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The Supreme Court and the Plain Meaning of the Bankruptcy Code: A Review of Recent and Pending Supreme Court Decisions

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THE SUPREME COURT AND THE "PLAIN MEANING" OF THE BANKRUPTCY CODE: A REVIEW OF RECENT AND PENDING SUPREME COURT DECISIONS

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I. INTRODUCTION

Bankruptcy law has changed drastically in the last fourteen years—from the revision of the Bankruptcy Code (Code) in 1978[1] to the 1982 *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*[2] decision of the United States Supreme Court. The Code was subsequently rewritten in 1984[3] and again in 1986.[4] The changes in 1984 were not as sweeping as the 1978 changes, and the subsequent legislative changes have not been as traumatic as the 1978 revisions.

This article will address the recent United States Supreme Court decisions of import to those practicing in bankruptcy. The recent judicial decisions in this area have had a major impact upon litigation, distribution and reorganization in bankruptcy. Some of these changes have had as wide ranging of an effect as the changes of the Code in 1978. The article will also address cases that are pending before the Supreme Court which will undoubtedly have an impact upon bankruptcy law.

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1. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101-1330).

2. 458 U.S. 50 (1982).

3. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).

4. Bankruptcy Judges, United States Trustee and Family Farmer Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986).

II. RECENT SUPREME COURT DECISIONS

A. AN INDIVIDUAL, ALTHOUGH NOT ENGAGED IN BUSINESS, MAY NEVERTHELESS BE A CHAPTER 11 DEBTOR

The Supreme Court in *Toibb v. Radloff*[5] addressed the issue of whether an individual who is not directly engaged in business may nevertheless be a debtor under Chapter 11 of the Bankruptcy Code.[6] In *Toibb*, the debtor originally filed for relief under Chapter 7 of the United States Bankruptcy Code. At the time he filed the action, the debtor was an unemployed energy consultant. The debtor owned approximately twenty-four percent of a corporation known as Independence Electric Corporation (IEC). Additionally, he formerly had been employed as an energy consultant for IEC but had lost his employment prior to the bankruptcy filing.[7] At the time of filing, the debtor had unsecured obligations in excess of $100,000[8] and some priority tax liability.[9] He failed to claim the stock that he owned in IEC as exempt under 11 U.S.C. § 522, asserting that the market value of the stock was unknown.[10] The trustee pursued an offer by the corporation to repurchase the debtor's shares for $25,000.[11] The debtor, realizing that the shares would be liquidated, converted the case to a Chapter 11 bankruptcy, which the court approved. The debtor subsequently filed a Chapter 11 bankruptcy plan of reorganization.[12] Under the plan, the debtor proposed to pay the creditors the value of the IEC stock less administrative expenses and priority tax claims, and in addition thereto, proposed to pay them fifty percent of any declared dividends from the IEC stock in the six years following confirmation.[13]

The bankruptcy court, on its own motion, ordered the debtor to show cause why his petition should not be dismissed since he

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5. 111 S. Ct. 2197 (1991).
6. Toibb v. Radloff, 111 S. Ct. 2197, 2198 (1991).
7. *Id.* at 2198.
8. *Id. Toibb* involved unsecured debts of $170,605. *Id.* This amount of debt exceeded the Chapter 13 debt limits and is most likely the reason the debtor eventually filed a Chapter 11 bankruptcy. With Congress's proposal to increase the debt limitation for Chapter 13 bankruptcies, this type of case may not be seen again. Further, there are questions as to whether or not this debtor could ever confirm a plan of reorganization under Chapter 11, given the "Absolute Priority Rule" provided for by § 1129(b)(2)(B) and the strong voting powers of unsecured creditors.
9. *Toibb*, 111 S. Ct. at 2198.
10. *Id.* The debtor also listed a possible claim against his former business associates at IEC and claimed its value as unknown. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*

was not engaged in business.[14] The debtor argued that Chapter 11 should be available to "individuals" even though they were not engaged in business. Citing the controlling Eighth Circuit precedent of *Wamsganz v. Boatmen's Bank of De Soto*,[15] the bankruptcy court ruled that the debtor was not able to seek the relief under Chapter 11 because he was not engaged in a business.[16] The district court, relying on the same precedent, upheld the bankruptcy court's decision. On appeal, the Eighth Circuit held that the bankruptcy court could, *sua sponte*,[17] dismiss the proceedings, and therefore, the court upheld the decision based upon *Wamsganz*. The United States Supreme Court granted certiorari and reversed.[18]

The Supreme Court, in a strict constructionist mode, held that the "plain language of the Bankruptcy Code disposes of the question before us."[19] The Court applied its "plain meaning" doctrine to the statutory provisions and definitions of §§ 109 and 101 of the Code. The Court held that a person not engaged in business was entitled to file under Chapter 7 or Chapter 11 in light of the fact that a "person" is defined under the Code to include an "individual."[20] The Court noted that there was no ongoing business requirement for a reorganization under Chapter 11.[21] In a stinging rebuke of the Eighth Circuit's decision, the Supreme Court opined that "we are loath to infer the exclusion of certain classes of

14. *Toibb*, 111 S. Ct. at 2198.

15. 804 F.2d 503 (8th Cir. 1986). In *Wamsganz*, the debtors filed a petition under Chapter 13, but the petition was subsequently dismissed. The debtors then filed a petition for relief under Chapter 11. At the time they filed their Chapter 11 petition, the debtors were indebted to Boatmen's Bank of De Soto, a lienholder on their residential property. Boatmen's moved to dismiss, arguing that the debtors could not qualify for relief under Chapter 11 since they were not engaged in a business. The Circuit Court agreed and held that the debtors never contended that they owned a business enterprise, but rather indicated that their income was derived solely from social security, pensions, and rental property. The court noted that several courts disagreed with the position that relief was not available to debtors under Chapter 11 if they were not engaged in business. *Wamsganz*, 804 F.2d at 504. The court stated that "[a]lthough chapter 11 contains no explicit limitation excluding persons not engaged in business, those courts have relied upon the purpose of chapter 11, as reflected in its legislative history, and on the provisions of chapter 11 itself to find such a limitation." *Id.* The Eighth Circuit agreed with the Fifth and Sixth Circuits and numerous other courts which have held that Chapter 11 relief is not available to persons not engaged in business because the legislative history evidenced Congress' intent to make Chapter 11 unavailable to persons not engaged in business. *Id.* at 505.

16. *Toibb*, 111 S. Ct. at 2199 (citing Wamsganz v. Boatmen's Bank of Desoto, 804 F.2d 503 (8th Cir. 1986)).

17. *Id.* (citing *In re* Toibb, 902 F.2d 14 (8th Cir. 1990)).

18. *Toibb*, 111 S. Ct. at 2199.

19. *Id.*

20. *Id.* Section 101(35) provides that a " 'person' includes [an] *individual*, partnership, and corporation . . . ." 11 U.S.C. § 101(35) (1988) (emphasis supplied).

21. *Toibb*, 111 S. Ct. at 2199.

debtors from the protections of Chapter 11, because Congress took care in § 109 to specify who qualifies—and who does not qualify—as a debtor under the various chapters of the Code."[22] Specifically, the Supreme Court held:

> Section 109(b) expressly excludes from the coverage of Chapter 7 railroads and various financial and insurance institutions. Only municipalities are eligible for the protection of Chapter 9. § 109(c). Most significantly, § 109(d) makes stockbrokers and commodity brokers ineligible for Chapter 11 relief, but otherwise leaves that Chapter available to any other entity eligible for protection of Chapter 7. Congress knew how to restrict recourse to the avenues of bankruptcy relief; it did not place Chapter 11 reorganization beyond the reach of a nonbusiness individual debtor.[23]

Mr. James Hamilton, as *amicus curiae* in support of affirming the circuit court's decision, argued that the legislative history supported the lower court's reasoning.[24] Mr. Hamilton further asserted that the structure of Chapter 11 clearly indicated a congressional intention that only business debtors qualify for relief under this particular chapter.[25]

The Supreme Court found these arguments unpersuasive for a number of reasons.[26] First, the Court noted that courts should not resort to legislative history when the statutory language is clear.[27] The Court stated that the statutory language of § 109 was clear, and therefore, there was no need to resort to legislative history in order to interpret the statute.[28]

Next, the Court indicated that the fact that many provisions of the Code refer to ongoing business debtors, in and of itself, did not preclude consumer debtors from filing for protection under Chapter 11. As an example, the Court indicated that § 1102 refers to an

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22. *Id.*
23. *Id.*
24. *Id.* at 2200. Mr. Hamilton echoed the Eighth Circuit in *Wamsganz* which held that "[t]he legislative history of the Bankruptcy Code, taken as a whole, shows that Congress meant for Chapter 11 to be available to businesses and persons engaged in business, and not to consumer debtors." *Id.* at 2200 (quoting *Wamsganz*, 804 F.2d at 505).

The United States Trustee supported the debtor's arguments to the Court, and the Court appointed an *amicus curiae* to support the judgment. *Toibb*, 111 S. Ct. at 2199 n.4. The *amicus curiae* appointed was Mr. James Hamilton of Washington, D.C., a member of the Supreme Court Bar. *Id.*
25. *Toibb*, 111 S. Ct. at 2200.
26. *Id.*
27. *Id.* (quoting Blum v. Stenson, 465 U.S. 886, 896 (1984)).
28. *Id.* at 2200.

equity security holders' committee, and § 1104 deals with the appointment of a trustee "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management . . . ."[29] The Court concluded:

> It does not follow, however, that a debtor whose affairs do not warrant recourse to these provisions is ineligible for Chapter 11 relief. Instead, these provisions—like the references to debtor business in the Chapter's legislative history—reflect an understandable expectation that Chapter 11 would be used *primarily* by debtors with ongoing business; they do not constitute an additional prerequisite for Chapter 11 eligibility beyond those established in § 109(d).[30]

The Court's analysis did not stop there, however, even though it had disposed of the question presented. The Court went on to consider Mr. Hamilton's contentions that policy considerations underlying the Code supported the inference that the congressional intent was to preclude a nonbusiness debtor from reorganizing under Chapter 11.[31]

First, Mr. Hamilton contended that bringing a consumer debtor within the scope of a Chapter 11 bankruptcy did not serve the congressional purpose of providing business debtors with the opportunity to reorganize and restructure debts in order to save jobs and protect investors. The Court noted that this argument assumed Congress intended a single purpose of Chapter 11;[32] this is certainly not the case, since Chapter 11 bankruptcy does have an underlying policy of maximizing return to the creditors. The Court concluded: "Under certain circumstances a consumer debtor's estate will be worth more if reorganized under Chapter 11 than if liquidated under Chapter 7. Allowing such a debtor to proceed under Chapter 11 serves the congressional purpose of deriving as much value as possible from the debtor's estate."[33]

Second, Mr. Hamilton argued that to allow an individual to proceed under Chapter 11 would allow the individual to have nonexempt assets and disposable income shielded from creditors.[34] Mr. Hamilton claimed that such a result would mean greater pro-

29. *Id.* (quoting 11 U.S.C. § 1104(a)(1) (1988)).
30. *Toibb*, 111 S. Ct. at 2200.
31. *Id.* at 2201.
32. *Id.*
33. *Id.*
34. *Id.*

tection than that afforded under Chapter 13, which does not permit the debtor to retain disposable income. The Court indicated that the differences in the chapters and the requirements therein reflected "Congress' appreciation that various approaches are necessary to address effectively the disparate situations of debtors seeking protection under the Code."[35] Moreover, the Court found that Chapter 11 affords protection to creditors in that they can object to the plan if they do not receive as much as they would receive in a Chapter 7 liquidation. The Court concluded that "[a]bsent some showing of harm to the creditors of a nonbusiness debtor allowed to reorganize under Chapter 11, we see nothing in the allocation of 'burdens' and 'benefits' of Chapter 11 that warrants an inference that Congress intended to exclude a consumer debtor from its coverage."[36]

Third, Mr. Hamilton argued that to allow a consumer to reorganize under Chapter 11 would cause a significant burden on an already severely burdened bankruptcy court system.[37] The Court found this argument unfounded for two separate reasons: The great expense and complexity of a Chapter 11 will disway most consumer debtors from seeking relief under that chapter; and additionally, Chapter 11 provisions give bankruptcy judges the authority to dismiss cases that the courts determine to be unworkable.[38]

Finally, Mr. Hamilton argued that to allow consumer debtors to file under Chapter 11 would permit creditors to file involuntary bankruptcies against those consumers, which is in contravention of Congress' intent to prevent involuntary Chapter 13 provisions against consumers.[39] The Court found this concern to be overstated. The Court noted that "[i]f an involuntary Chapter 11 debtor fails to cooperate, this likely will provide the requisite

35. *Toibb*, 111 S. Ct. at 2201. This difference in chapters is obvious when one compares the Chapter 12 provisions of 11 U.S.C. § 1225 to the Chapter 11 provisions of 11 U.S.C. § 1111(b) and 11 U.S.C. § 1129(b)(2)(B). In its enactment of Chapter 12, Congress clearly avoided placing the stringent requirements of the absolute priority rule and the 1111(b) election requirements upon a Chapter 12 debtor, because it would make it nearly impossible for a Chapter 12 debtor to confirm a plan. Additionally, Congress' enactment of Chapter 12 did not put the adequate protection requirements on a Chapter 12 farm debtor that exist in Chapter 11. *See* 11 U.S.C. § 1205 (1988). Thus, it is clear that Congress anticipated different treatment under different sections of the Code.

36. *Toibb*, 111 S. Ct. at 2201.

37. *Id.*

38. *Id.*

39. *Id.* at 2201-02. Section 303(a) provides in part as follows: "An involuntary case may be commenced only under chapter 7 or 11 of this title, and only against a person . . . that may be a debtor under the chapter under which such case is commenced." 11 U.S.C. § 303(a) (1988).

'cause' for the bankruptcy court to convert the Chapter 11 case to one under Chapter 7."[40] The Court further stated that this "argument overlooks Congress' primary concern about a debtor's being forced into bankruptcy under Chapter 13: that such a debtor, whose future wages are not exempt from the bankruptcy estate, § 1322(a)(1), would be compelled to toil for the benefit of creditors in violation of the Thirteenth Amendment's involuntary servitude prohibition."[41] The Court concluded that because there is no comparable provision in Chapter 11 requiring debtors to pay their future wages to the plan, the involuntary servitude argument used in the Chapter 13 is not relevant to the Chapter 11 proceedings.[42] Thus, a debtor need not be engaged in business in order to be afforded the benefits of a Chapter 11 bankruptcy.

B. A DEBTOR MAY NOW FILE A "CHAPTER 20"—A CHAPTER 7 FOLLOWED BY A CHAPTER 13

The Supreme Court in *Johnson v. Home State Bank*[43] held that a mortgage lien could be restructured in a Chapter 13 reorganization after the underlying debt is discharged in a Chapter 7.[44] In *Johnson*, the debtor granted Home State Bank a mortgage on farm property in order to secure a promissory note of $470,000. Subsequently, the debtor defaulted on the notes and foreclosure proceedings were instituted by Home State Bank.[45] During the pendency of the foreclosure proceedings, the debtor filed a Chapter 7 bankruptcy and discharged his personal liability to the creditor.[46] After the Chapter 7 discharge, the bank proceeded to foreclose on its real estate mortgage.[47]

Before the foreclosure sale was scheduled, the debtor filed a Chapter 13 petition and listed the bank's mortgage on the farm real estate as a claim against the estate. The debtor proposed to pay the bank on the mortgage over four annual installments, coupled with a final balloon payment equal in total value to the bank's *in rem* judgment.[48] The bankruptcy court confirmed the Chapter

40. *Toibb*, 111 S. Ct. at 2202. *See* 11 U.S.C. § 1112(b) (1988).
41. *Toibb*, 111 S. Ct. at 2202.
42. *Id.*
43. 111 S. Ct. 2150 (1991).
44. Johnson v. Home State Bank, 111 S. Ct. 2150, 2152 (1991).
45. *Id.* at 2152.
46. *Id. See* 111 U.S.C. § 727 (1988). Section 727 discharges the debtor of personal liability on the debt listed in the schedules. *See id.*
47. *Johnson*, 111 S. Ct. at 2152. The Court opined that since this foreclosure proceeding was an *in rem* proceeding, the proceeding was not a violation of the debtor's continuing injunction provisions upon discharge. *Id.*
48. *Id.*

13 reorganization plan over the bank's objection. The bank appealed the decision to the district court on several grounds,[49] but its primary contention was that the indebtedness could not be reorganized under Chapter 13 because the Bankruptcy Code does not allow a debtor to include in a Chapter 13 plan a mortgage to secure an obligation that has been discharged in a Chapter 7 proceeding.[50] The district court accepted the bank's argument[51] that the claim could not be reorganized under Chapter 13 and reversed the bankruptcy court.

On review, the Tenth Circuit Court of Appeals affirmed the decision of the district court.[52] The circuit court reasoned that since petitioner's personal liability on the promissory notes which secured the mortgage had been discharged, there was no further claim which the debtor could reschedule under a Chapter 13.[53]

The issue before the Supreme Court was whether a debtor could include a mortgage lien in a Chapter 13 bankruptcy reorganization plan "once the personal obligation secured by the mortgaged property has been discharged in a Chapter 7 proceeding."[54] The Court noted that the creditor's right to foreclose the mortgage passed through the bankruptcy estate and survived the discharge.[55] Accordingly, the Court held that the lien could be

49. *Id.* The bank argued to the district court that the bankruptcy court erred in finding that "the plan lack[ed] feasibility, was not proposed in good faith, and improperly schedule[d] a debt previously discharged in a debtor's Chapter 7 bankruptcy proceeding." *In re* Johnson, 96 B.R. 326, 326 (D. Kan. 1989). The district court did not address these arguments because it was not necessary for the disposition of the case. *Id.* at 330. Like the district court, the Tenth Circuit Court of Appeals did not need to reach the issues of good faith and feasibility, as it disposed of the case without addressing those issues. *Johnson*, 111 S. Ct. at 2153. The United States Supreme Court unanimously concluded that it would not address other issues raised on appeal (such as the good faith filing provisions or the feasibility test to be established in a Chapter 13 confirmation), and remanded to the district court to address those issues. *Id.* at 2156. Therefore, if a debtor files for bankruptcy under Chapter 7 and subsequently files under Chapter 13, the debtor arguably could address issues of bad faith filing or issues of feasibility because the Court did not address those issues. The same analysis applies equally if the debtor files under Chapter 7 and subsequently files under Chapter 12.

50. *Johnson*, 111 S. Ct. at 2152.

51. *Id.* The bank's principal argument was that the claim could not be rescheduled in a Chapter 13 bankruptcy once discharged in a previous Chapter 7. *Id.* (citing *Johnson*, 96 B.R. at 328). The district court had noted that a majority of courts considering the issue have not allowed a debtor to reschedule a debt in a Chapter 13 plan if the debt had been previously discharged in a Chapter 7 proceeding. *Johnson*, 96 B.R. at 329 (citing *In re* McKinstry, 56 B.R. 191, 193 (Bankr. D. Vt. 1986) and *In re* Binford, 53 B.R. 307, 309 (Bankr. W.D. Ky. 1985)). The district court noted that the primary rationale for rejecting the debtor's position was that "the mortgagee no longer holds a 'claim' against the debtor, but rather, holds a lien against the debtor's real estate. Thus, the mortgagee is not a 'creditor' of the debtor and holds no claim which can be scheduled in the debtor's Chapter 13 plan." *Id.* at 329-30.

52. *Johnson*, 111 S. Ct. at 2152.

53. *Id.* at 2152-53.

54. *Id.* at 2152.

55. *Id.* at 2153.

reorganized.[56]

The Court noted that, in light of the Chapter 7 discharge, the issue was really whether or not a claim existed that could be subject to the Chapter 13 reorganization.[57] The Court indicated that the issue was plainly answered by reference to the construction of the statute, its history and purpose.[58] The Court then analyzed the definition of "claim" found at § 101(5) of the Bankruptcy Code. In doing so, it explained that it had adopted a broad interpretation of the definition of the term "claim."[59] The Court added that "we have no trouble concluding that a mortgage interest that survives the discharge of a debtor's personal liability is a 'claim' within the terms of § 101(5)."[60] The Court stated that "[t]he conclusion that a surviving mortgage interest is a 'claim' under § 101(5) is consistent with other parts of the Code."[61] The bank argued that to treat the claim in this fashion would circumvent the purposes of Chapter 13.[62] The bank stated that to allow such an interpretation of "claim" would encourage serial filings, which would be an abuse of

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56. *Id.* at 2156.

57. *Johnson*, 111 S. Ct. at 2153. The Court stated that a mortgage was an interest in real property which secured the creditor's right to repayment, but it was not the sole remedy available to the creditor. *Id.* The creditor may instead choose to sue on the note itself and collect payment from the debtor's remaining personal assets to satisfy the debt. *Id.* Under North Dakota law, the creditor is limited solely to the foreclosure action of the real estate mortgage. If the creditor desires to obtain a deficiency judgment, the creditor must determine through a jury trial the fair value of the real estate. *See* Brunsoman v. Scarlett, 465 N.W.2d 162, 164 (N.D. 1991); First Interstate Bank v. Larson, 475 N.W.2d 538, 542 (N.D. 1991); H & F Hogs v. Huwe, 368 N.W.2d 553, 556 (N.D. 1985); Mischel v. Austin, 374 N.W.2d 599, 600 (N.D. 1985).

58. *Johnson*, 111 S. Ct. at 2153.

59. *Id.* at 2154.

60. *Id.*

61. *Id.* The interpretation of similar terms throughout the Code would be consistent with Justice Scalia's stinging attack in *Dewsnup v. Timm*, in which he concluded that the Court seems to be taking a "willy nilly" approach to the application of the use of similar language throughout the Code. Dewsnup v. Timm, 112 S. Ct. 773, 780 (1992) (Scalia, J., dissenting).

As an example, the Supreme Court in *Johnson* noted that § 502(b)(1) provides that the bankruptcy court is to determine the amount of a claim which is in dispute except to the extent that it is unenforceable against the debtor or against the property of the debtor. The Court noted that "[i]n other words, the court must allow the claim if it is enforceable against *either* the debtor *or* his property." *Johnson*, 111 S. Ct. at 2155 (emphasis in original). As a further example, the Court stated that § 102(2) establishes, as a rule of construction, that the phrase "claim against the debtor" also includes claims against property of the debtor. *Id.* The Court found that the legislative history and the history of the Code supported a liberal construction of the definition of "claim." The Court cited to the pre-Bankruptcy Act in which the Act defined a claim to mean "all claims of whatever character against a debtor, *or its property*." *Id.* (emphasis in original). The Court concluded that the legislative history of § 102(2) and the committee reports accompanying § 102(2) explain that this rule of construction contemplates, among other things, " 'non-recourse loan agreements where the creditor's only rights are against property of the debtor, and not against the debtor personally.' " *Id.* at 2155 (quoting H.R. REP. NO. 595, 95th Cong., 2d Sess. 315 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6272).

62. *Johnson*, 111 S. Ct. at 2156.

the bankruptcy court system. The Court vehemently disagreed, stating that Congress had "expressly prohibited various forms of serial filings."[63] The Court noted various prohibitions of serial filings in other sections of the Code. However, the Court stated:

> The absence of a like prohibition on serial filings of Chapter 7 and Chapter 13 petitions, combined with the evident care with which Congress fashioned these express prohibitions, convinces us that Congress did not intend categorically to foreclose the benefit of Chapter 13 reorganization to a debtor who had previously filed for Chapter 7 relief.[64]

Under *Johnson*, the Supreme Court has opened the door to debtors who would not originally qualify under Chapter 13 by allowing them to file a Chapter 7 bankruptcy, which would discharge the unsecured obligations. Debtors may therefore qualify for the Chapter 13 debt limit and restructure their indebtedness using the Chapter 13 provisions. However, this analysis is not limited exclusively to Chapter 13 bankruptcies. As a result of *Johnson*, it is now possible that if the debtor's debts exceed the Chapter 12 $1.5 million cap on indebtedness, the debtor could also file a Chapter 7, discharge the unsecured indebtedness to get the debt below the $1.5 million cap, and thereby qualify for a Chapter 12 bankruptcy.

C. ERISA PLANS ARE *NOT* PROPERTY OF THE ESTATE; THEREFORE, THEY DO NOT AFFECT EXEMPTION CLAIMS

In *Patterson v. Shumate*,[65] a case of seminal importance to retirement plan providers and debtors, the United States Supreme Court held that the Employee Retirement Income Security Act (ERISA)-qualified plans were not property of the bankruptcy estate.[66] *Patterson* involved an interpretation of 11 U.S.C. § 541(c)(2), the provision concerning property of the estate. Specifically, the Court was concerned with property that was

63. *Id.*
64. *Id.*
65. 112 S. Ct. 2242 (1992).
66. Patterson v. Shumate, 112 S. Ct. 2242, 2247 (1992). *See* 11 U.S.C. § 541(a)(1) (1988). Property of the estate is defined to include "all legal and equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The legislative history demonstrates that the scope of this provision was to be broadly construed. United States v. Whiting Pools, Inc., 462 U.S. 198, 204-05 (1983); *see also In re* Swanson, 873 F.2d 1121, 1123 (8th Cir. 1989).

excluded from the estate under "applicable nonbankruptcy law."[67] The Court was confronted with an ERISA-qualified pension plan which, under the ERISA statutes, had restrictions on its transferability.[68] Prior to the Court's consideration of the issue, ERISA plans had spurred a substantial amount of litigation concerning whether they were exempt property of the estate.[69]

The debtor in *Patterson* was employed with the Coleman Furniture Company for thirty years, ultimately becoming president and chairman of the board of directors. He filed a petition under Chapter 11 of the Bankruptcy Code.[70] Subsequently, his case was converted to a Chapter 7 bankruptcy and a trustee was appointed. The bankruptcy proceeding was consolidated with a district court action that was pending at the time.[71] The district court rejected the debtor's contention that his retirement plan should be excluded from the estate. The district court held that the § 541(c)(2)'s exclusion and reference to applicable " 'nonbankruptcy law' " applied only to state law, not to ERISA or other federal law.[72] In this case, if the state law of Virginia was applied to Shumate's interest in the plan, it would not qualify as a spendthrift trust. If it was not a spendthrift trust, then under this interpretation of 11 U.S.C § 541(c)(2), the property would not be excluded from the estate.[73] Furthermore, the debtor argued that the property was exempt under 11 U.S.C. § 522(b)(2)(A) as property " 'exempt under Federal law.' "[74] The district court rejected this argument as well. The court of appeals reversed.[75] The Supreme Court granted certiorari and affirmed the court of appeals.[76]

The Supreme Court found that a plain reading of § 541 of the

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67. *Patterson*, 112 S. Ct. at 2245.

68. *Id.*

69. As examples of the litigation on ERISA plans, see *In re* Moore, 907 F.2d 1476 (4th Cir. 1990) (ERISA-qualified plan excluded from the estate); *In re* Harline, 950 F.2d 669 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 2291 (1992) (ERISA-qualified plan was excludable); *In re* Fritsvold, 115 B.R. 192 (Bankr. D. Minn. 1990) (state statute was preempted by ERISA and not excluded); *In re* Volpe, 100 B.R. 840 (Bankr. W.D. Tex. 1989) (ERISA exempted under state statute and preemption not applicable).

70. *Patterson*, 112 S. Ct. at 2245. Coleman Furniture Company also filed a petition in bankruptcy. *Id.*

71. *Id.*

72. *Id.* (citing Creasy v. Coleman Furniture Corp., 83 B.R. 404, 406 (W.D. Va. 1988)).

73. *Id.* A spendthrift trust is generally defined as one in which:

> (1) the trust implicitly or explicitly prohibits the voluntary and involuntary alienation of the beneficiary's interest; (2) the beneficiary is the *donee* or *testamentary beneficiary* and is not the settlor of the trust; (3) the beneficiary has no present dominion or control over the trust corpus.

In re Fritsvold, 115 B.R. 192, 195 (Bankr. D. Minn. 1990) (emphasis in original).

74. *Patterson*, 112 S. Ct. at 2245.

75. *Id.* at 2245-46.

76. *Id.* at 2246.

Bankruptcy Code suggested that property excluded from the estate under applicable nonbankruptcy law included all law, not just state law.[77] The Court held that "to include federal law as well as state law comports with other references in the Bankruptcy Code to sources of law."[78] Comparing several other aspects and sections of the Code, the Court held that where Congress wanted to restrict applicable nonbankruptcy law to state law, it did so specifically throughout the Code.[79]

After determining that applicable nonbankruptcy law was not limited to state law, the Court then looked at the anti-alienation provisions of ERISA.[80] The petitioner urged the Court to consider the legislative history, which the petitioner contended would demonstrate that ERISA plans were not intended to be excluded from the definition of property of the estate.[81] The Court stated that when a statutory ambiguity exists, it may be appropriate to refer to legislative history. The Court opined, however, that "the clarity of the statutory language at issue in this case obviates the need for any such inquiry."[82] The Court noted that although § 522(d)(10)(e) exempts such plans from property of the estate, it does exempt more property than do the ERISA-qualified plans.[83] The Court stated that Individual Retirement Accounts (IRAs) are not ERISA-qualified plans and, therefore, are not subject to exclusion from the estate and must be exempted by the debtor.[84]

It is important to note that qualified plans such as Keogh plans, Seps, Basics, or 401(k)s are excluded from the bankruptcy estate and will not be subject to the exemption laws. On the other hand, if a debtor has an IRA, the IRA is subject to the limitations that the state or the federal bankruptcy law impose on what can be exempted.

In a concurring opinion, Justice Scalia stated that he was amazed that three courts of appeals could even think that " 'appli-

77. *Id. See* 11 U.S.C. § 541(a) (1988). Section 541(a) provides for broad interpretation of what constitutes property of the estate. *Id.* Section 541(c)(2) excludes property from the debtor's estate if the property is subject to "a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under *applicable bankruptcy law* is enforceable in a case under this title." *Id.* § 541(c)(2) (emphasis added). This restriction had been interpreted to apply only to spendthrift trusts. *See, e.g., In re* Fritsvold 115 B.R. 192 (Bankr. D. Minn. 1990).

78. *Patterson*, 112 S. Ct. 2246.

79. *Id. See* 11 U.S.C. §§ 109(c)(2), 522(b)(1), 523(a)(5), 903(1) (1988) (examples of state law restrictions in the Code).

80. *Patterson*, 112 S. Ct. at 2247.

81. *Id.* at 2248.

82. *Id.*

83. *Id.* at 2248-49.

84. *Id.* at 2249.

cable non-bankruptcy law' " was synonymous to " 'state law.' "[85] Justice Scalia found that the legal culture had "so far departed from attention to text, or is so lacking in agreed-upon methodology for creating and interpreting text, that it any longer makes sense to talk of 'a government of laws, not of men.' "[86] Justice Scalia noted that the Bankruptcy Code must be read as a whole and that individual sections cannot be examined in isolation.[87]

The *Patterson* decision makes it clear that debtors are not only entitled to retain their exempt property, but if they have an ERISA-qualified plan, they may also keep that plan from becoming part of the estate and thereby prevent its distribution to their creditors. The Supreme Court's interpretation, however, creates a consistency between state court exemptions and exemptions that are claimed under bankruptcy court jurisdiction. Debtors, however, must be careful to be certain that their plans are qualified. After *Patterson*, courts will more carefully scrutinize whether, in fact, those plans are technically qualified plans. It is important to remember, however, that the Supreme Court found that IRAs are not covered by ERISA statutes and, therefore, IRAs are property of the estate. As such, they may be available for an eventual distribution to creditors, if they are not exempt.

D. OBJECTIONS TO EXEMPTIONS MUST BE TIMELY, EVEN THOUGH THERE IS NO BASIS FOR THE EXEMPTIONS

In *Taylor v. Freeland & Kronz*,[88] the Supreme Court addressed an untimely objection to the debtor's exemptions by the Chapter 7 trustee.[89] The debtor in *Taylor* filed a petition in bankruptcy while she was pursuing an employment discrimination claim in state court. The discrimination proceedings began in 1978 when the debtor filed a complaint with the Pittsburgh Commission on Human Relations. She had alleged that her employer, Trans World Airlines (TWA), had denied her promotions on the basis of her race and sex.[90] The debtor followed the Pittsburgh Commission on Human Relations administrative process, and then

85. *Patterson*, 112 S. Ct. at 2250 (Scalia, J., concurring).
86. *Id.* at 2250-51.
87. *Id.* at 2251. Justice Scalia pointed out, however, that the Court, in the same term as in the case of *Dewsnup v. Timm*, had in fact taken that very approach to the analysis. *Id.* *See* Dewsnup v. Timm, 112 S. Ct. 773 (1992).
88. 112 S. Ct. 1644 (1992).
89. Taylor v. Freeland & Kronz, 112 S. Ct. 1644, 1646 (1992).
90. *Id.*

appealed to the Pennsylvania state court system. In October 1984, while the matter was pending in state court, the debtor filed a Chapter 7 bankruptcy. The petitioner, Robert J. Taylor, was appointed as trustee. The law firm of Freeland & Kronz represented the debtor in the discrimination lawsuit.[91]

On the exemption schedule filed with the court, the debtor claimed the money that she expected to win in the lawsuit was exempt property.[92] This property was described in the bankruptcy proceedings as "proceeds from a lawsuit—[Davis] v. TWA" and as a "[c]laim for lost wages" with its value listed as "unknown."[93] At the first meeting of creditors, the attorneys for the debtor told the trustee that the claim might be worth $90,000. Several days after the first meeting, the trustee wrote to the attorneys representing the debtor, telling them that he considered the claim to be property of the bankruptcy estate and asking the attorneys for more details about the suit. The debtor's attorneys responded, indicating with even more optimism, that the lawsuit might be worth as much as $110,000.[94] Taylor, the trustee, did not object at that time to the exemption and, as noted by the Court, the record indicated that even the trustee believed the lawsuit had no value.[95]

Subsequently, the law suit was settled whereby TWA paid Davis the sum of $110,000. A total of $71,000 was paid jointly to Davis and the attorneys Freeland & Kronz. Apparently, Davis had signed over this check for payment of attorney fees.[96] The remainder of the settlement was paid in other means.[97] Upon learning of the settlement, the trustee commenced an action against Freeland & Kronz in bankruptcy court, requesting the law firm to relinquish the money to the estate because it was nonexempt property.[98]

The bankruptcy court agreed with the trustee and concluded that there was "no statutory basis" for claiming the proceeds of the lawsuit as exempt. Consequently, the court ordered that approximately $23,000 be returned to Taylor. This sum would have been sufficient to pay all of Taylor's creditors in full.[99] The district court

91. *Id.*
92. *Id.*
93. *Id.*
94. *Taylor*, 112 S. Ct. at 1646-47.
95. *Id.* at 1647.
96. *Id.*
97. *Id.*
98. *Id.*
99. *Taylor*, 112 S. Ct. at 1647.

affirmed, but the Third Circuit Court of Appeals reversed, holding that the objection was not timely and therefore, all proceeds were exempt.[100]

The Supreme Court granted certiorari and affirmed.[101] Again, applying a plain meaning interpretation of the Code, the Court held that both the exemption statutes and the procedural statutes for objecting to exemptions are to be plainly read.[102] The Court noted that § 522(b) allowed the debtor to choose either state or federal exemptions and that § 522(*l*) set forth the procedure for claiming such exemptions. All a debtor needs to do is file a list of property claimed as exempt. The Court also noted that unless a party in interest objects in a timely fashion to the property claimed as exempt, the property becomes exempt.[103] The Court held that although § 522(*l*) does not specify the time for objecting to the claimed exemptions, Bankruptcy Rule 4003(b) does.[104] The Court noted that the debtor properly followed the rules and exempted the property, and the trustee did not object. The Court further stated that the parties agreed that the amount of the exemption to which Davis would have been authorized under either state or federal law would not have encompassed all of the property that she in fact received. The Court postulated that "Taylor . . . apparently could have made a valid objection under § 522(*l*) and Rule 4003 if he had acted promptly. We hold, however, that his failure to do so prevents him from challenging the validity of the exemption now."[105]

The trustee argued that exemptions must be filed in good faith and that the failure to do so was a basis for allowing the trustee to object in an untimely fashion. The Court flatly rejected this argument.[106] The Court noted that if Taylor did not know the value of the potential proceeds of the lawsuit, he could have sought a valuation hearing under Bankruptcy Rule 4003(c) in order to assign a value to the proceeds; or in the alternative, he could have simply asked the bankruptcy court for an extension in order to object to

100. *Id.*

101. *See id.* Justice Thomas wrote for the majority of the Court.

102. *Id.* at 1648. This case is another block in the strict constructionist foundation being cemented by the Court.

103. *Id.* Once the property is exempt, it is no longer property of the estate within the meaning of 11 U.S.C. § 541. *See, e.g., In re* Sherk, 918 F.2d 1170, 1174 (5th Cir. 1990).

104. *Taylor*, 112 S. Ct. at 1648. *See* FED. R. BANKR. P. 4003(b). Bankruptcy Rule 4003(b) provides that unless a trustee or a creditor objects within 30 days after the conclusion of the first meeting of creditors or the amendment of the exemption schedule, the property is deemed exempt. *Id.*

105. *Taylor*, 112 S. Ct. at 1647-48.

106. *Id.* at 1648.

the exemption.[107] Therefore, the Court found that there was a remedy available to the trustee.[108]

The trustee further argued that to allow the debtor to claim as exempt any property that the debtor clearly knew was not exempt, would lead to what the Eighth Circuit called " 'exemption by declaration.' "[109] The Court found that there were a number of means to ensure that debtors and their attorneys do not exercise improper conduct as postulated by the trustee.[110] Such means include a denial of discharge for fraudulent claims under § 727(a)(4)(B), Rule 9011 sanctions, and criminal sanctions under 18 U.S.C. § 152. The Court noted that "[w]e have no authority to limit the application of § 522(*l*) to exemptions claimed in good faith."[111]

Justice Stevens, in dissent, noted that the Court should have considered the equitable doctrine of tolling in order to suspend the thirty-day limitation for objecting to exemptions.[112] He also noted that it was a wide-spread practice of bankruptcy law to consider strong equitable considerations and that, in this case, equity would justify the trustee's position in the matter.[113] Justice Stevens concluded that courts have avoided the harsh result of federal statutes by relying on either fraudulent concealment or undiscovered fraud in order to toll the period of limitation.[114] Justice Stevens was concerned about what the Eighth Circuit and other bankruptcy courts had raised as exemption by fiat or by declaration. He stated:

> The equitable principles that motivated these bankruptcy courts are best encapsulated by the court in *In re Bennett*. There, the court explained that to apply Rule 4003(b) rigidly would be to encourage a debtor to claim that all of her property was exempt, thus leaving it to the trustee and creditors to sift through the myriad claimed exemptions to assess their validity. Such a policy would

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107. *Id.*
108. *Id.*
109. *Id. See also In re* Peterson, 920 F.2d 1389, 1393 (8th Cir. 1990).
110. *Taylor*, 112 S. Ct. at 1648. Such "improper conduct," for example, could be claiming as exempt property that is clearly not exempt. *Id.*
111. *Id.* Taylor made an additional argument in his Supreme Court brief that he had not addressed in his request for certiorari: He argued that 11 U.S.C. § 105(a), the general equity provisions of the Code, allowed the Court to consider the provision of good faith. However, the Court said that it would not consider the argument because it was not addressed in the petition for certiorari. *Id.* at 1649.
112. *Id.* at 1649 (Stevens, J., dissenting).
113. *Id.*
114. *Id.* at 1651.

> result in reversion to "the law of the streets, with bare possession constituting not nine, but ten, parts of the law; orderly administration of estates would be replaced by uncertainty and constant litigation if not outright anarchy."[115]

Justice Stevens concluded: "In my view, it is a mistake to adopt a 'strict letter' approach . . . when justice requires a more searching inquiry."[116]

Thus, if a creditor or the trustee objects to the debtor's exemptions, the objection must be made within thirty days after the first date set for the first meeting of creditors, or thirty days after the exemption claim or amendment is served. If the trustee is concerned about the value of the property or concerned that the property may be of inconsequential value, the trustee still must object to the exemption, or seek either a valuation from the court or an extension of time to object to the exemption. However, such action must be taken within the thirty-day period, or the failure to act in a timely fashion will be fatal to the objecting party.

E. JUDGMENTS GRANTED IN DIVORCE PROCEEDINGS WHICH DIVIDE EXISTING PROPERTY OF THE PARTIES MAY NOT BE AVOIDED UNDER 11 U.S.C. § 522

1. *Property transferred in divorce which was owned by the parties jointly during the marriage may not be avoided under 11 U.S.C. § 522.*

In *Farrey v. Sanderfoot*,[117] the Supreme Court was confronted with a lien avoidance issue under 11 U.S.C § 522(f) involving the debtor's attempt to avoid the judgment lien of his ex-spouse which transferred jointly owned property.[118] Prior to filing a Chapter 7 bankruptcy, the debtor-respondent, Gerald Sanderfoot, had received a divorce decree from the petitioner, Jeanne Farrey.

Farrey and Sanderfoot were married for approximately twenty years and resided in Wisconsin throughout the marriage. At the time of the divorce decree, they owned an interest in Wisconsin real estate, which was the family home. The decree awarded the family home to Sanderfoot and a payment of

115. *Taylor*, 112 S. Ct. at 1651 (citing *In re* Bennett, 36 B.R. 893, 895 (Bankr. W.D. Ky. 1984)) (footnote omitted).
116. *Id.* at 1652 (quoting Bailey v. Glover, 21 Wall 342, 347 (1875)).
117. 111 S. Ct. 1825 (1991).
118. Farrey v. Sanderfoot, 111 S. Ct. 1825, 1827 (1991).

$29,208.44 to Farrey. The divorce court ordered the payment to be secured by a lien against the real estate. In exchange for the lien, Farrey was to convey her interest in the real estate to Sanderfoot.[119]

After Sanderfoot filed a Chapter 7 bankruptcy, he commenced an action pursuant to 11 U.S.C. § 522(f)(1) to avoid Farrey's lien.[120] Farrey objected to the motion to avoid her lien, arguing that § 522(f)(1) could not divest her of her interest in the real estate.[121] The bankruptcy court held for Farrey. The district court reversed, and the Seventh Circuit Court of Appeals affirmed the district court. The Supreme Court granted certiorari and reversed the circuit court.

The Supreme Court noted that under § 522(f)(1), a debtor may avoid a lien on an interest a debtor has in property to the extent that such a lien impairs the debtor's exemption if such lien is a judicial lien. The Court found, however, that § 522(f)(1) created a number of conditions in order to avoid the lien.[122] First, the lien has to be a judicial lien; second, it must impair an exemption available to the debtor; and third, it must be a lien on an interest of the debtor in property of the estate.[123] In the instant case, the lien was created by a judgment of divorce and was encumbering the debtor's homestead. Therefore, the lien impaired the homestead exemption under state law.[124] However, the third element must also be met in order to avoid the lien.

The Court stated that the debtor may *only* avoid the " 'fixing of a lien on an interest of the debtor in . . . property.' "[125] The Court found that this phrase required that the lien could not attach to the property prior to the debtor's interest in the property. In other words, if the lien was against the property when the debtor received it from a third party, the lien was not avoidable.

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119. *Id.*

120. *Id. See* 11 U.S.C. § 522(f)(1) (1988). Section 522(f)(1) provides as follows:

> (f) Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—
>
> (1) a judicial lien . . . .

Id.

121. *Farrey*, 111 S. Ct. at 1828.

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* (citing 11 U.S.C. § 522(f) (1988)). The Court held that Farrey's lien did not attach to the pre-existing interest of the husband because the divorce decree which conveyed the entire property to the debtor, also created the judgment lien. *Id.* Therefore, the debtor had no interest in the ex-spouse's property at the time of the lien. *Id.*

Conversely, if the lien arose after the debtor owned an interest in the property, it was avoidable. The Court held that since the lien was simultaneously transferred within the division and conveyance of the property in the divorce judgment, that the debtor did not own a fee simple interest prior to the attachment of the lien.[126] In the words of the Court: "Since Sanderfoot never possessed his new fee simple interest before the lien 'fixed,' § 522(f)(1) is not available to void the lien."[127] Therefore, the debtor could not avoid the judicial lien in this case.[128]

Farrey instructs that in order for a debtor to avoid a judicial lien under § 522(f), the debtor must have a fee simple interest in the property prior to the fixing of the lien. Therefore, in a divorce situation in which the property is jointly owned by the parties, and the divorce decree separates and conveys the property to one of the spouses, and a judgment lien is ordered for the benefit of the other spouse, the debtor could not avoid the judicial lien and claim the property exempt in a subsequent bankruptcy filing.

2. *A debtor may avoid a lien of the former spouse that impairs exemptions under § 522(f) if the property was not acquired during the marriage.*

In *Owen v. Owen*,[129] the Court held that a judgment lien on property not acquired during the marriage or in a dissolution action was avoidable under 11 U.S.C. § 522(f) if it impaired an exemption of the debtor.[130] *Owen* was factually similar to *Farrey v. Sanderfoot*.[131] There was, however, one distinction: The property at issue in *Owen* had never been owned either jointly or individually by the nondebtor former spouse and was not split up in the dissolution action.

In *Owen*, a Florida debtor, Dwight Owen, divorced the creditor, Helen Owen.[132] In 1975, Helen Owen had obtained a judgment against her former husband for approximately $160,000.[133] The judgment was docketed in Sarasota County, Florida. However, at the time the judgment was docketed, the debtor did not

126. *Farrey*, 111 S. Ct. at 1830-31.
127. *Id.* at 1831.
128. *Id.* at 1830.
129. 111 S. Ct. 1833 (1991).
130. Owen v. Owen, 111 S. Ct. 1833, 1835-36 (1991).
131. *Id.* at 1834-35. *See Farrey*, 111 S. Ct. at 127-28.
132. *Owen*, 111 S. Ct. at 1834-35. It is worth noting that *Owen* was decided on the same day as *Farrey*.
133. *Id.* at 1834.

own any property in Sarasota County.[134] Subsequently, the debtor purchased a condominium in Sarasota County. Upon the acquisition of the title, the property, which did not qualify as a homestead at that time, became subject to his former spouse's judgment lien.[135] One year later, Florida amended its homestead law so that the debtor's condominium property thereafter qualified as a homestead under state law.[136]

In January of 1986, Mr. Owen filed for relief under Chapter 7 of the Bankruptcy Code and claimed the condominium was his homestead and therefore exempt. The bankruptcy court allowed his exemption in the homestead, but did not allow him to avoid the lien of the former spouse pursuant to 11 U.S.C. § 522(f)(1). The district court affirmed, holding that the property did not qualify for an exemption because the lien attached prior to the time the exemption was allowed. The Eleventh Circuit Court of Appeals affirmed on similar grounds.[137] The Supreme Court granted certiorari and reversed.

The Supreme Court noted that the estate consisted of all interests in property, legal and equitable, and that an exemption was an interest that was drawn from the estate for the benefit of the debtor. The Court noted that § 522(b) set forth the property that a debtor may exempt. A debtor may choose either federal or state exemptions unless the state "opts" to limit the exemptions to only those allowed under state law. Florida was such an "opt out" state; it permitted the debtor to choose only state exemptions.[138] The Court was concerned solely with the issue of whether the debtor could avoid a lien which impaired an exemption to which the debtor would have been entitled under § 522(b) had the state permitted the debtor to use the federal exemptions.[139] The Court held that if it did not allow the lien avoidance, it would be reversing widely accepted and uniform positions taken by federal bankruptcy courts regarding federal exemptions.[140] The Court

134. *Id.*
135. *Id.* at 1834-35.
136. *Id.* at 1835.
137. *Owen*, 111 S. Ct. at 1835.
138. *Id.* at 1835-36. States may "opt out" of the federal exemptions. 11 U.S.C. § 522(b)(1) (1988). Therefore, the federal exemptions do not apply and the debtor is limited to the state exemptions. 3 COLLIER BANKRUPTCY MANUAL ¶ 522.01, at 522-11 to 522-12 n.4a (1992).
139. *Owen*, 111 S. Ct. at 1836.
140. *Id.* The creditor in *Owen* had argued that to allow the lien to be avoided under § 522(f) "would not *preserve* the exemption but would *expand* it." *Id.* The Supreme Court held that this position has been "widely *and uniformly* rejected with respect to built-in limitations on the *federal* exemptions." *Id.* (emphasis in original). To take the creditor's argument to its logical conclusion would basically render § 522(f) meaningless, because no

reasoned that to read § 522(f) in such a manner would not allow any debtor to avoid any lien even with the federal exemptions. The sole question addressed by the *Owen* court was whether the lien impaired an exemption to which the debtor would have been entitled *but for* the lien itself. The Court said that the debtor would have been entitled to the exemption but for that lien and, therefore, the debtor could avoid the fixing of the lien. If the Court refused to allow the judgment to be avoided, then § 522(f) would in essence be a nullity—as no debtor could ever avoid a judgment lien, because a judgment always arises before the bankruptcy filing.

The *Owen* decision must, however, be read in conjunction with *Farrey v. Sanderfoot*[141] because the *Owen* Court did not address whether the lien fixed on "an interest of the debtor."[142] Therefore, if the divorce judgment attaches to property acquired by the debtor which was either nonmarital property or was acquired by the debtor after the dissolution of the marriage, then the judgment lien of the former spouse may be avoided under § 522(f) as long as the property is subject to exemption by the debtor.

F. A DEBTOR IN A CHAPTER 7 BANKRUPTCY MAY NOT "STRIP DOWN" A CREDITOR'S CLAIM AGAINST REAL PROPERTY EVEN THOUGH THE DEBT EXCEEDS THE VALUE OF THE PROPERTY

In *Dewsnup v. Timm*,[143] the Supreme Court refused to allow the debtor to redeem property by "stripping down" the creditor's lien. The Chapter 7 debtor commenced an adversary proceeding in order to determine the validity and extent of the note and deed

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liens could be avoided if they encumbered any exemption. *Id.* The Supreme Court noted that this position has been uniformly rejected by the federal courts as applied to federal exemptions. The Supreme Court gave, as an example, the federal homestead exemption. *Id.* The Supreme Court stated:

> [I]f respondents' interpretations of section 522(f) were applied to this exemption, a debtor who owned a house worth $10,000 that was subject to a judicial lien of $9,000 would not be entitled to the full homestead exemption of $7,500. The judicial lien would not be avoidable under § 522(f), since it does not "impair" the exemption, which is limited to the debtor's "aggregate interest" of $1,000.

Id.

141. 111 S. Ct. 1825 (1991).

142. *Owen*, 111 S. Ct. at 1838. The Court remanded the case to the court of appeals to address the issue of whether the lien fixed on the interest of the debtor and also the issue of whether the Florida statute extending the homestead exemption was an impermissible "taking" under the Constitution. *Id. See* United States v. Security Indus. Bank, 459 U.S. 70 (1982).

143. 112 S. Ct. 773 (1992).

of trust held on the debtor's real estate. The debtor complained that the creditor's debt was far in excess of the fair market value of the real estate. The debtor requested that the fair value of the real estate debt be set and the claim be revalued pursuant to 11 U.S.C. § 506(d) in order to allow the debtor to redeem the property at its fair market value.[144]

The United States Bankruptcy Court held that the debtors could not redeem the real estate, which had been abandoned to them by the trustee, by paying the secured creditor the fair market value of the property. The district court affirmed, as did the court of appeals.

Justice Blackmun, writing for the United States Supreme Court, held that the debtors could not "strip down" the creditor's lien on real property to the judicially determined value of the collateral.[145] The debtor took the position that § 506(a) and § 506(d) were complimentary and should to be read together. Section 506(a) provides that a claim is secured only to the extent of the judicially determined value of the real estate on which the lien is fixed. The Court noted that § 506(a) bifurcates the classes of claims allowed under § 502 into secured claims and unsecured claims.[146] The debtor can avoid the lien on the property pursuant to § 506(d) to the extent the lien is no longer secured and, thus, not an allowed secured claim. The Court was persuaded by the debtor's argument that § 506(a) and § 506(d) should be read in conjunction. However, the Court indicated that it was not writing on a "clean slate" and that, if it was, it

> might be inclined to agree with the [debtor] that the words "allowed secured claim" must take the same meaning in section 506(d) as in section 506(a). But, given the ambiguity in the text, we are not convinced that Congress intended to depart from the pre-Code rule that liens pass through bankruptcy unaffected.[147]

The Court espoused that if it were to allow the debtor to strip down the lien to the secured value as of the date of the filing of the bankruptcy, the debtor may gain a windfall if the property value increased between the time of the bankruptcy strip down and the foreclosure sale.[148] The Court concluded that the creditor's lien

144. Dewsnup v. Timm, 112 S. Ct. 773, 776 (1992).
145. *Id.* at 778.
146. *Id.* at 777.
147. *Id.* at 778.
148. *Id.*

stays with the property until the foreclosure.

In some very curious language, which may potentially be applicable to 11 U.S.C. § 1225(a)(4) and 11 U.S.C. § 1325(a)(4) dealing with the valuation of an interest, the Court held that "[a]ny increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain."[149] The Court continued by noting that the lienholder should not be subject to such action simply because it subjected itself to the bankruptcy proceedings by filing its proof of claim. The Court stated that the lienholder would not have been subject to the strip down of its lien if it would have "stayed aloof from the bankruptcy proceedings."[150] The creditor would be able, under state law, to foreclose its interest and sell the property for whatever value it could obtain at the sale. There would be no strip down in the sale and the creditor would be entitled to the full value of its lien.

Furthermore, the Court did not address the issue raised by debtor's *amicus*: The "plain language of § 506(d) dictates that the proper portion of an undersecured lien on property in a Chapter 7 case is void."[151] The *amicus* asserted that to hold otherwise would eliminate "an undersecured creditor's ability to participate in the distribution of the estate's assets."[152]

Finally, the Court concluded by indicating that its decision was congruent with both the Bankruptcy Act and the Court's recent acknowledgment under *Farrey v. Sanderfoot*[153] and *Johnson v. Home State Bank*[154] that "a lien on real property passes

149. *Dewsnup*, 112 S. Ct. at 778. Do the Court's statements mean that if the debtor has expended unsecured assets or labor between the time of filing and confirmation on secured assets, that the benefit goes to the secured creditor? If so, then what if the property is a depreciable asset that loses value in this time period? Does this loss fall to the creditor? Should the debtor immediately upon filing bring a motion to value the assets? All these questions are left for future determination by the Court. *Compare In re* Lupfer Bros., 120 B.R. 1002 (Bankr. W.D. Mo. 1990); *In re* Musil, 99 B.R. 448 (Bankr. D. Kan. 1988); *In re* Bluridg Farms, Inc., 93 B.R. 648 (S.D. Iowa 1988); *In re* Perdue, 95 B.R. 475 (Bankr. W.D. Ky. 1988) *with In re* Nielsen, 86 B.R. 177 (Bankr. E.D. Mo. 1988).

150. *Dewsnup*, 112 S. Ct. at 778. This is an interesting statement in that the recent cases dealing with jury trials indicate that if an entity stays aloof from the bankruptcy proceedings, that entity has the right to a jury trial; however, an entity that does not stay aloof from the bankruptcy proceedings is subject to different treatment in that there it has no right to a jury trial. *See* Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989).

151. *Dewsnup*, 112 S. Ct. at 777.

152. *Id.*

153. 111 S. Ct. 1825 (1991).

154. 111 S. Ct. 2150 (1991).

through the bankruptcy [estate] unaffected."[155] This statement is even more interesting because it seemingly implies that the bankruptcy court cannot strip down any liens against property if the liens are going to pass through the estate unaffected.[156]

Justice Scalia, joined by Justice Souter in a stinging dissent, held to his theory of a "plain reading" or strict construction of the statute.[157] Justice Scalia pointed out that "allowed secured claim" was not an ambiguous phrase.[158] Moreover, the terminology "allowed secured claim" was specifically set forth in § 506, as well as throughout the Code; therefore, its application and use should be consistent across the statutory provisions.[159]

Justice Scalia quite correctly pointed out that § 1225(a)(4) and § 1325(a)(4) deal with "allowed secured claims" and the treatment of those claims under reorganization plans. The dissent noted that when Congress wanted to refer to the complete claim of the creditors, as opposed to the secured and allowed unsecured claims of the creditors, that it referred to the combined claim as being the "allowed claim."[160] Justice Scalia wrote that "[g]iven this clear and unmistakable pattern of usage, it seems to me impossible to hold, as the Court does, that the words 'allowed secured claim' in § 506(d) need not be read as an indivisible term of art defined by reference to § 506(a).' "[161] Justice Scalia criticized the Court for not following the traditional rules of statutory construction in following the meaning of the language of the text in the same section and throughout the Code.[162] Justice Scalia also criticized the Court for not following the "plain meaning" of the statute and for making decisions which rest "upon policy intuitions of a legislative character."[163]

As a result of the *Dewsnup* decision, a debtor may not use Chapter 7 to "strip down" liens against property which are in excess of the fair market value of the property. *Dewsnup*, however, is one case in which the Supreme Court's use of the "plain meaning" of the statute becomes a bit clouded. Justice Scalia, in his dissenting opinion, reminds the Court that it has lost sight of

155. *Dewsnup*, 112 S. Ct. at 778.
156. Does that mean that the Court can not strip down liens in reorganization cases? Clearly not. *See* 11 U.S.C. §§ 1225(a)(5), 1325(a)(5) (1988).
157. *See Dewsnup*, 112 S. Ct. at 779-80 (Scalia, J., dissenting).
158. *Dewsnup*, 112 S. Ct. at 780 (Scalia, J., dissenting).
159. *Id.*
160. *Id.* The dissent noted 11 U.S.C. § 363(k) as an example which refers to an allowed claim. *Id.*
161. *Id.* (citations omitted).
162. *Id.* at 781.
163. *Id.*

the pea under the shell. Moreover, although it is a dissent, Justice Scalia's opinion surely sets the tone of the Court for a strict constructionist attitude in bankruptcy matters and presumably will be the basis for many more decisions in this area. At a minimum, it is consistent with Scalia's other recent opinions dealing with bankruptcy issues in which he has written for the majority of the Court.

G. THE ORDINARY COURSE OF BUSINESS DEFENSE AND THE TIMING OF A TRANSFER ARE NOW MORE CLEARLY DEFINED BY THE COURT

1. *The Court held that there is no difference between long-term and short-term debt under the ordinary course of business defense in preference actions*

In *Union Bank v. Wolas*,[164] the Supreme Court addressed whether there was a distinction between short-term and long-term debt for purposes of the ordinary course of business defense to a preference action.[165] The Court held that the creditor, obligated with either short-term or long-term debt, could raise the defense of ordinary course of business payments within the meaning of 11 U.S.C. § 547(c)(2).

The creditor in *Wolas* loaned the debtor seven million dollars. The debtor made two interest payments on the indebtedness, which amounted to approximately $100,000 within ninety days prior to the filing of a Chapter 7 bankruptcy proceeding.[166] The Chapter 7 trustee commenced an action against the bank, alleging that the payments were avoidable preferences. The bankruptcy court held in favor of the bank, finding that the payments were made in the ordinary course of business, and therefore, an excep-

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164. 112 S. Ct. 527 (1991).

165. Union Bank v. Wolas, 112 S. Ct. 527, 533 (1991). *See* 11 U.S.C. § 547(c)(2) (1988). Section 547(c)(2) provides in pertinent part:

> The trustee may not avoid under this section a transfer—
>
> . . . .
>
> (2) to the extent that such transfer was—
>
> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
>
> (C) made according to ordinary business terms . . . .

Id. The definitional sections in the Bankruptcy Code do not distinguish between short-term or long-term indebtedness. *Wolas*, 112 S. Ct. at 530, n.7. The Ninth Circuit rejected the bank's argument that the revolving line of credit involved in this transaction was not long-term debt because it was for less than one year. *Id.* at 529 n.5.

166. *Wolas*, 112 S. Ct. at 529.

tion to the preference rule.[167] The district court affirmed in favor of the bank, but subsequently decided a parallel case and reversed the prior decision. The Supreme Court granted certiorari.[168]

Using a strict constructionist analysis, the Court held that § 547(c)(2) did not specifically distinguish between short-term and long-term indebtedness. The Court rejected the trustee's argument that both the Bankruptcy Act and the legislative history indicated that the defense of ordinary course of business[169] was only available to trade creditors or short-term creditors.[170] The Court said that the statutory language of § 547 did not specifically refer to either short-term or long-term debt;[171] consequently, any creditor is entitled to use the ordinary course of business defense. The Court, therefore, reversed the case without commenting on whether the ordinary course of business exception would have any merit as applied to the facts. However, the Court did find that the exception could be raised as a legal defense in order to preclude summary judgment.[172]

Therefore, any indebtedness, whether for a short-term basis or a long-term basis, is still subject to the ordinary course of business defense as set forth in 11 U.S.C. § 547(c)(2). If the transfer is incurred in the ordinary course of business, the creditor has a defense to the preference action irrespective of how long the loan is in place.

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167. *Id.* The purpose behind the preference statute is to undo certain pre-bankruptcy transactions, the effect of which is to frustrate the distribution scheme set forth in the Bankruptcy Code. The second policy is to permit the trustee to avoid pre-bankruptcy transactions which occur within a short period before bankruptcy. This discourages creditors from racing to the courthouse to dismember debtors during their slides into bankruptcy. H.R. REP. No. 595, 95th Cong. 2d Sess. 177, 178 (1978).

168. *Wolas*, 112 S. Ct. at 529.

169. *Id.* at 531. Prior to the amendments of the Code in 1984, § 547(c)(2) provided that the transfer which was subject to the avoidance action had to be "made not later than forty-five days after such debt was incurred." *Id.* at 530 n.8. *See* 11 U.S.C. § 547(c)(2)(B) (1982). At the same time, the 1984 amendment also added § 547(c)(7). In effect, the prior version of § 547(c)(2) excluded from avoidance many ordinary course of business payments, but the forty-five day provision of subparagraph (B) caused some difficulty. It failed to take into consideration short-term financing that calls for payment beyond the forty-five days. The courts had a difficult time deciding when the forty-five day period started and when the debt was really incurred. Because Congress dropped this provision, it was argued by the respondents in *Wolas* that Congress had no intention of extending the defense to long-term lenders. *Wolas*, 112 S. Ct. at 531.

170. *Wolas*, 112 S. Ct. at 530-31.

171. *Id.* at 530.

172. *See id.* at 533-34. Justice Scalia, in a concurring opinion, was very critical of the legal culture and the Ninth Circuit Court of Appeals because it gave merit to the argument that the ordinary course of business defense was available only to short-term debt. He reasoned that the statute was completely devoid of any language concerning short-term or long-term debt. *Id.* at 534. Justice Scalia's concurrence is consistent with his writings which advocate a strict constructionist approach of the Court.

2. *A "transfer" involving a check occurs for purposes of § 547 when the check is "honored" by the bank.*

The Supreme Court in *Barnhill v. Johnson*[173] decided the issue of when a "transfer" takes place for purposes of § 547, when the payment is made by a check.[174] *Barnhill* involved the interpretation of the preference provision of the Bankruptcy Code found at 11 U.S.C. § 547. In this case, the debtor made a payment on a good faith debt to Barnhill. The check was delivered to Barnhill on November 18th, but was postdated to November 19th, and was honored by the drawee bank on November 20th. The debtor subsequently filed a Chapter 11 petition. The parties agreed that November 20th was the ninetieth day prior to the bankruptcy filing.[175]

Johnson, the bankruptcy trustee, commenced an adversary action against Barnhill, requesting him to return the proceeds as a preference under 11 U.S.C. § 547(b).[176] Johnson contended that the transfer occurred on November 20th, the date the check was honored by the bank ("honor rule"). Consequently, Johnson contended that the transfer occurred within the ninety-day preference period.[177] Barnhill claimed that the transfer occurred on November 18th, the date the check was delivered ("delivery rule"). As such, Barnhill asserted that the transfer occurred outside the ninety-day preference period.[178]

The bankruptcy court concluded that the "delivery rule" governed and, therefore, held that the transfer took place outside the ninety-day period. Accordingly, the bankruptcy court determined that there was no preferential transfer, and the court denied recovery to the trustee.[179] The district court affirmed. The Tenth Circuit reversed, concluding that the "honor rule" should govern actions under § 547(b).[180] The Supreme Court granted certiorari,

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173. 112 S. Ct. 1386 (1992).

174. Barnhill v. Johnson, 112 S. Ct. 1386, 1388 (1992).

175. *Id.*

176. *Id.*

177. *Id.* If the transfer took place within ninety days before the filing of the bankruptcy and assuming that the rest of the other elements of § 547 could be met, the trustee could recover the transfer as an avoidable preference. 11 U.S.C. § 547(b)(4) (1988). In this case, it was not established that there were any insiders and, therefore, 11 U.S.C. § 547(b)(4)(B) did not apply.

178. *Barnhill*, 112 S. Ct. at 1388.

179. *Id.*

180. *Id. See* 11 U.S.C. § 547(b) (1988). Section 547(b) provides that the trustee may avoid a transfer of a debtor's interest in property made within ninety days before the filing of a bankruptcy petition. *Id.*

noting that there was a split among the circuits as to which date to use when determining the occurrence of a transfer for preference actions—the date of delivery or the date of honor.[181] The Supreme Court, applying the date of "honor rule," affirmed the decision of the Tenth Circuit.[182]

The Court analyzed what constituted a "transfer" within the meaning of the Code. Under § 101(54) of the Code, a "transfer" is defined to mean every mode of disposing of property, either directly or indirectly, absolute or conditional, voluntarily or involuntarily, including a retention of a security interest.[183] The Court noted that 11 U.S.C. § 547(e) also aided in ascertaining the meaning and dating of a "transfer."[184] The Court held that what constituted a transfer was determined in accord with federal law unless there was no federal law to apply. Under such circumstances, however, the property law of the state may be used for guidance.[185] The Court, reviewing New Mexico's statute dealing with Uniform Commercial Code,[186] stated that "[a] person with an account at a bank enjoys a claim against the bank for funds in an amount equal to the account balance."[187] The Court noted that a check is merely an instrument ordering the drawee bank to pay upon demand.[188] The receipt of the check does not give the recipient a right against the bank because the drawee bank can refuse to honor the check, and the drawee has no recourse against the bank.[189]

Applying the law to the facts before it, the Court found that the recipient of the checks had no rights against the bank, noting that several events could interfere with the delivery and presentment of the check.[190] For example, the debtor could have chosen to close the account; a third party could have acquired a lien on the account through garnishment or other proceedings; and the bank may have mistakenly refused to honor the check.[191] Therefore, the Court found that the transfer did not take place until the

181. *Barnhill*, 112 S. Ct. at 1388 & n.3.
182. *Id.* at 1388.
183. *Barnhill*, 112 S. Ct. at 1388-89.
184. *Id.* at 1389.
185. *Id.*
186. *Id.* at 1389 n.5. The Court noted that all fifty states, the District of Columbia, Guam, and the Virgin Islands have adopted the relevant portions of the Uniform Commercial Code. *Id.*
187. *Barnhill*, 112 S. Ct. at 1389.
188. *Id.*
189. *Id.*
190. *Id.* at 1390.
191. *Id.*

bank honored the check—the time when the bank had a right to charge the debtor's account pursuant to the state's version of the Uniform Commercial Code.[192] The Court stated that using the date of honor "left the debtor in the position that it would have occupied if it had withdrawn cash from its account and handed it over to the [creditor]."[193]

The creditor argued that the Court should review the expansive definition of transfer as set forth by the Bankruptcy Code and consider the delivery of a check as a "conditional" transfer. Rejecting this argument, the Court noted that at the most, the check gave the creditor a mere right to sue the debtor on the account, which is no better than a suit on a mere promissory note.[194]

The Court refused to consider any legislative history, stating that legislative history is relevant only when there is "statutory ambiguity."[195] The Court found no such ambiguity.

Justices Stevens and Blackmun dissented, rebuking the Court for neither following the "plain meaning" of the statute nor strictly construing the transfer provisions. The dissent stated:

> Thus §§ 101(54) and 547 when read together, plainly indicate that a "transfer" by check occurs on the date the check is delivered to the transferee, provided that the drawee bank honors the check within 10 days. If, however, the check is not honored within the 10 days, the "transfer" occurs on the date of honor.[196]

The dissent analogized perfecting the transfer to the rights of parties to recover property within ten days of the bankruptcy filing.[197]

The *Barnhill* Court held that a transfer takes place not when a check is issued, but rather by the date the check is honored by the drawee bank. This holding becomes important not only in the context of a § 547 preference situation, but also in defining the property of the estate. Debtors' checking accounts would not be determined from the debtors' personal check register, but would be determined based upon the bank's records as of the date of the filing since debtors may have outstanding checks. *Barnhill* illus-

192. *Barnhill*, 112 S. Ct. at 1390.
193. *Id.*
194. *Id.* at 1390-91.
195. *Id.* at 1391 (quoting Toibb v. Radloff, 111 S. Ct. 2197 (1991)).
196. *Barnhill*, 112 S. Ct. at 1393 (Stevens, J., dissenting).
197. *Id.* *See* 11 U.S.C. § 547(c)(3) (1988).

trates that an account could be levied upon before the checks are actually delivered to the bank. For protection, a creditor who suspects that a debtor may file bankruptcy should require payment in cash, a cashier's check, money order, or certified check. In order to identify estate property and exemptions, counsel for the debtor should request a bank statement which indicates the amount held for the debtor as of the date of the filing.

H. JURY TRIALS REVISITED SINCE *GRANFINANCIERA S.A. V. NORDBERG*, 109 S. CT. 2782 (1989).

In *Langenkamp v. Culp*,[198] the Supreme Court addressed the issue of whether jury trials were permitted in bankruptcy court proceedings. The debtor, Republic Trust and Savings Company, a failed Oklahoma financial corporation, filed a Chapter 11 bankruptcy.[199] The successor trustee to the debtor Langenkamp filed an action against respondents who held passbook savings certificates issued by the debtors. These respondents had received payment on their saving certificates within the ninety-day period prior to the filing of the Chapter 11 petition.[200] The trustee alleged that these payments were preferences and therefore recoverable as property of the estate.[201] The respondents, some of whom had filed proofs of claims against the bankruptcy estate, requested a jury trial.[202]

The Court, relying on *Granfinanciera S.A. v. Nordberg*,[203] held that the Court's equitable jurisdiction involved the resolution of allowance and disallowance claims, including actions by the trustee for preferences when the individual had filed a claim against the estate.[204] In circumstances in which a creditor has filed a claim against the estate, the creditor is not entitled to a jury trial. If the creditor does not file a proof of claim against the estate, then the trustee can only seek recovery of a preference through a legal action which allows the defendant to request a jury trial.[205]

198. 111 S. Ct. 330 (1990), *reh'g denied*, 111 S. Ct. 721 (1991).
199. Langenkamp v. Culp, 111 S. Ct. 330, 330 (1990), *reh'g denied*, 111 S. Ct. (1991).
200. *Id.*
201. *Id.* at 331.
202. *Id.*
203. *Id.* (citing Granfinanciera S.A. v. Nordberg, 109 S. Ct. 2782 (1989)).
204. *Langenkamp*, 111 S. Ct. at 331.
205. *Id.* Some creditors have tried to get courts to delay the time to file claims or to extend the time to file timely proofs of claims in order that they could get a jury trial on any actions against them, and thereafter wait to file proper claims. Most probably courts will reject their requests, however, the issue is unresolved.

Therefore, the only way creditors can obtain jury trials is if they do not file a proof of claim.

I. WAIVER OF SOVEREIGN IMMUNITY IS NEEDED BEFORE ANY MONETARY ACTION IS FILED AGAINST THE UNITED STATES

The Supreme Court in *United States v. Nordic Village, Inc.*[206] addressed the issue of whether the requirement of waiver of sovereign immunity was necessary to maintain an action against the federal government.[207] In *Nordic Village*, the debtor filed for protection under Chapter 11 of the Bankruptcy Code. During the Chapter 11 bankruptcy proceeding, an officer of the corporation withdrew $26,000 from the corporation's checking account and used $20,000 of it to obtain a cashier's check payable to the Internal Revenue Service on the officer's personal tax liability.[208] The Chapter 7 trustee sought recovery of the $20,000 by filing an action under 11 U.S.C. § 549.[209] The bankruptcy court granted judgment for the trustee against the United States and entered a money judgment against the United States for the $20,000.[210] The district court affirmed, as did the Sixth Circuit Court of Appeals.[211] The Supreme Court reversed, holding that 11 U.S.C. § 106(c) did not waive the United States' sovereign immunity for an action seeking monetary relief.[212]

The Court, strictly construing § 106(c), held that only those suits authorized under subsections 106(a) and (b) were permitted

206. 112 S. Ct. 1011 (1992).

207. United States v. Nordic Village, Inc., 112 S. Ct. 1011, 1014 (1992). The Supreme Court previously decided in *Hoffman v. Connecticut Dep't of Income Maintenance*, 492 U.S. 96 (1989), that 11 U.S.C. § 106(c) did not authorize monetary recovery against a state. That decision, however, was a plurality decision, in which the deciding vote of the concurrence denied amenability to suit based upon an Eleventh Amendment claim applicable only to the states. *Hoffman*, 492 U.S. at 105. The majority opinion of the Court was authored by Justice White and joined by the Chief Justice and Justices O'Connor and Kennedy. *Id.* at 98. Justice Scalia concurred in the judgment but stated that the court of appeals should be affirmed, barring petitioners' action against the sovereign because it violated the Eleventh Amendment. *Id.* at 105 (Scalia, J., concurring). Justice Scalia opined: "I reach this conclusion, however, not on the [Court's] basis that 'Congress did not abrogate Eleventh Amendment immunity' of the States, but on the ground that it had no power to do so." *Id.* (citation omitted). Since *Hoffman* applied only to the states and not to the federal government, *Hoffman* had no binding effect. *Nordic Village*, 112 S. Ct. at 1014. However, the Court did use the plurality decision in *Hoffman* to resolve the statutory question before it in *Nordic Village*. *Id.*

208. *Nordic Village*, 112 S. Ct. at 1013. The tax liability was not for the corporation. *Id.*

209. *Id.* *See* 11 U.S.C. § 549 (1988). Section 549 prohibits post-petition, unauthorized transfers and allows recovery for the benefit of the estate pursuant to 11 U.S.C. § 550. *Id.*

210. *Nordic Village*, 112 S. Ct. at 1013.

211. *Id.* Upon appeal, the Sixth Circuit affirmed by a divided panel.

212. *Id.*

against the United States.[213] As such, the statutory waiver of sovereign immunity must be unequivocally expressed. Moreover, the Court held that the waiver of sovereign immunity is not to be liberally construed.[214] The Court noted that unless the United States files a claim against the bankruptcy estate for which the trustee could seek a permissive (subject to set-off limitations) or compulsory counterclaim, there was no waiver of sovereign immunity.[215] Since the United States had not filed a proof of claim,[216] the trustee could not sue the United States for monetary damages.[217]

The ruling seems to indicate that the waiver of sovereign immunity requirement is going to be strictly construed, and that no monetary action can be maintained against the United States unless the United States has filed a claim in the case. The Court did indicate that other types of actions (such as injunctive or declaratory relief action) could be entertained against the United States. However, a creative lawsuit by a trustee seeking a declaration that the United States received a fraudulent and unauthorized transfer would, most likely, be a circumvention of the holding in *Nordic Village* and would probably not pass muster, given the interpretation of the Court. The general principle that one cannot do indirectly what one cannot do directly, would seem to apply.[218]

J. THE BURDEN OF PROOF STANDARD UNDER § 523 IS THE MERE PREPONDERANCE OF THE EVIDENCE STANDARD, NOT THE CLEAR AND CONVINCING EVIDENCE STANDARD

In *Grogan v. Garner*,[219] the United States Supreme Court lowered the standard for the burden of proof in nondischargeability actions.[220] In *Grogan*, the Court was confronted with the burden of proof standard applied under the nondischargeability provisions of 11 U.S.C. § 523. The debtor in *Grogan*

213. *Id.* at 1015.

214. *Id.* at 1014.

215. *Nordic Village*, 112 S. Ct. at 1015.

216. There was no evidence in the record indicating whether the United States filed a claim. Thus, one may assume that, based on the Court's analysis, it did not file a claim.

217. *See Nordic Village*, 112 S. Ct. at 1015.

218. A trustee may not be without recourse. Judge Kroger suggests the use of the Tucker Act or the Little Tucker Act to bring the monetary action against the United States. He opines that the action may possibly find its way back into the Bankruptcy Act. *See* The Honorable Frank W. Kroger & Dennis M. Garvis, *If at First You Don't Succeed . . . : An Alternative Remedy, After* Nordic Village, 66 AM. BANKR. L.J. 423 (Fall 1992).

219. 111 S. Ct. 654 (1991).

220. Grogan v. Garner, 111 S. Ct. 654, 659 (1991). *See* 11 U.S.C. § 523 (1988) (setting forth exceptions to discharge).

lost a civil action in federal court[221] for fraud, based upon a jury verdict finding that the debtor had defrauded a creditor.[222] The burden of proof in the civil action was the mere preponderance of the evidence standard.[223] Upon the filing of the Chapter 11 bankruptcy petition, the debtor attempted to avoid the fraud judgment. The creditor argued that the doctrine of collateral estoppel prevented the debtor from discharging the debt because actual fraud had been proven and, therefore, the debt was not dischargeable under § 523(a).[224]

The bankruptcy court found that the elements of fraud had been proven in a civil forum and that the doctrine of collateral estoppel prevented the discharge of the debt.[225] The district court affirmed.[226]

The Eighth Circuit Court of Appeals reversed, holding that the Bankruptcy Code was silent as to the burden of proof under the exceptions of the § 523 discharge provision.[227] The court found that two factors support the imposition of a clear and convincing evidence standard.[228] First, the court stated that the higher standard had generally been applied in common law fraud actions and in resolving dischargeability issues prior to enactment of § 523(a). Therefore, Congress could not have intended by its silence to change this settled law.[229] Second, the court opined that the fresh start policy of the Code militated in favor of a strict construction of § 523 which favored the debtor.[230]

The Supreme Court granted certiorari and reversed the Eighth Circuit Court of Appeals.[231] The Supreme Court held that the validity of a creditor's claim is determined by state law and the issue of nondischargeability is determined by federal law.[232] The Supreme Court noted that the creditor in *Grogan* reduced its fraud claim to a valid final judgment in a jurisdiction that required proof of fraud by a mere preponderance of the evidence, and then sought to minimize additional litigation costs by invoking the doc-

221. *Grogan*, 111 S. Ct. at 656 (citing Grogan v. Garner, 806 F.2d 829, 831 (8th Cir. 1986)).
222. *Id.*
223. *Id.* at 657.
224. *Id.* The debt was alleged to be nondischargeable under 11 U.S.C. § 523(a)(2)(A), because the money was obtained by actual fraud. *Id.*
225. *Id.* at 656 (citing *In re* Garner, 73 B.R. 26 (Bankr. W.D. Mo. 1987)).
226. *Grogan*, 111 S. Ct. at 657.
227. *Id.* (citing *In re* Garner, 881 F.2d 579 (8th Cir. 1989)).
228. *Id.* (citing *In re* Garner, 881 F.2d at 581).
229. *Id.*
230. *Id.*
231. *Grogan*, 111 S. Ct. at 657.
232. *Id.* at 657-58.

trine of collateral estoppel.[233] The Court found that if the preponderance of the evidence standard applies to the question of nondischargeability, the bankruptcy court could give collateral affect to those issues that had been established and litigated in the prior action.[234] On the other hand, if the clear and convincing standard applies to nondischargeability, a prior judgment cannot be given the collateral effect.[235] Although the debtor had argued that the fresh start policy of the Bankruptcy Code supported a conclusion that clear and convincing evidence standards should be applied, the Court noted that an " 'honest but unfortunate debtor' " is entitled to a fresh start, and that a debtor that perpetrates a fraud is clearly not entitled to that same presumption.[236] Thus, the Court concluded that "[r]equiring the creditor to establish by a mere preponderance of the evidence that his claim is not dischargeable reflects a fair balance between these conflicting interests"[237] and would be consistent with both the state court litigation on the matter and the issue of collateral estoppel.[238]

The Court noted that Congress had not clearly set out a heightened standard for nondischargeability, and there were many federal law examples in which the mere preponderance of the evidence standard was required only in fraud cases.[239] Most notably, the Court found that Congress chose the preponderance of evidence standard to govern the lack of discharge in cases in which fraud is committed on the bankruptcy court by a debtor.[240]

Finally, the Court noted that it was not persuaded by the Eighth Circuit's finding that courts must effectuate the fresh start policy of the Bankruptcy Code for the debtor. The Court stated that the debtor was not entitled to a fresh start as a matter of a constitutional right and that although an honest debtor may receive a fresh start, a dishonest debtor may not be entitled to the same benefit of the doubt.

Therefore, a creditor's burden of proof will be less stringent when bringing a nondischargeability claim under § 523 for fraud against a debtor who has acted fraudulently. In light of *Grogan*, the creditor may only have to prove by a mere preponderance of

233. *Id.* at 658.
234. *Id.*
235. *Id.*
236. *Grogan*, 111 S. Ct. at 659.
237. *Id.*
238. Id. at 658-60.
239. *Id.* at 660.
240. *Id. See* 11 U.S.C. § 727(a)(4) (1988).

the evidence that the debtor acted fraudulently.[241]

K. A LIQUIDATING AGENT OR TRUSTEE IN A LIQUIDATING CHAPTER 11 PLAN MAY BE LIABLE FOR THE PAYMENT OF ANY TAX LIABILITY INCURRED

In the seemingly innocuous decision of *Holywell Corp. v. Smith*,[242] the Supreme Court held that the Chapter 11 trustee, appointed under a confirmed Chapter 11 plan to liquidate a portion of the estate, must file a tax return and pay the tax on behalf of the estate.[243] In *Holywell*, the debtor filed a Chapter 11 bankruptcy. Subsequently, a consolidated liquidating plan was put together presumably by the creditors. The plan provided for liquidation of a hotel and office complex in Miami, Florida, and property in Washington, D.C.[244]

The court appointed a trustee,[245] Mr. Smith, to liquidate the estate pursuant to the confirmed plan.[246] The United States was a party, but did not object to the confirmation of the plan. After confirmation, the assets of the corporations were sold for cash in order to retire the debt to the secured creditors.[247] The plan required that the debtors give up their interests in the Miami and Washington, D.C. properties, but otherwise provided that the debtors could stay in business.[248]

After the liquidation of the property, neither the debtors nor the trustee filed federal tax returns or paid any taxes from the gains on sales on the bankruptcy estate's behalf.[249] The bankruptcy court declared that the trustee did not have to file the estate's tax returns.[250] The district court and the Eleventh Circuit

241. *See Grogan*, 111 S. Ct. at 661. That evidence which may reach the level of mere preponderance of the evidence to one bankruptcy judge may be construed as clear and convincing evidence to another. As Judge Kroger stated in *Garner*, "there is no real distinction between 'preponderance of evidence' and 'clear and convincing' as regards § 523 litigation." Henson v. Garner (*In re* Garner), 73 B.R. 26, 29 (Bankr. W.D. Mo. 1987). Judge Kroger may be "hitting the nail right on the head" when he infers that a bankruptcy judge may decide how the case is going to come out and simply make the evidence fit the standard that is applied.

242. 112 S. Ct. 1021 (1992).

243. Holywell Corp. v. Smith, 112 S. Ct. 1021, 1025 (1992).

244. *Id.* at 1023. This Chapter 11 case was a consolidation of five different bankruptcy cases. *Id.*

245. *Id.* at 1024. The Court did not decide whether the trustee appointed under this factual situation was a true " 'trustee in a case under Title 11 of the United States Code . . . .' " *Id.* at 1025 (quoting 26 U.S.C. § 6012 (b)(3)). Instead, the Court held that this "trustee" was an "assignee" of the corporate debtors under 26 U.S.C. § 6012(b)(3). *Id.*

246. *Id.* at 1024.

247. *Id.* at 1023.

248. *Holywell*, 112 S. Ct. at 1023.

249. *Id.* at 1024.

250. *Id.*

Court of Appeals both affirmed the bankruptcy court decision.[251] The Supreme Court granted certiorari and reversed.[252]

The Court held that the appointed trustee was an assignee within the meaning of 26 U.S.C. § 6012(b)(3), and that the trustee was therefore required to file a tax return on behalf of the estate pursuant to 26 U.S.C. § 6151(a) and § 6012(b)(4).[253] The Court held that it was the trustee's responsibility to file and pay for the taxes in this liquidating case.[254]

Creditors must be aware that if they do put together a liquidating plan, creditors may be personally responsible for all tax liabilities which could arise from the liquidating plan once the liquidation occurs. Given the substantial tax liabilities that can be incurred in today's farm bankruptcies, this could be a severe personal tax liability for any liquidating trustee.

L. THE APPLICATION OF QUALIFIED IMMUNITY UNDER 42 U.S.C. § 1983

In *Wyatt v. Cole*,[255] the Supreme Court addressed the issue of qualified immunity under 42 U.S.C. § 1983.[256] Although the debtor in *Wyatt* was in bankruptcy, the case did not involve issues of bankruptcy law, but instead dealt with the question of whether private defendants, sued under 42 U.S.C. § 1983 "for invoking state replevin, garnishment, and attachment statutes later declared unconstitutional are entitled to qualified immunity from suit."[257]

The dispute arose out of a failed cattle partnership between

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251. *Id.*

252. *Id.*

253. *Holywell*, 112 S. Ct. at 1025. *See* 26 U.S.C. § 6012(b)(4) (1988). Section 6012(b)(4) provides in part:

> For Returns of Estates and Trust.
> Returns of an estate, a trust, or an estate of an individual under Chapter 7 or Chapter 11 of Title 11 of the United States Code shall be made by the fiduciary thereof.

Id.

Section 6151(a) provides, in pertinent part, that "when a return of tax is required . . . the person required to make such return shall . . . pay such tax." 26 U.S.C. § 6151(a) (1988).

254. *Holywell*, 112 S. Ct. at 1025-26.

255. 112 S. Ct. 1827 (1992).

256. Wyatt v. Cole, 112 S. Ct. 1827, 1830-34 (1992). *See* 42 U.S.C. § 1983 (1988). Section 1983 provides, in pertinent part, that "[e]very person who, under color of any statute . . . of any State . . . subjects, or causes to be subjected, any citizen . . . to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws . . . shall be subject to a cause of action." *Id.* The Court noted that "[t]he purpose of § 1983 is to deter state actors from using the badge of their authority to deprive individuals of their federally guaranteed rights and to provide relief to victims if such deterrence fails." *Wyatt*, 112 S. Ct. at 1830.

257. *Wyatt*, 112 S. Ct. at 1829.

the petitioner Howard Wyatt and respondent Bill Cole. When no agreement could be reached to resolve the dispute, Cole brought a complaint for replevin against Wyatt and filed a replevin bond.[258]

At that time, Mississippi law allowed an individual to obtain a court order and seize property possessed by another person by posting a bond and swearing that the applicant was entitled to that property.[259] Later, the statute was declared unconstitutional and Wyatt sued Cole and his attorney, Robbins, alleging a violation of his civil rights under 42 U.S.C. § 1983. The district court declared the statute unconstitutional because it violated Wyatt's due process rights while granting qualified immunity to Cole and Robbins. The Fifth Circuit Court of Appeals affirmed. The Supreme Court granted certiorari and reversed.[260]

The sole question before the Supreme Court was "[w]hether private persons, who conspire with state officials to violate constitutional rights, have available the good faith immunity applicable to public officials."[261] The Court was referring to Cole and his attorney, Robbins, who conspired to replevy property by use of a statute which was later declared unconstitutional. The Court noted that private individuals were not going to be treated similarly to public servants who rely on state laws which they did not create and which they have no reason to believe would be invalid. The Court held that such interests were not sufficiently similar to the traditional purposes of qualified immunity to justify such an exception.[262] The Court found, however, that it did not foreclose the possibility that private defendants faced with § 1983 actions may be entitled to affirmative defenses based on good faith or probable cause, or that § 1983 suits against private parties could

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258. *Id.*

259. *Id.*

260. *Id.*

261. *Id.* at 1834.

262. *Wyatt*, 112 S. Ct. at 1833. The Supreme Court held that qualified immunity strikes a balance between compensating those who have been injured by official misconduct and protecting the traditional functions of government. *Id.* The Supreme Court noted that it had, in the past, recognized qualified immunity for government officials when it was necessary to preserve the government's ability to serve the public and insure that talented individuals would take up those actions which serve the public good without being deterred by the threat of damages. *Id.* The Supreme Court concluded that "a qualified immunity recognized . . . acts to safeguard government, and thereby to protect the public at large, not benefit its agents." *Id.* The Court stated "[t]hese rationales are not transferable to private parties. Although principals of equality and fairness may suggest, as respondent's argue, that private citizens who rely unsuspectingly on state laws they did not create and may have no reason to believe are invalid should have some protection from liability, as do their government counterparts, such interests are not sufficiently similar to the traditional purposes of qualified immunity to justify such an expansion." *Id.*

require plaintiffs to carry additional burdens.[263]

The Court remanded the case to the district court in order to decide the issue of whether Cole and Robbins, invoking the state replevin statute, acted under the color of state law.[264] Therefore, when a party acts under color of state law to replevin, garnish, or collect property under a statute which the party knows may be unconstitutional, that party is moving forward at its own risk since it may not have the defense of qualified immunity available for a subsequent § 1983 action.

M. INTERLOCUTORY ORDERS ISSUED BY A DISTRICT COURT SITTING AS A COURT OF APPEALS IN BANKRUPTCY ARE APPEALABLE PURSUANT TO 28 U.S.C. § 1291

In *Connecticut National Bank v. Germain*,[265] the Supreme Court addressed the appellate jurisdiction of the district court on interlocutory appeals.[266] In *Germain*, the debtor originally filed a Chapter 11 bankruptcy petition in 1984, but the case was subsequently converted to a Chapter 7 bankruptcy.[267] Connecticut National Bank (CNB) was a successor in interest to one of the debtor's creditors, and respondent, Thomas Germain, was the trustee of the estate.[268] The trustee sued CNB in state court, alleging lender liability against the bank for various torts and contract breaches.[269] CNB removed the action to the United States District Court, which then referred the matter to the bankruptcy court. The trustee then filed a demand for a jury trial. CNB moved to strike the demand for a jury trial.[270] The bankruptcy court denied CNB's motion, and the district court affirmed. CNB tried to appeal the decision to the Court of Appeals for the Second Circuit, whereby the circuit court dismissed for lack of jurisdiction

263. *See* Lugar v. Edmondson Oil Co., 457 U.S. 922 (1982). In *Lugar*, the Supreme Court considered the scope of § 1983 liability in the context of garnishment, pre-judgment attachment, and replevin actions. The Supreme Court held that private parties who attach a debtor's assets pursuant to a state attachment statute were subject to § 1983 liability if the statute was constitutionally infirm. *Id.* at 942. The Supreme Court noted that these types of cases—garnishment, prejudgment attachment, and replevin—established that private use of state laws to secure property could constitute "state action" for the purposes of the Fourteenth Amendment, and that private defendants invoking state created attachment statutes "under the color of state law" were within the meaning of § 1983 if their actions were fairly attributable to the state. *Id.*

264. *Lugar*, 457 U.S. at 942.

265. 112 S. Ct. 1146 (1992).

266. Connecticut Nat'l Bank v. Germain, 112 S. Ct. 1146, 1148 (1992).

267. *Id.* at 1147-48.

268. *Id.* at 1148.

269. *Id.*

270. *Id.*

over the appeal.[271] The Supreme Court granted certiorari and reversed.[272]

The majority opinion[273] noted that the interlocutory orders of the United States District Court are subject to review only under 28 U.S.C. § 1292.[274] The trustee contended that § 1292 did not apply because Congress limited its scope when it enacted 28 U.S.C. § 158(d).[275] The bankruptcy court held that a "plain reading" of 11 U.S.C. § 158(d) did not limit the scope of 28 U.S.C. § 1292.[276]

The Court observed that 28 U.S.C. §§ 1291 and 1292 overlapped with 11 U.S.C. § 158(d); however, "[r]edundancies across statutes are not unusual events in drafting, and so long as there is no 'positive repugnancy' between two laws, a court must give effect to both."[277] The Court noted that while courts should disfavor interpretations which render some language of a statute superfluous, that canon did not apply, or even if it did apply it was "no more than [a] rule[ ] of thumb" which helped courts determine the meaning of the legislation.[278]

The Court refused to consider the issue of legislative history and concluded that "[w]e have stated time and again that courts

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271. *Germain*, 112 S. Ct. at 1148.

272. *Id.*

273. *Id.* at 1147. Five Justices joined in the majority opinion: Justices Thomas, Rehnquist, Scalia, Kennedy, and Souter. Justice Stevens filed a separate concurring opinion as did Justices O'Connor, White, and Blackmun. *Id.*

274. *See* 28 U.S.C. § 1292 (1988). Section 1292 provides, in pertinent part:

> (a) [T]he courts of appeals shall have jurisdiction of appeals from:
>
> 1. Interlocutory orders of the district courts of the United States . . . or of the judges thereof, granting, continuing, modifying, refusing or dissolving injunctions, or refusing to dissolve or modify injunctions, except where a direct review may be had in the Supreme Court;
>
> 2. Interlocutory orders appointing receivers, or refusing orders to wind up receiverships or to take steps to accomplish the purposes therefore . . . ;
>
> 3. Interlocutory orders of such district courts or of the judges thereof determining the rights and liabilities of the parties to admiralty cases in which appeals from final decrees are allowed.
>
> (b) When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The court of appeals which would have jurisdiction of an appeal of such action may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within 10 days after entry of the order. . . ."

Id.

275. *Germain*, 112 S. Ct. at 1148. *See* 28 U.S.C. § 158(d) (1988). Section 158(d) provides, in pertinent part: "[T]he courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section." *Id.*

276. *Germain*, 112 S. Ct. at 1148.

277. *Id.* at 1149 (citations omitted).

278. *Id.*

must presume that a legislature says in a statute what it means and means in a statute what it says there."[279] The Court noted that "[n]owhere does § 1292 limit review to orders issued by district courts sitting as trial courts in bankruptcy rather than appellate courts, and nowhere else, whether in § 158(d) or any other statute, has Congress indicated that the unadorned words of § 1292 are in some way limited by implication."[280] Thus, the Court held that the Second Circuit had jurisdiction to hear the case because 28 U.S.C. § 158 does not displace 28 U.S.C. § 1292.

Justice Stevens, in his concurring opinion, indicated that it might be prudent to consider the legislative history; however, even after considering legislative history in this case, there was no indication that Congress intended to limit the scope of § 1292(b).[281] Justice O'Connor, joined by Justices White and Blackmun, also concurred, and stating that the rules of statutory construction should have been applied and the court should have noted that its interpretation "*does* render § 158(d) largely superfluous."[282] Further, the concurring opinion indicated that Congress, in all likelihood, inadvertently created the redundancy, that Congress' inadvertence should be overlooked, and the statute should be interpreted so that the long-standing rule of appellate jurisdiction over interlocutory appeals in bankruptcy cases is maintained.[283]

III. PENDING SUPREME COURT DECISIONS

The following cases are bankruptcy-related cases that are currently pending before the United States Supreme Court on certiorari. Presumably, these cases will be decided by the Court next term.

A. DOES THE "FILED RATE" DOCTRINE ASSIST THE TRUSTEE IN COLLECTION OF MOTOR CARRIER UNDERCHARGES?

In *In re Carolina Motor Express, Inc.*,[284] the Supreme Court is asked to consider whether a trustee can collect undercharges of a

279. *Id.*
280. *Id.* at 1150.
281. *Germain*, 112 S. Ct. at 1150 (Stevens, J., concurring).
282. *Id.* at 1151 (O'Connor, J., concurring) (emphasis in original).
283. *Id.*
284. 949 F.2d 107 (4th Cir. 1991), *cert. granted sub nom.*, Reiter v. Cooper, 112 S. Ct. 1934 (1992).

debtor motor carrier.[285] This case involves the requirements under the Interstate Commerce Act, 49 U.S.C. § 10101 *et seq.*, 1982, which requires motor carriers to file their rates with the Interstate Commerce Commission (ICC) and that both the shippers and the carriers adhere to those rates. This requirement is the so-called "filed rate" doctrine.[286] In *Carolina*, the trustee for the debtor motor carrier seeks to recover those undercharges which occurred on a privately negotiated contract between the shipper and the motor carrier.[287] The trustee filed two adversary actions in the bankruptcy court in order to collect the undercharges from different shippers. The bankruptcy court held that the trustee for the carrier debtor was entitled to recover irrespective of any equitable defenses and irrespective of its own actions.[288] On appeal, the district court reversed the bankruptcy court and referred the matter to the ICC on the question of whether the carrier's collection of undercharges would amount to an unreasonable practice.[289] The carrier appealed to the Fourth Circuit Court of Appeals.

In a third and separate action, the district court withdrew reference from the bankruptcy court and referred the matter to the ICC. The ICC decided that the carrier's collection of undercharges constituted an unreasonable practice. Based on the ICC's findings, the district court granted summary judgment in favor of the defendant carrier, thereby dismissing plaintiff's action. The plaintiff debtor appealed the district court's decision to the Fourth Circuit Court of Appeals.[290] The Fourth Circuit reversed, ordered the district court to reinstate the decisions of the bankruptcy court, and ordered that judgment be entered in favor of the plaintiff on a separate case in which the district court had withdrawn reference.[291] The Supreme Court granted certiorari.

The Fourth Circuit did not set forth the exact factual scenario of the parties in its opinion, but cited to the Fifth Circuit's presentation of a similar factual scenario. The Fourth Circuit stated that "the Fifth Circuit aptly described the present scenario as follows:

285. *In re* Carolina Motor Express, Inc., 949 F.2d 107, 108 (4th Cir. 1991), *cert. granted sub nom.*, Reiter v. Cooper, 112 S. Ct. 1934 (1992).
286. *Id.* at 110.
287. *Id.* at 108.
288. *Id.*
289. *Id.*
290. *Id.*
291. *Carolina Motor Express*, 949 F.2d at 108.

> 'The well-worn choreography for these cases involves a motor carrier's action against a shipper to collect for undercharges; that is, to collect the difference between the higher rate which the carrier has filed with the Interstate Commerce Commission . . . and the rate which the parties had negotiated.' "[292]

Under 49 U.S.C. § 10761, a motor carrier subject to the Interstate Commerce Act " 'may not charge or receive a different compensation for . . . transportation or service than the rate specified in the tariff' filed with the ICC." The Interstate Commerce Act also specifies that " '[a] rate, classification, rule, or practice related to transportation or service provided by a carrier . . . must be reasonable.' "[293]

The Court has most recently re-emphasized the importance of this "file rate" doctrine as "essential to preventing price discrimination and stabilizing rates."[294] The defendants in *Carolina Motor Express* argued that the carrier's attempt to collect undercharges was an unreasonable practice under the Act.[295] After *Maislin Industries, U.S., Inc., v. Primary Steel*,[296] this argument was clearly rejected by the Supreme Court. Next, the defendants argued that notwithstanding its decision in *Maislin*, the Supreme Court should remand the cases "to the district court with instructions to refer them to the ICC for determination of the reasonableness of the carrier's filed tariff rates."[297] The Court found that the reasonableness of the rates may be contested by the defendants. However, the court indicated that the Supreme Court has not addressed the issue of whether the ICC should, at the first instance, decide the reasonableness of the rates.[298] The Court stated "*Maislin* . . . did mention in a footnote that the issue of rate reasonableness was not presented in the case and would be 'open for exploration' on remand."[299] The court believed that a

> defense attacking the reasonableness of a carrier's filed rates should not operate to stay enforcement of the filed rate doctrine. Rather, shippers must pay the filed rates

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292. *Id.* at 109 (quoting Supreme Beef Processors, Inc. v. Yaquinto, 864 F.2d 388, 388-89 (5th Cir. 1989), *cert. denied*, 110 S. Ct. 3254 (1990)).
293. *Id.* (quoting 49 U.S.C. §§ 10701(a), 10761(a)).
294. Maislin Indus. U.S., Inc. v. Primary Steel, Inc., 110 S. Ct. 2759, 2766 (1990).
295. *Carolina Motor Express*, 949 F.2d at 109.
296. 110 S. Ct. 2759 (1990).
297. *Id.*
298. *Id.* at 110.
299. *Id.*

> and contest those filed rates before the ICC independently if they wish to seek reparations from the carrier. We believe that such an approach is preferable to an alternative procedure under which the courts would automatically refer cases to the ICC whenever a rate was challenged. This alternative approach would provide a strong incentive for shippers routinely to contest the validity of the carrier's rates in order to delay paying the carrier's filed rate. Such a situation would be wholly inconsistent with a filed rate doctrine.[300]

The appellate court concluded that it would not delay enforcement of a judgment to turn over the property as the shippers are charged with knowledge of the filed rate and can contest its reasonableness with the ICC at any time.[301] The court noted that its rule in no way forecloses the shipper from raising the issue of reasonableness with the ICC at a later date and potentially recovering the money.[302] However, the court would not delay the process and ordered the shipper to pay the filed rate as provided in the judgments.[303]

The sole issue on certiorari is whether the debtor carrier can collect the undercharges. This case does not involve issues of bankruptcy law per se, but rather will be more of an interpretation of motor carrier law. It was only raised because the debtor filed for bankruptcy and brought an action to collect undercharges. However, there have been several Chapter 7 cases in which trustees have been trying to collect undercharges. Consequently, this decision will have an impact on those actions.

B. CAN THE "BAR DATE" TO FILE CLAIMS BE EXTENDED AFTER IT HAS EXPIRED?

In re Pioneer Investment Services Co.[304] involved a Chapter 11 bankruptcy case of an untimely filed proof of claim. In *Pioneer*, the creditor alleged excusable neglect and moved for an extension of the "bar date"[305] after untimely filing proofs of claims.[306] The

300. *Id.*
301. *Carolina Motor Express*, 949 F.2d at 110.
302. *Id.*
303. *Id.* at 111.
304. 943 F.2d 673 (6th Cir. 1991), *cert. granted sub nom.*, Pioneer Inv. Serv. Co. v. Brunswick Assoc. Ltd. Partnership, 112 S. Ct. 2963 (1992).
305. The "bar date" is the last date set by the Court to timely file proofs of claims. FED. R. BANKR. P. 3003(c)(3). One court has suggested that the phrase "bar date" is a misnomer, in that claims are not barred past this date, they are just treated differently than

debtor in *Pioneer* filed a voluntary Chapter 11 bankruptcy on April 12, 1989. At the same time, the debtor filed a list of its twenty largest unsecured creditors which included Brunswick Associates Limited Partnership (Brunswick), Clinton Associates Limited Partnership (Clinton), and West Knoxville Associates Limited Partnership (West Knoxville). Pioneer requested an extension of time to file its schedules; the extension was granted through May 17, 1989.[307]

On April 13, 1989, the Notice of First Meeting of Creditors was mailed by the bankruptcy clerk's office, setting May 5, 1989, as the date for the meeting to be held under § 341(a).[308] This notice also set the bar date for filing proofs of claims as August 3, 1989.[309] The notice contained a statement in conformity with 11 U.S.C. § 1111 and Bankruptcy Rule 3003, that proofs of claims must be filed "if your claim is scheduled as disputed, contingent or unliquidated, is unlisted or you do not agree with the amount."[310]

The bankruptcy court determined that Mark A. Berlin, President of Robriste Enterprises, Inc., a general partner of Clinton, West Knoxville, and Brunswick, received and read the April 13th notice.[311] The bankruptcy court also found that Mr. Berlin was an experienced businessman engaged in real estate financial matters, a certified public accountant, and an attorney licensed to practice in Florida and New York.[312] The bankruptcy court further found that Berlin attended and participated in the May 5th meeting of creditors.[313] The schedules were timely filed, and the creditors were not listed; however, on May 25th, Pioneer amended its schedules and included the creditors involved in this action, holding that their claims were contingent, unliquidated, and dis-

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timely filed claims. *See In re* Hausladen, 146 B.R. 557, 559 (Bankr. D. Minn. 1992). The court in *Hausladen* stated:

> All of this has been compounded by attorneys, judges and commentators who have carried forward the old Act habit of referring to the date set for filing claims as the "bar date." Under Section 57(n) of the Act it was a bar date; however under section 502 of the Code it is not. Continued mischaracterization of the time period has led to reliance on the words themselves without actually understanding them or what the statute actually says.

Id.

306. *In re* Pioneer Inv. Serv. Co., 943 F.2d 673, 675 (6th Cir. 1991), *cert. granted sub nom.*, Pioneer Inv. Serv. Co. v. Brunswick Assoc. Ltd. Partnership, 112 S. Ct. 2963 (1992).

307. *Id.* at 674.

308. *Id.*

309. *Id.* at 675.

310. *Id.*

311. *Pioneer Inv.*, 943 F.2d at 675.

312. *Id.*

313. *Id.*

puted.[314] The creditor, Ft. Oglethorpe Associates Limited Partnership (Ft. Oglethorpe), was not listed as a creditor in either filing. Berlin was also the President of Pudding Enterprises, which was the general partner of Ft. Oglethorpe. The United States Trustee's Office appointed Clinton as a member of the creditors' committee. Berlin, representing Clinton, was a member on that committee.[315]

Thereafter, the creditors retained Marc Richards as their legal counsel. Mr. Richards, as the bankruptcy court found, was an experienced bankruptcy attorney.[316] The testimony indicated that Richards advised Berlin that there was no bar date in the file, and therefore, "filing proofs of claim was not a matter of urgency."[317]

On August 23, 1989, twenty days after the expiration of the bar date, the creditors filed, and Mr. Berlin signed their proofs of claim.[318] The creditors acknowledged that they filed untimely claims, but asked that their claims be allowed because of excusable neglect or, in the alternative, that they be allowed *nunc pro tunc* to the bar date.[319] The bankruptcy court denied their motion to file their claims after the bar date.[320] The creditors appealed to the district court which accepted all of the bankruptcy court's findings, but found that the bankruptcy court had applied an overly strict interpretation of the excusable neglect standard. Consequently, the district court remanded for a more liberal interpretation.[321] On remand, the bankruptcy court found that, even under a more liberal interpretation of excusable neglect, there was no basis for allowing the claims after the bar date.[322] The creditors again appealed.[323] The district court affirmed, and the creditors

314. *Id.*
315. *Id.*
316. *Pioneer Inv.*, 943 F.2d at 675.
317. *Id.*
318. *Id.*
319. *Id.* Bankruptcy Rule 9006(b)(1) allows for an extension of time if the request is made prior to the expiration of the original period. FED. R. BANKR. P. 9006(b)(1). Alternatively, a motion may be made after the expiration of the specified time period within which to act if the failure to act was the result of an excusable neglect. *Id.* Excusable neglect is not defined in the Code. *Pioneer Inv.*, 943 F.2d at 676. Under a strict interpretation of excusable neglect, it would have to be established that the failure to act was caused by circumstances beyond one's control. *Id.* A more lenient reading of the standard of excusable neglect would lead one to consider various other factors, including prejudice to the parties, prejudice to the plaintiff, merits of the defendant's defenses, and any exculpable conduct on the part of the defendant in determining what satisfies good cause or the excusable neglect standard. *Id.* at 676-77.
320. *Pioneer Inv.*, 943 F.2d at 675.
321. *Id.*
322. *Id.*
323. *Id.*

appealed to the Sixth Circuit Court of Appeals.[324]

The Sixth Circuit Court of Appeals held that § 1111(a) of the Bankruptcy Code required creditors to file proofs of claims if their claims are "scheduled as disputed, contingent, or unliquidated."[325] The creditors acknowledged that Bankruptcy Rule 3003(c) required the court to set a time in which proofs may be filed, and provided that an extension of time may be granted "for cause shown."[326] The court noted that Bankruptcy Rule 3003 should be read in conjunction with Bankruptcy Rule 9006(b)—which allows a court to extend the time to act.[327] The court indicated that Rule 9006 provided that a period of time may be extended even after the expiration of that time for "excusable neglect."[328]

The bankruptcy court, adopting the Eleventh Circuit standard, held that the strict reading of excusable neglect requires an application of excusable neglect only when the failure to perform the act was due to "circumstances beyond the reasonable control of the party."[329] The Sixth Circuit Court of Appeals noted that on the first appeal, the district court had correctly analyzed the standard because it applied a more liberal standard of excusable neglect with a more "textured" approach.[330] The court agreed with the Ninth Circuit's standard in the case of *In re Dix*,[331] a more liberal approach.[332] The district court remanded the matter to the bankruptcy court to consider the *Dix* standards. The bankruptcy court, applying the more liberal *Dix* standards, found that relief was not appropriate.[333] However, the circuit court found that the bankruptcy court, even though it applied the factors correctly, had inappropriately penalized the plaintiffs for the errors of their counsel.[334]

The circuit court noted that Official Bankruptcy Form 16 provided for a model form to give creditors notice with respect to what a bar date means, and the impact of that bar date.[335] The court also noted that the forms sent out by the clerk's office in this case were ambiguous in that they contained merely an inconspicu-

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324. *Id.*
325. *Pioneer Inv.*, 943 F.2d at 676.
326. *Id.*
327. *Id.*
328. *Id.*
329. *Id.*
330. *Pioneer Inv.*, 943 F.2d at 677.
331. 95 B.R. 134 (Bankr. 9th Cir. 1988).
332. *Pioneer Inv.*, 943 F.2d at 677.
333. *Id.*
334. *Id.*
335. *Id.* at 678.

ously labeled bar date without any reference to the significance of what the date meant.[336] The court opined that only parties with extensive experience in bankruptcy would have known what the term "bar date" meant.[337] The circuit court said that the creditors in this case should not be "unjustifiably punished . . . for the sins and neglect of their lawyer."[338] Thus, the Court held that the claims would be allowed as timely filed.[339] The *Dix* standard justified the excusable neglect relief sought.[340]

It will be interesting to see how the Supreme Court will deal with this case, given its strict constructionist, plain meaning interpretation of the Code. It is almost certain that Justice Scalia will vote to reverse the decision, strictly applying the language of the statute, and determining that any claims filed late are untimely.

IV. CONCLUSION

The Supreme Court has taken the position of reviewing cases in which there is a conflict in the circuits, in order that the application of bankruptcy law is uniform. The judicial pronouncements, although not as comprehensive as the legislative changes in the past, have still had a dramatic impact on the application of bankruptcy law. The Court has clarified some bankruptcy issues and has created additional issues. What can fairly be said, however, is that the Court is going to strictly construe all statutory interpretations, or rely on, in Justice Scalia's words—*The Plain Meaning of the Code.*

336. *Id.*
337. *Pioneer Inv.*, 943 F.2d at 678.
338. *Id.*
339. *Id.*
340. *Id.*