'' isn't fraud on the court.

Although the ex-husband may have fabricated his testimony originally, his conduct didn't impede the trustee, who hadn't sought the canceled check before trial and ``thus failed to meet his burden of proof.''

It was a ``tactical litigation strategy'' by the trustee not to seek the check before trial, according to Thurman.

Thurman said Rule 60(b) is ``extraordinary'' and forms the basis for relief ``only in exceptional circumstances.'' Nondisclosure of facts ``will not ordinarily rise to the level of fraud on the court,'' Thurman said, quoting a decision by the U.S. Court of Appeals in New Orleans.

The case is Hill v. Jankowski (In re Dey), 14-026, U.S. Court of Appeals for the 10th Circuit (Denver).

Published February 19, 2015